

## **GARCIA GOMEZ SOLER & ASOCIADOS - UPDATED**

### **Venezuelan Tax System**

Venezuela is a country with huge potential to develop high scale projects in South America. It is a nation with access to almost all the markets around the world and with natural resources to create new products every day. However, Venezuela's Local Tax System is quite complicated, due to its variety of Direct and Indirect Tax Laws and important effects of the inflation over the economy.

Income Tax Return is the most significant obligation. The Venezuelan Income Tax is a direct tax, applied nationwide. Such tax levies the annual net and available income, obtained in money or in kind by diverse liable subjects which are established by the standards.

Every individual or company with a residence or domicile in the country pay taxes over all income earned from any origin, being the cause or source of such income located within or outside the country, therefore allows the application of the worldwide income.

To determinate the income tax returns must be considered the following: i) global gross income (amount of the sales of goods and services in general, of leases and any other income, regular or incidental, such as that produced by work under a dependence relationship or due to free exercise of non-mercantile professions, and that provided by royalties or similar participations) that are not exempted, exonerated or not available; ii) Costs (imputable to income available); iii) expenses composed of outlays caused not imputable to cost, normal and necessary, made in the country in order to produce income; and iv) regular readjustment for inflation applied to: a.- non-monetary assets and liabilities, b.- equity at the beginning of the period and c.- increases and decreases of equity conducted during the taxable income.

Once all these elements are considered, without prejudice of the incorporation of the effects (if any) regarding transfer pricing matters, the entity will determine the taxable base for purposes of applying the corresponding rate in case of having obtained a net taxable income and not (tax loss).

The applicable rate in Venezuela depends on the activities carried out by each individual or company. For activities no related with oil and gas sector (principally), the rate would not be higher than 34% over the net income. The entities engage in activities relating to the exploitation of hydrocarbons and related activities, it will be subject to the 50% rate, applicable to entire generated income. Final tax returns must be filed up annually within the next three months of the fiscal year-end.

It is very important to comment, the mechanism established in the local law to avoid the double taxation with dividends paid by a Venezuelan entity. Also, in order to determine the taxable portion of the dividends, the distributing company must deduct from the total amount of the dividends paid as follows: (a) the portion thereof attributable to exempted or exonerated income; and (b) the portion thereof attributable to dividends received from

companies incorporated abroad, whether or not domiciled in Venezuela. The amount resulting from this operation, if any, is deemed to be net income of the distributing company. From net income, the company must deduct in the following preclusive order: (a) net taxable income of the preceding fiscal year on which the payment of the dividends occurs and other income subject to flat rates; and (b) dividends received by the paying company from companies incorporated in Venezuela. The resulting amount, if any, is the portion of the dividends that will be subject to tax based on the applicable rate. This tax must be totally withheld at the source by the distributing company.

As we comment before, the inflation is probably the most important issue to be resolved, therefore, the inflation adjustments must to be implemented in two phases and are not recorded in the accounting books. The first step must be applied as an “Initial Adjustment for Inflation” at the end of the first year of operations. The second one is denominated as “Regular Readjustment for Inflation”, and must be made at the end of each fiscal year, commencing next year on which the Initial Adjustment for inflation is made.

If you need further request, please do not hesitate to contact us as soon as you consider.

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