



MERGERS AND ACQUISITIONS

# Uruguay

Taxation of Cross-Border  
Mergers and Acquisitions

2010 Edition

TAX

# Uruguay

## Introduction

The competitive forces in the global economic environment have increasingly caused companies to consolidate their operations, and as a result, mergers and acquisitions (M&A) have become an important component of business strategies throughout the world. Uruguay is no exception, particularly after the recovery from the region's economic crisis in 2002.

## Recent Developments

In the year 2007, Law 18.083 introduced a complete reform of the Uruguayan tax system, which has affected M&A in several ways. The changes include:

- The creation of Non-Resident Income Tax (IRNR), applied on Uruguayan-source income obtained by non-residents. This tax requires the withholding on certain payments made abroad by local companies, including dividends, interest, royalties, and technical fees. Capital gains resulting from the disposal of local assets (including shares) by a non-resident are also considered taxable, except for bearer shares, which are subject to an exemption.
- Corporate Income Tax (IRAE) was reformulated, and important limitations were introduced on the deductibility of expenses, which are now only deductible if they represent taxable income for the counterpart (for non-residents taxation by IRNR or a foreign income tax is required).

## Asset Purchase or Share Purchase

Asset purchases and share purchases, the two main options for acquisitions, have different legal and tax consequences in Uruguay, as explained later in the chapter.

### Purchase of Assets

In most cases, the purchase of substantial assets of an existing business will fall into the category of a transfer of a commercial establishment, requiring a special procedure to be followed under Laws 2.904 and 14.433. According to court precedents the concept of substantial assets includes those that, being transferred would not make it possible for the transferor to continue developing its business as before. This procedure is quite lengthy and complex, involving a promise to sell

the commercial establishment, a request for special certificates from the Tax and Social Security Offices, and the convening of a meeting of the seller's creditors by means of special publications.

### Purchase Price

The proceeds from a sale of local assets will be subject to corporate income tax.

### Goodwill

The difference between the purchase price and the fiscal value of the transferred assets will be considered goodwill for tax purposes (the fiscal value of an asset will depend on its nature and although sometimes it will be equivalent to market value, this will not always be the case).

### Depreciation

The fiscal goodwill will be booked as an asset by the buyer, but it is not depreciated or revalued.

Other assets must be booked at the same fiscal value used by the seller, and will be subject to the general rules for depreciation and revaluation.

### Tax Attributes

Tax losses are not transferred to the buyer.

### Value-Added Tax (VAT)

The transfer of local assets resulting from the transaction as a rule will be subject to VAT. This tax is levied at a basic rate of 22 percent, with a lower rate of 10 percent for a prescribed list of goods or services (some items are exempt). The fiscal goodwill is also subject to VAT at the basic 22-percent rate.

### Transfer Taxes

There is no stamp duty or stamp duty land tax in Uruguay, but if an acquisition includes a transfer of real estate it will be subject to real estate transfer tax, levied at the rate of 4 percent (2 percent each for the buyer and seller) on the cadastral value of the real estate (a notional value established by the National Direction of Cadaster).

## **Purchase of Shares**

---

The transference of shares takes place through a very simple procedure (basically by their simple delivery in the case of bearer shares or through their endorsement in the case of nominative titles).

### *Tax Indemnities and Warranties*

When the buyer purchases a company it takes over all its tax liabilities, existing or contingent. It is, therefore, usual for the buyer to protect itself from eventual contingencies by commissioning a due diligence investigation of the target's affairs, including its tax affairs, and to require contractual tax indemnities and warranties from the seller.

### *Tax Losses*

The tax losses of the purchased company are not affected by the sale of its shares.

## **Choice of Acquisition Vehicle**

There are several potential acquisition vehicles available to the foreign purchaser.

### **Local Holding Company**

---

This would not normally be a suitable vehicle for a purchase of shares, because it would not produce any tax advantages in Uruguay. Moreover, apart from investment companies (entities whose main business consists of investment activities), local companies cannot participate in the capital of other entities for a value that exceeds their net worth.

### **Foreign Parent Company**

---

This is the vehicle used most frequently by foreign investors. Dividends received from Uruguay will be subject to IRNR withholding (more on this below) and gains on a subsequent disposal of the shares of the local company, notionally established at 20 percent of the selling price, will be taxable under IRNR.

