



# KPMG's Latin American Capital Flows Survey 2008

A study of the investment intentions of companies in seven Latin American states, and their attitudes to international proposals for tax reform.

September 2008

TAX



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# Introduction



KPMG's 2008 Iberoamerica Tax Summit in São Paulo, Brazil, coincides with a major global reassessment of the economic assumptions that have driven world commerce for the past decade.

The reasons for this change are many and varied, from the immediate impact of the credit crunch, to the longer term influence of globalization, increased mobility of capital and labor, and the inexorable march of new technology. But businesses all over the world are being required to look again at their methods of working, adopt a global mindset, and reassess the opportunities open to them.

To find out how these changes are affecting businesses in Latin America, we have commissioned a survey of nearly 140 senior corporate decision makers covering Mexico, Brazil, Argentina, Chile, Colombia, Peru and Venezuela. To build up a picture of how Latin American business is reacting to these global challenges we followed the pattern established by KPMG's global study of future capital flows (published earlier in the year) and asked the corporate executives about their companies' investment plans now and in five years' time.

More specifically, we asked them what view they took of proposals from the Organisation for Economic Co-operation and Development for a new way of working between taxpayers, tax authorities and tax advisers, based on mutual trust and voluntary disclosure of information.

This is our report on what these forward-thinking executives said. It paints a fascinating picture of a set of economies in transition. We hope it adds real value to the debate on the future direction of Latin American business.

**Jose Aldrich**

Managing Partner,  
KPMG's Iberoamerica Tax Services

# Commentary

- Latin American business is focusing on investments in the Americas in the next 12 months.
- Brazil is the country of choice for investors now and in five years' time, but global interest means that competition for Brazilian investment opportunities could be fierce.
- A cautious approach to investments outside Latin America and the US.
- Enthusiasm for OECD proposals to improve tax administration.

This is the second of KPMG's 2008 inquiries into international capital flows. The first, published at the Europe, Middle East and Africa Tax Summit in Barcelona in June, looked at capital flows across 15 countries around the world, and concluded that we may be seeing the emergence of a roughly equal, three-bloc world economy, comprising the Americas, Europe and Asia Pacific.

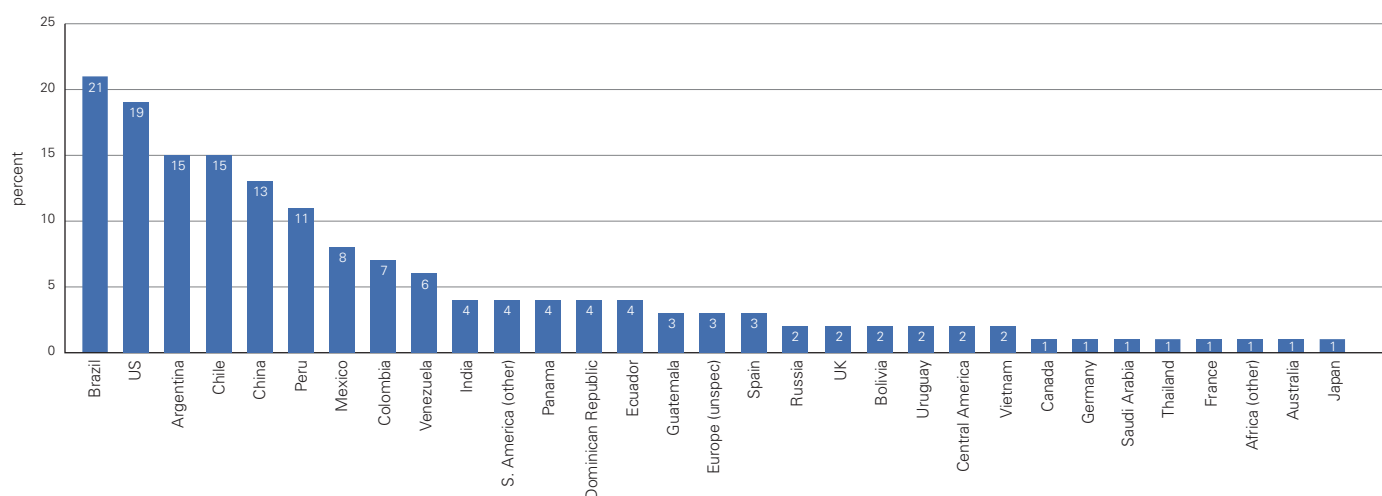
For this study we have focused on seven large Latin American economies, Mexico, Brazil, Argentina, Chile, Colombia, Peru and Venezuela. Researchers asked nearly 140 senior corporate decision makers which countries (other than their own) they intend to invest in during 2008/09 and where they are looking to invest in five years' time.

