ARGENTINA'S COMPREHENSIVE TAX REFORMS OF 2017

APRIL OF 2018

Ministerio de Hacienda
República Argentina

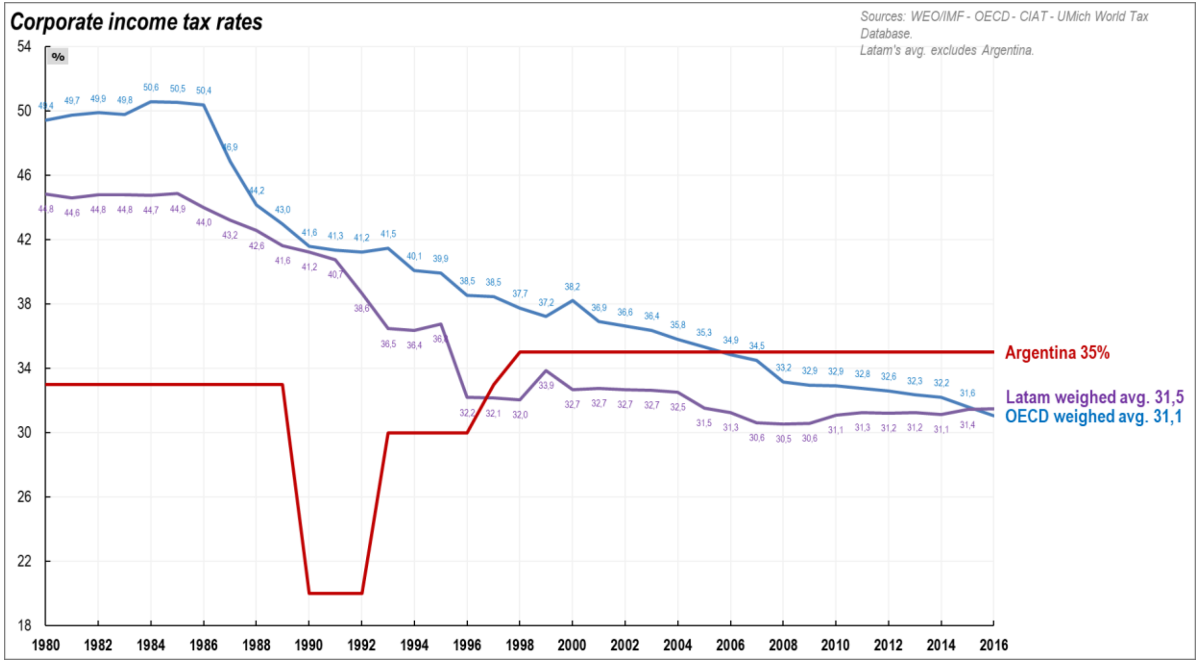
Main objectives

- Argentina enacted a comprehensive federal tax reform in december 2017 with these main aims:
  - ✓ Reduce or eliminate the biggest distortions caused by the tax system
  - ✓ Increase investment and job creation
  - ✓ Improve equity
  - ✓ Broaden tax bases
  - ✓ Improve tax administration and reduce tax evasión
  - ✓ Improve welfare through deeper pigouvian taxation
  - ✓ **A gradual implementation (over 5 years) providing forward guideance and assurances of meeting the fiscal result targets**
- We also reached an accord with the provinces (the Fiscal Consensus) that intends to overhaul the provincial tax structure

Income tax

Alignment of the Corporate Income Tax rate to international standards, from 35% to 30% in 2018 and 25% beginning 2020.

- This was one of the biggest distortions of our tax system due to the large divergence in the tax rate with regards to international standars and the highly mobile nature of the tax base.



Income tax II

- Several financial asset returns previously exempt for individuals are now taxed (eg. gov't bonds).
- Real capital gains on real estate are now taxed (except for the principal residence).
- Several tax administration improvements are to be implemented, among others:
  - The application of the Controlled Foregin Companies rules is broadened following BEPS Action 3 recommendations. Trusts and other similar arrangements and contract types are included.
  - Interest deduction is limited in certain cases where loans are originated in controlled entities, in line with the BEPS Action 4 excessive interest deduction recommendations.
  - Permanent stablishments are defined in the tax law according to BEPS Action 7 guidelines.
  - Sanctions are introduced for not reporting activities following the BEPS Action 13 minimum standard that aims to block transfer pricing maneuvers using international intermediaries.
  - Improvements through the implementation of the BEPS Action 14 mínimum standard regarding double taxation dispute resolution through mutual agreement procedures.