### **Non-Resident Intermediate Holding Company**

---

From the Uruguayan point of view the use of this structure would not generate any tax advantage.

### **Local Branch**

---

A local branch of a foreign company is considered permanent establishment (PE) of the foreign entity. Uruguay applies the force of attraction principle under which all income obtained in Uruguay by the foreign entity must be imputed to the PE (whether or not it has participated in obtaining it). The effects of this rule should be carefully evaluated before choosing a branch structure for investment purposes.

## **Joint Ventures**

---

Not really a separate entity in itself, but rather a contractual arrangement. Its use should be analyzed on a case-by-case basis.

## **Choice of Acquisition Funding**

The purchaser will also have to decide whether to fund its acquisition vehicle with debt or equity. Some factors to be considered when making this decision are discussed below.

### **Debt**

---

The principal attraction of debt is the potential tax deductibility of interest. Uruguay has no thin-capitalization rules, but other aspects of the Uruguayan tax regime may limit such deductibility.

### **Deductibility of Interest**

---

As indicated in previous sections, under Uruguayan Corporate Income Tax rules, deductibility of expenses is conditional on their taxability as income in the hands of the counter-party.

This also applies to interest. Assuming that the whole income of the local company is of Uruguay source, the deductibility will be determined by the difference between the IRNR withholding rate (12 percent) plus the foreign tax rate applied to the interest in the foreign lender's country, and the corporate income tax rate of 25 percent. Thus deductibility will only be 100 percent if the IRNR withholding rate plus the foreign tax rate exceeds 25 percent.

It is worth noting that financing through debt will generate additional tax effects for foreign currency gains or losses (if the loan is denominated in foreign currency), and inflation adjustment must also be taken into account. The combined tax effects of these external factors may be very material, but are very hard to predict in a particular case.

### **Withholding Tax on Debt and Methods to Reduce or Eliminate**

---

Interest paid by a local company on foreign loans is subject to IRNR withholding at 12 percent, but loans granted to local entities which employ more than 90 percent of their assets in obtaining non-taxable income are exempt.

### **Checklist for Debt Funding**

---

- No thin-capitalization provisions.
- No restrictions on interest payments or currency exchange limitations.

- 12-percent IRNR withholding.
- Full deductibility by local company is conditional on foreign tax treatment.
- Additional effects in terms of inflation adjustment and currency exchange are difficult to forecast and may result in taxable gains.

## **Equity**

---

A purchaser may also fund its acquisition through equity. The disadvantage of funding through equity is that there would be no interest to deduct and dividends are not deductible. But equity may be preferable for non-tax reasons and the limitations on interest relief and the ultimately negative effects that might result from external factors such as inflation and currency exchange rates must also be taken into account.

For these reasons, no general rules can be established for the choice of debt or equity as alternatives for financing. Each case must be evaluated on its own merits.

## **Hybrids**

---

There are no specific rules in Uruguay relating to this type of instrument. Their use would have to be analyzed on a case-by-case basis.

## **Discounted Securities**

---

There are no specific rules in Uruguay relating to this type of instrument. Their use would have to be analyzed on a case-by-case basis.

## **Deferred Settlement**

---

Uruguay has no specific provisions regarding deferred settlement. It would be computed for tax purposes on its accrual.

## **Other Considerations**

Other than the options considered above, a legal merger may be another option for acquiring a local target.

Under article 26 of Law 16.906, the Executive Power can exempt merger transactions from applicable taxes (corporate income tax, VAT, and real estate transfer tax) when the operation is likely to strengthen the activities of the companies involved. To obtain this exemption, a special request has to be submitted, demonstrating the economic purposes of the transaction.

## **Concerns of the Seller**

---

The tax position of the seller may be relevant when deciding how to structure the transaction, but there are no general rules.

## **Company Law and Accounting**

---

Company Law 16.060 contains the main legal provisions applicable to commercial companies in Uruguay, including formation, operation, reorganization, and dissolution.