This group of people was chosen because their investment decisions are medium to long term, they are intended to generate real growth for the companies they run, and they are usually made on the basis of careful analysis of the underlying prospects for markets and countries.

The results show a strong preference this year for investment in the Americas, especially in Latin America. In fact, of all the investment decisions our respondents have made for this coming year, 63 percent have resulted or will result in an investment in a Latin American country.

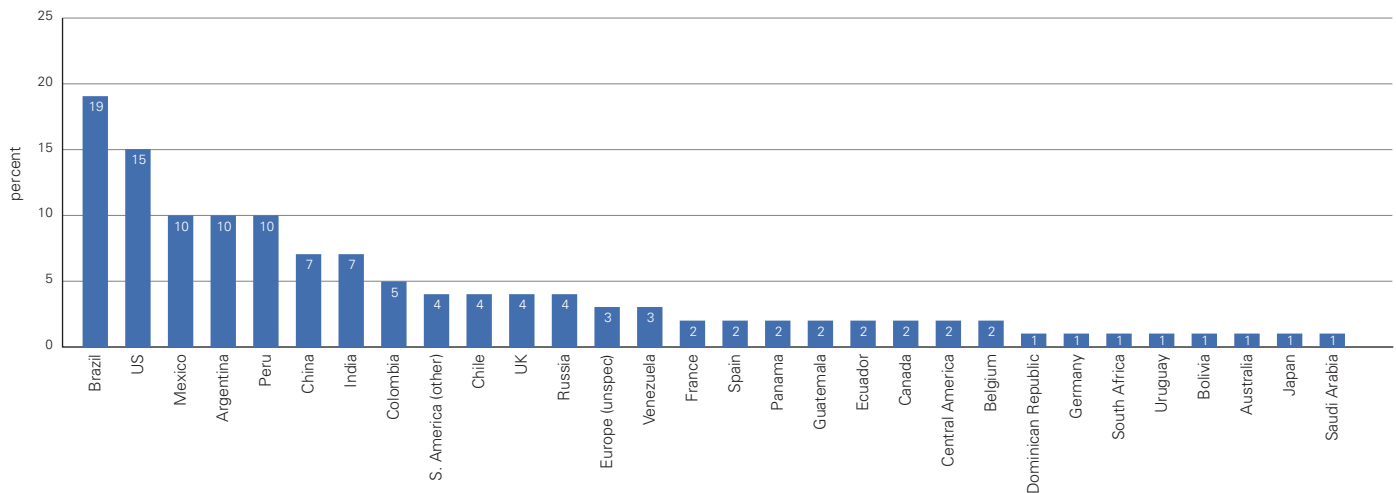
Brazil heads the table with 21 percent of respondents planning an investment in the next year, followed by the US with 19 percent, and Argentina and Chile with 15 percent each.

