DO CFC REGULATIONS ACCLIMATIZE IN LATIN AMERICA?:
A CASE STUDY OF MEXICO, ARGENTINA, VENEZUELA, AND BRAZIL

A THESIS SUBMITTED TO THE
STANFORD PROGRAM IN INTERNATIONAL LEGAL STUDIES
AT THE STANFORD LAW SCHOOL,
STANFORD UNIVERSITY
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
MASTER IN THE SCIENCE OF LAW

By
Hector J. Lehuede
May 2003
TABLE OF CONTENTS

Abstract ............................................................................................................................................. 1

1. Introduction .................................................................................................................................. 1

1.1 International Taxation: From Double Taxation To Tax Competition ........................................ 2
1.2 Harmful Tax Competition And The OECD Report .................................................................... 7
1.3 CFC Regulations: A Three-Step Test To Prevent Abusive Deferral ........................................ 12

  1.3.1 Control Test .......................................................................................................................... 13
  1.3.2 Business Test ........................................................................................................................ 14
  (i) Passive Income ......................................................................................................................... 15
  (ii) Base Company Income .......................................................................................................... 15
  (iii) Active Income ....................................................................................................................... 16
  1.3.3 Tax Haven Test ..................................................................................................................... 16

2. CFC Rules In Latin America ......................................................................................................... 16

  2.1 The Policy Described: On The Books and In Action .................................................................. 18
  2.2 Mexico: Pioneers of the Region .................................................................................................. 22

    2.2.1 The Rules ........................................................................................................................... 22
    2.2.2 The Practice ....................................................................................................................... 26

  2.3 Argentina: The Tax Planner Domain .......................................................................................... 28

    2.3.1 The Rules ........................................................................................................................... 28
    2.3.2 The Practice ....................................................................................................................... 31

  2.4 Venezuela: Same Norms; Different Outcome ............................................................................. 32

    2.4.1 The Rules ........................................................................................................................... 32
    2.4.2 The Practice ....................................................................................................................... 35

  2.5 Brazil: A Different Approach .................................................................................................... 36

    2.5.1 The Rules ........................................................................................................................... 36
    2.5.2 The Practice ....................................................................................................................... 39

3. Empirical Policy Assessment ........................................................................................................ 41

  3.1 The Methodology ....................................................................................................................... 42

    3.1.1 The Sample Frame .............................................................................................................. 42
    3.1.2 The Questionnaire ............................................................................................................. 45

  3.2 The Results .................................................................................................................................. 47

    3.2.1 Response Rate and Profile ................................................................................................. 47
    3.2.2 The Domestic CFC Policy ................................................................................................. 48
    3.2.3 CFC Policy Enforcement ................................................................................................. 50
    3.2.4 Factors and Influence ........................................................................................................ 58

4. Conclusions .................................................................................................................................... 62

Bibliography .................................................................................................................................... 66

Appendix: Survey Instrument ......................................................................................................... 69
DO CFC REGULATIONS ACCLIMATIZE IN LATIN AMERICA?

A case study of Mexico, Argentina, Venezuela, and Brazil

ABSTRACT

This paper investigates the impact that anti-deferral tax policy has had in four Latin American countries. It is based on empirical evidence from a case study of the domestic laws and regulations, selected interviews with local experts on the subject, and a survey of over one hundred tax practitioners from these countries. The results show that the perception about the general level of enforcement of the policy is low across the board, with high but varied levels of evasion and avoidance. However, the results also suggest that certain features of the policy implemented may improve or damage this outcome, providing clues to policymakers interested in adopting or revising this policy.

1. INTRODUCTION

Controlled Foreign Corporation (CFC) regulations are a sophisticated tax policy that plays a key, though often problematic, role in the international tax laws of most capital-exporting developed countries. Originally designed over thirty years ago by the U.S. to unilaterally prevent abusive deferral within an international trade context, globalization and the surge of tax havens have placed CFC rules on the frontlines of an international campaign designed to curb harmful tax competition. This campaign has effectively encouraged many developing countries to adopt these rules.

Policymakers in developing countries, upon enacting their domestic CFC regulations, had as a reference the legislation of developed countries with CFC rules, as well as literature and studies on the effect that those rules had within such countries. However, hardly any of these materials focus on the issues at stake from the perspective of a capital-importing developing country. In fact, most of the literature implicitly assumes, to varying degrees, a dichotomy where undeveloped tax havens face high-tax developed jurisdictions, as if there were no high-tax developing countries.