Mergers are specifically regulated in article 115 and following article, which stipulate that a merger by creation will take place when two or more companies dissolve without liquidation, transferring their whole net worth to a newly-created company. There will be a merger by absorption when one or more companies dissolve without liquidation transferring their whole net worth to an already existing company.

In both alternatives, the shareholders or partners of the merged companies will receive as compensation shares, quotas or participations in the newly created company or the absorbing company.

The merger will be effected by majority votes and the formal requirements of corporate by-laws, as amended.

A special balance sheet must be prepared by each of the merging companies before the merging resolution can be adopted by the competent corporate bodies. Uniform criteria should be applied by the merging companies for the preparation of the special balance sheets, for the valuation of the assets and liabilities, for establishing the date in which they have been prepared, and for treating subsequent changes.

The decision to merge should be preceded by a promissory contract, setting out the bases of the merger. Special publications of the promissory contract must be made for 10 days, convening the shareholder and creditors.

Company creditors will have to justify their credits within 20 of the final publication, and if they oppose to the merger, they will have to be paid or provided guarantees of payment.

Shareholders who oppose the merger will have the possibility to leave the company within 30 days of the final publication, and their holdings will be paid for out of the special balance.

Once the indicated terms have ended the final merger contract will be executed and filed in the Register of Commerce.

## **Group Relief/Consolidation**

---

Group relief or consolidation does not apply for tax purposes in Uruguay.

### Transfer Pricing

Uruguay introduced transfer pricing provisions in 2007 based on Organization for Economic Cooperation and Development (OECD) guidelines. They are regulated by a decree issued in 2009.

### Foreign Investments of a Local Target Company

Uruguay applies the source principle for income taxation purposes, so the foreign investments made by local companies are not subject to tax.

## Comparison of Asset and Share Purchases

### Advantages of Asset Purchases

- It is possible to isolate the purchasing entity from previous tax liabilities by following a special procedure (transference of commercial establishment).
- It is possible to acquire only part of a business.

### Disadvantages of Asset Purchases

- The purchase procedure is fairly complex and lengthy (involves publications and special certificates must be obtained from the tax authorities).
- The transaction is subject to local taxes, including corporate income tax, VAT and real estate transfer

## Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Germany	7% (max. under DTT 15%)	7% (max. under DTT 15%)	12% (max. under DTT 15%)	12% (max. under DTT 15%)
Hungary	7% (max. under DTT 15%)	7% (max. under DTT 15%)	12% (max. under DTT 15%)	12% (max. under DTT 15%)

### Notes

1. Treaties provide for an exemption for certain types of interest, such as interest paid to government institutions or to state-owned institutions, etc. Such exemptions are not dealt with in this chart.

tax (if real estate is involved). If the transaction is structured as a merger an exemption may be granted by the Executive Power.

- Tax losses remain with the seller.

### Advantages of Share Purchases

- The legal procedure for share transfers is very simple and quick.
- As a rule the consent of third parties (such as creditors) is not required.
- It is not necessary to obtain special certificates from the tax authorities.
- From the legal point of view the operation of the target company remains unchanged, since the transaction is between the purchaser and the shareholders of the target company.

### Disadvantages of Share Purchases

- The purchaser acquires the target company with all its liabilities and contingencies (declared or not). As a result, the due diligence procedures have special importance and are normally more intense.
- The fiscal costs are usually lower (e.g. sale of shares is exempt from VAT; real estate transfer tax does not apply, etc.).

**KPMG in Uruguay**

Luis Waksman  
KPMG Sociedad Civil  
Plaza de Cagancha 1335 Piso 7  
Montevideo  
11100  
Uruguay

Tel. +598 2 9024546  
Fax +598 2 9083918  
e-Mail: [luiswaksman@kpmg.com](mailto:luiswaksman@kpmg.com)

Alicia Seijas  
KPMG Sociedad Civil  
Plaza de Cagancha 1335 Piso 7  
Montevideo  
11100  
Uruguay

Tel. +598 2 9024546  
Fax +598 2 9083918  
e-Mail: [aliciaseijas@kpmg.com](mailto:aliciaseijas@kpmg.com)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2010 KPMG Sociedad Civil, a Uruguayan partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (KPMG International), a Swiss entity. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International Cooperative ("KPMG International"), a Swiss entity.