## In the next year, Brazil is most popular for investment, followed by the US



Source: Latin American Capital Flows Survey 2008, KPMG International

### In five years' time, Brazil is still expected to be popular for investment, again followed by the US



Source: Latin American Capital Flows Survey 2008, KPMG International

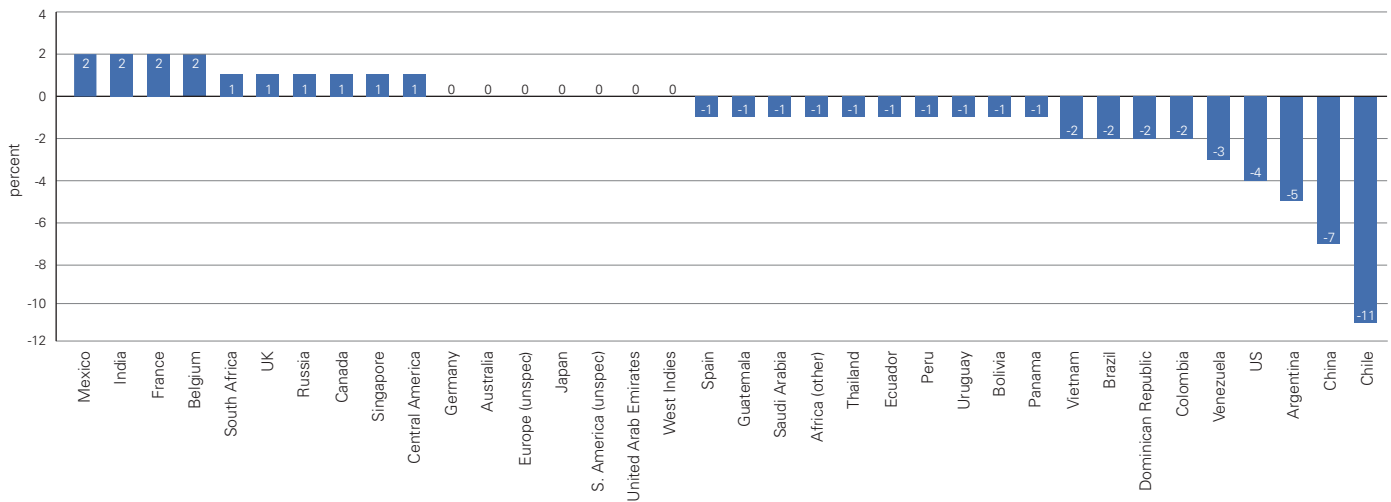
The only country outside the Americas to make it into the top five is China, which is the preferred investment choice of 13 percent of respondents. Next comes Peru with 11 percent, Mexico with 8 percent, Colombia with 7 percent and Venezuela with 6 percent.

Looking ahead to 2013/14, countries in the Americas still dominate investment plans, but the spread is more even. Brazil is still at the head of the table, but its share of investment falls 2 percent to 19 percent. The US is next, but its share has also fallen, by 4 percent to 15 percent.

Next come Mexico, Argentina and Peru, all at 10 percent. Mexico does particularly well, increasing its share of investments by 2 percent, one of the largest increases recorded by this survey. But Argentina and Peru both give up part of their share, Argentina by 5 percent and Peru by one percent.

China falls by 6 percent to 7 percent, but India's share nearly doubles, from 4 percent this year to 7 percent in five years' time. Colombia falls 2 points to 5 percent but the biggest faller is Chile, which gives up 11 points to record 4 percent, alongside the UK and Russia.

Change in percentage of corporates planning a significant investment, 2008/9 – 2013/14



Source: Latin American Capital Flows Survey 2008, KPMG International

Comparing these results with the global study, it's clear that the appetite for investments in China, Russia and India and the UK is much greater outside Latin America than inside. All four countries top the global table, along with the US. But among the investors polled in the global study, Brazil is the sixth most popular choice for investment, increasing its share from 10 per cent in the coming year to 14 percent in 2013/14.