Employer's social contributions (payroll taxes)

Argentina's high labour informality attests to the distortions created by our high payroll taxes and mandatory social contributions on the low end of the income distribution.

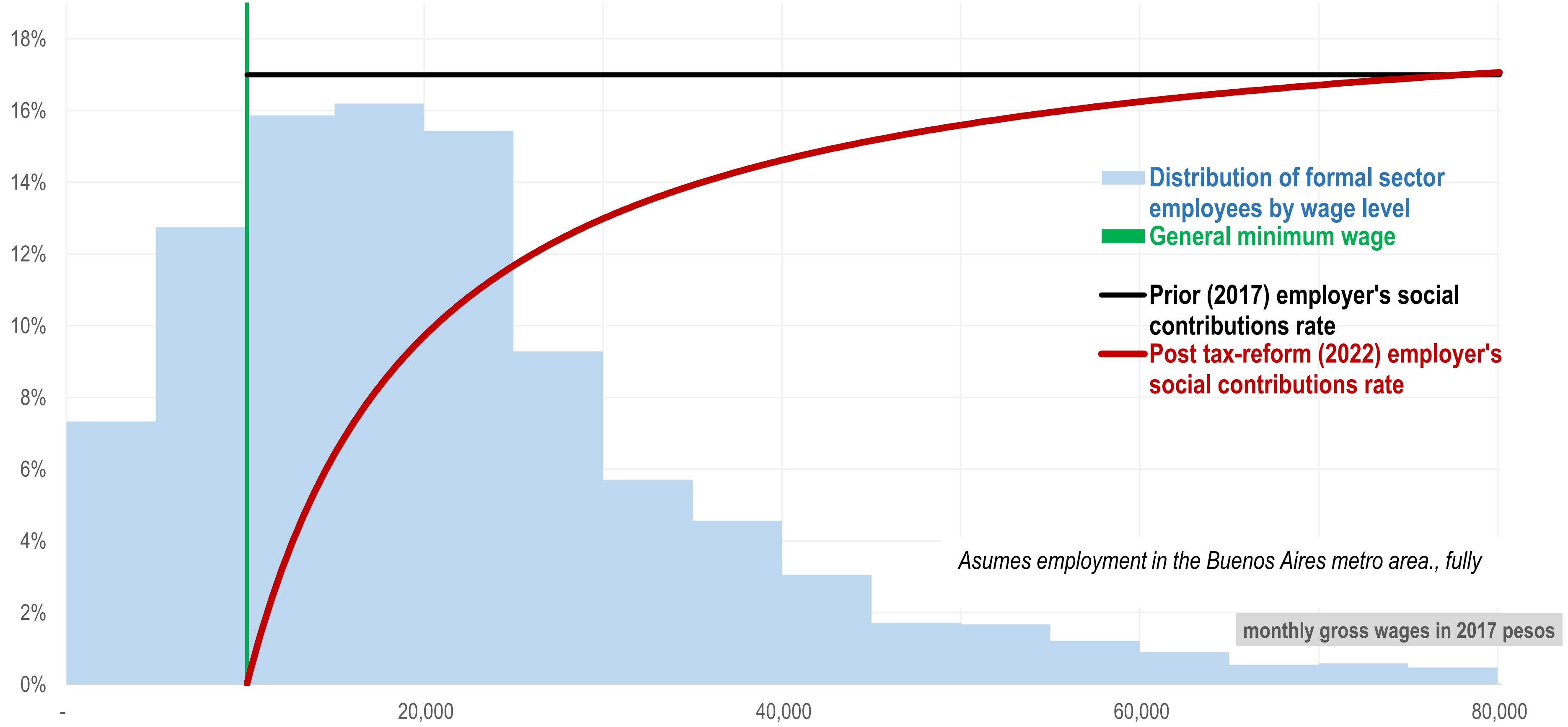
Also: there's a need to future-proof the payroll tax promoting an increase in the demand of unskilled labour.

With the Tax Reform Act:

- ✓ **A non-taxable mínimum for the employer's social contributions of AR$ 12.000/month (approx. US$600/month) is implemented gradually over 5 years.**
- ✓ Apportioned according to number of hours/days worked.
- ✓ It includes the (gradual) reduction and eventually removal of VAT tax credits for payroll taxes.
- ✓ Current promotional regimes and VAT tax credits create geographic and sectorial distortions, and have a reduced uptake due to lack of the employer's lack of knowledge of the benefits and/or fear of the tax administration agency.
- ✓ Partially offsets the effects of the national minimum wage, which might be high for the labour markets of some areas.