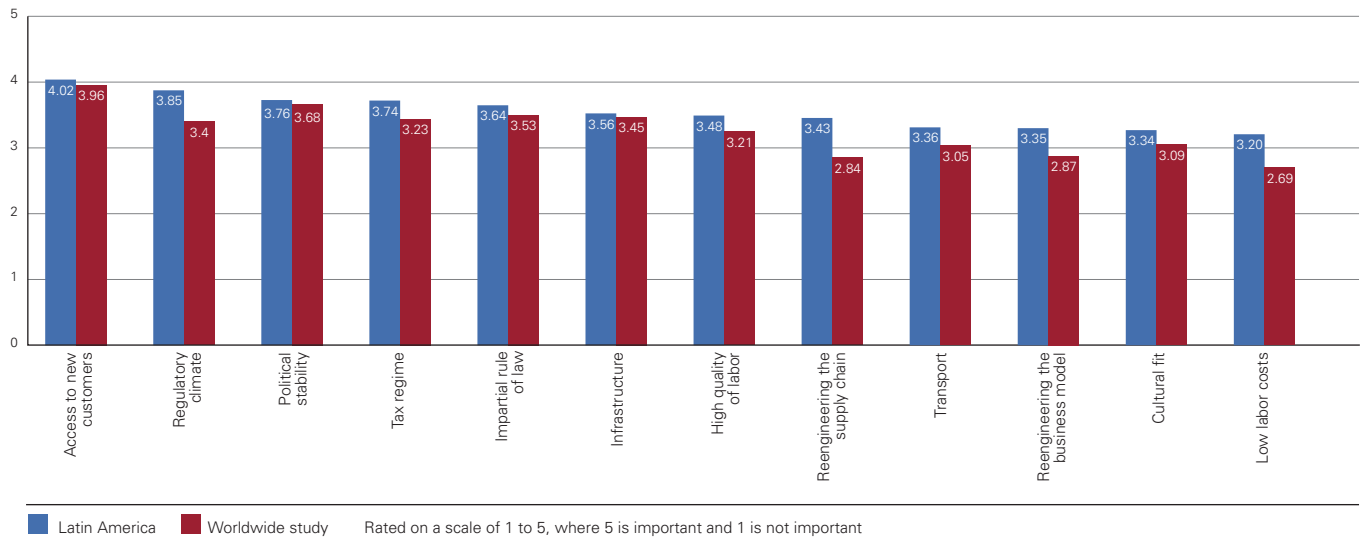
Since Brazil's share among Latin American investors declines over the same period, Brazil seems to be substantially more popular among investors outside Latin America than it is among those inside.

This may be because the two groups of investors have different priorities when it comes to choosing countries in which to invest. To test this, we selected 12 characteristics that an investor might consider when assessing whether to invest in a country, and asked respondents to rank them in order of importance.

Top of the list in both studies was access to new customers, and both sets of investors saw political stability as a major factor. But while the global study ranked the regulatory climate and tax regime below impartial rule of law and good infrastructure, Latin American investors rated tax and regulation much more highly.

Tax in particular was thought to be much more important among Latin American respondents than among the global group, although both groups had the same preference for stability and simplicity over a low rate.

### What makes a country attractive? Comparison between Latin America and Global study



Source: Latin American Capital Flows Survey 2008, KPMG International

The most likely explanation for this difference is the difference in size of companies between the two samples. In each case, the sample was made up of the largest companies in the countries surveyed. But while 70 percent of the companies in the global sample had revenues of \$2 billion or more, the largest proportion of Latin American companies (57 percent) had revenues of less than \$500 million.

This translates into fewer resources available to deal with complex tax and regulatory systems. So while larger companies may be less concerned about the business friendliness of a country because they have well-resourced departments able to deal with the necessary administration, smaller companies will have to think much harder about the administrative burden of investing in a country because the cost will have a proportionally greater impact on their revenues.

This has great implications for Latin American governments wanting to encourage investment in their territories from neighboring countries, and indeed for those wanting to encourage their own companies to grow across borders.

A country may offer significant opportunities for growth, but if its tax and regulatory systems are too complex and therefore costly for taxpayers, these opportunities may go to large foreign enterprises rather than to smaller local companies, simply because they are better able to bear the cost. This seems to be borne out in the investment intentions of large and small companies that we have identified in both our studies.

### **Responses to the Organisation for Economic Co-operation and Development (OECD) proposals for improved relationships between tax authorities, taxpayers and their advisers**

Latin American companies feel that their size is a handicap in world markets, however they also seem very optimistic that tax systems can be simplified and costs reduced based on our survey results with respect to the OECD proposals.

In a report published in January 2008 after more than a year of investigation, consultation and analysis, the OECD recommended that tax authorities, taxpayers and their advisers should actively work to develop an enhanced relationship based on trust. The report said that companies should volunteer information on their operations, where they believe there may be a different interpretation of tax law between them and the applicable revenue authority. Companies should also provide broad ranging responses to questions from the revenue body so that officials can understand the significance of issues, deploy appropriate resources and reach the right tax conclusions.

In return, revenue bodies should offer, " understanding based on commercial awareness, impartiality, proportionality, openness through disclosure and transparency, and responsiveness."

More than 70 percent of Latin American respondents thought that it would be possible to develop an enhanced relationship of mutual trust with their tax authority, and would be prepared to provide more information on their businesses in return for lighter regulation.

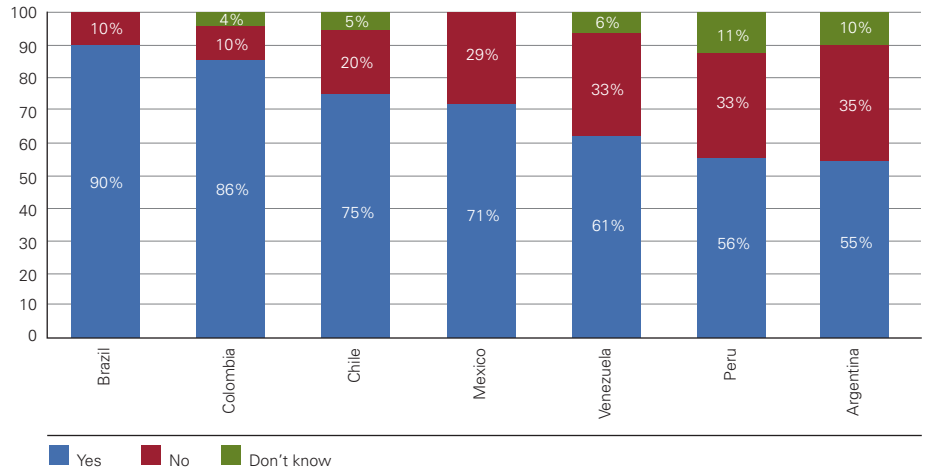
In Brazil and Colombia, around 90 percent took this view. In Peru and Argentina, the numbers who felt an enhanced relationship was possible fell to 56 percent and 55 percent respectively, but although only 33 percent of Peruvians were prepared to volunteer more information, 70 percent of Argentinians said this was something they would do.

Asked if light touch regulation would make any difference to their company's tax policies, 68 percent of respondents said that it would prompt a review of their policies. Of these, half said that it would allow them to make their tax policies simpler and more transparent and half said they would check to ensure full compliance with tax regulations.

Again, Brazilian companies were most enthusiastic, with 75 percent saying they would adopt simpler tax policies. The most skeptical response came from Chile, but even here, 45 percent thought that they would at least review their tax strategies.

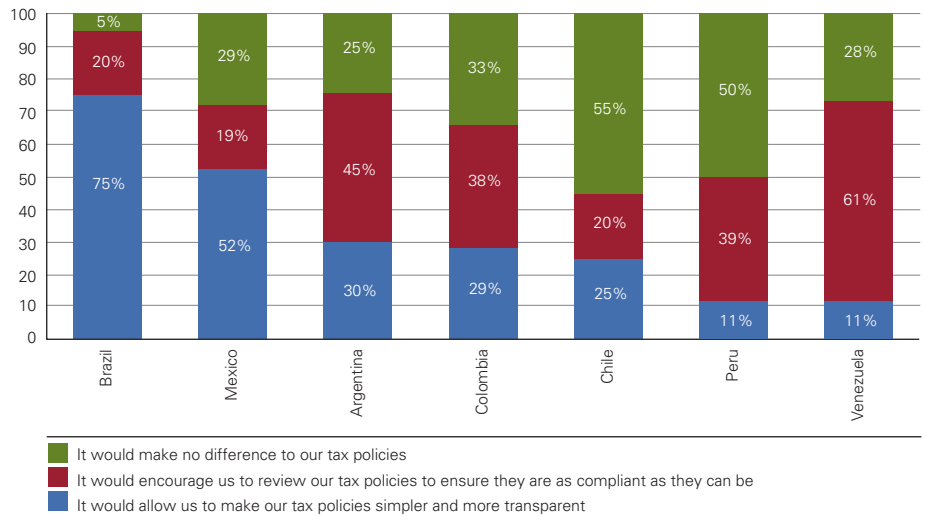
This is a remarkably strong response from our respondents in favor of simpler, better informed, and more collaborative tax regulation, even at the cost of going beyond legal obligations in providing information. It provides confirmation of the OECD view that there is an appetite for an enhanced relationship, and presents a clear opportunity for those governments willing to move in this direction.