Employer's social contributions by 2022

Effective mandatory social contributions rates, as a % of gross wages – general case



VAT & bank deposits and withdrawals tax

VAT

- Expedites recovery of tax credits originated in capital expenditures: they can now be fully claimed after 6 months.
- Expedites recovery of tax credits for subsidized public services providers.
- Taxes digital services consumed in Argentina and provided by suppliers abroad.
- Addresses some distortions regarding the differencial treatment of substitute goods.

Bank deposits and withdrawals tax

- Significant revenue is raised by a bank withdrawals and deposits tax at the rate of 0.6%, that excludes most individuals and thus acts as a turnover sales tax.
- Up until 2015 a third of the tax could be used as payment on account of the corporate income tax. Since 2016 Small Enterprises can use the full tax liability as payment on account of the CIT.
- The Tax Reform Act increases the payment on account rate from 1/3 to 100% for medium and large enterprises over the next five years.
- This reduces a highly distortionary tax on transactions and also fiscal dwarfism incentives.

Pigouvian taxation iniciatives included in the tax reform

The Tax Reform Act included several pigouvian taxation iniciatives aimed at improving welfare and revenues

- Revenue neutral improvements to tobacco taxation were proposed. They create a specific mínimum tax that allows for future raises on tobacco taxes. It passed Congress.
- Increases to alcoholic drinks taxes were proposed, with a minimum ad-valorem tax of 17%. Increases were approved by Congress for some beverages, but locally produced wine and other product remain exempt.
- A sugary drinks tax, with a specific rate proportional to the added sugar content of beverages, was proposed. It wasn't approved by Congress.
- An upstream carbon tax of USD25/tnCO2e for all fossil fuels, based on emission factors, was proposed. Congress approved a USD10/tnCO2e rate and excluded several products, though every fossil fuel with higher emissions per caloric content tan gasoline is now taxed.

These taxed fared poorly because they're highly visible and easy to block in Congress by legislators threatening to veto the whole reform.

Other relevant and recent taxation related changes

Included in the tax reform

- The tax on real estate transfers is replaced by a tax on the real capital gains originated from real estate transactions.
- Taxes on vehicles and electronic products are lowered accross the board. Only high end vehicles remain taxed, consistent with a luxury goods justification for the internal tax.
- Independent workers now enjoy a higher income tax deduction, reducing the gap with dependant workers.

Outside the tax reform

- Export duties have been eliminated for almost all goods
  - Excepting soybeans and related products, and some minor exceptions.
  - A gradual reduction path has been enacted for those goods.
- The minimum corporate income tax based on firm assets has been eliminated for SMEs and is slated to be completely repealed in 2019.

Federal tax reform impacts w/ growth effects

	% of GDP				
	2018	2019	2020	2021	2022
Federal tax reform – static impacts					
Federal gov't	-0,41%	-0,66%	-0,97%	-1,27%	-1,54%
Provinces	-0,10%	-0,12%	-0,18%	-0,26%	-0,32%
Total	-0,51%	-0,78%	-1,15%	-1,53%	-1,85%
+ Tax evasión reduction					
Federal gov't	0,10%	0,20%	0,30%	0,40%	0,50%
Provinces	0,10%	0,20%	0,30%	0,40%	0,50%
Total	0,20%	0,40%	0,60%	0,80%	1,00%
+ Effect on growth					
Federal gov't	0,09%	0,18%	0,27%	0,37%	0,46%
Provinces	0,06%	0,12%	0,18%	0,24%	0,30%
Total	0,15%	0,30%	0,45%	0,60%	0,76%
= Total impacts					
Federal gov't	-0,22%	-0,28%	-0,40%	-0,50%	-0,57%
Provinces	0,06%	0,20%	0,30%	0,37%	0,48%
Total	-0,16%	-0,08%	-0,10%	-0,13%	-0,09%

The Fiscal Consensus and the provincial tax reform

The provinces, through the Fiscal Consensus accord, agreed (among other things) to:

- The immediate termination of taxpayer discrimination based on location, which difficults trade between provinces.

- A substantial reduction in turnover sales taxes and stamp duty taxes of approx. 1,6% of GDP:
  - These are among the most distortionary taxes in the system, due to the cascading effect.
  - Tradeable goods production is to be exempt.
  - Retarget the tax towards taxing consumption.

- An increase in real estate taxation by updating fiscal valuations:
  - Valuations where severely outdated in a context of high accumulated inflation.
  - In the first round of updates, many provinces increased nominal valuations by 10x (and partially offset the changes reducing rates).

Turnover sales tax maximum future rates, as per the Fiscal Consensus