**Most Brazilian respondents think it is possible to develop mutual trust with the revenue authority**



Source: Latin American Capital Flows Survey 2008, KPMG International

**Brazilian respondents would make their policies simpler and more transparent**



Source: Latin American Capital Flows Survey 2008, KPMG International

The overall theme arising from our research seems to be that Latin American business is prepared to meet the challenges of the new global market, but it needs the help and support of its governments if it is to compete effectively with much larger foreign operations.

Authorities wanting to engage with business may be able to take a global lead by exploring the opportunities for collaboration that the OECD's tax initiative presents. In the increasingly competitive conditions presented by the developing three bloc world, that may be an advantage worth taking.

# Country by country

These are summaries of the results of the survey for each of the countries which took part. Each section looks at the attractiveness of the country to corporate investors this year and in five years' time, broken down where possible into results for different sectors. The summaries also look at the international investment preferences of corporate investors based in each country, and at their attitudes to proposals from the OECD for developing an enhanced relationship with their tax authorities.

# Brazil

Brazil is the clear leader among the Latin American economies. It is the preferred investment destination for 21 percent of Latin American corporates this year, and for 19 percent in five years' time. The country is particularly popular in the manufacturing sector, with 25 percent of manufacturers planning an investment there in the next year, and 26 percent in the period to 2013/14.

Brazilian investors seem to have a particularly international outlook by comparison with the rest of Latin America. Their country of choice now is the US, followed by a wide spread of investments in South America and Europe. China is next, as the choice for 15 percent of investors, with Mexico fifth at 10 percent.

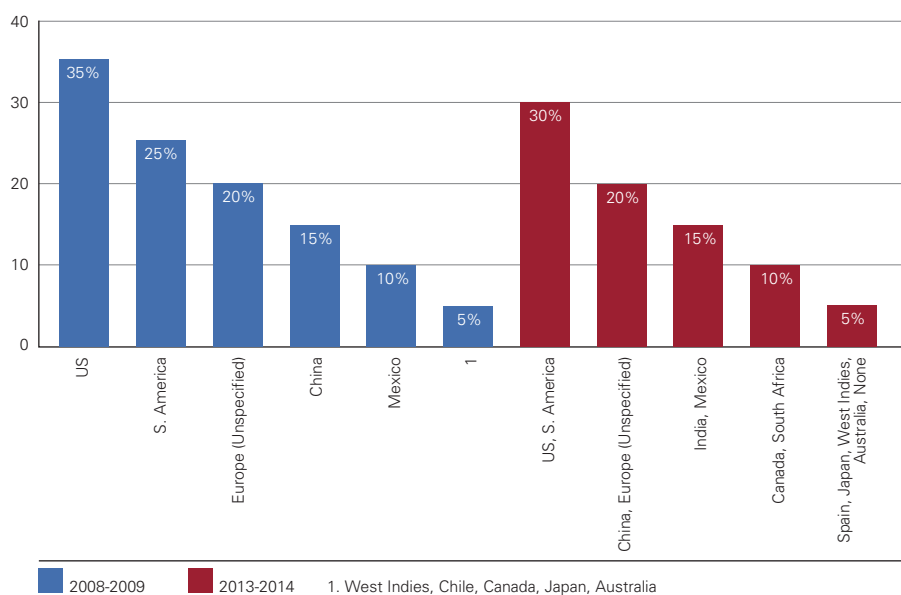
Looking ahead, the US and South America keep their lead, but their share of investment falls in favor of a spread of deals in China and Europe. India makes an appearance for the first time as a place to invest alongside Mexico, followed by Canada and South Africa.

The OECD's proposals for an enhanced revenue authority/taxpayer relationship are especially popular in Brazil, with 90 percent believing that an enhanced relationship is possible and offering to provide more information to the authorities, and 75 percent saying that light touch regulation would prompt them to make their tax policies simpler and more transparent.

But respondents were critical of their country's tax regime, with 50 percent saying that it does not offer a competitive advantage in international markets, and a further 50 percent saying that the tax authority has a poor understanding of tax regulations in the rest of Latin America.

The overall picture seems to be of a commercial sector keen to take its place in international markets, and keen to work with government to improve its ability to compete.

## Investment intentions – Brazil



Source: Latin American Capital Flows Survey 2008, KPMG International

# Argentina

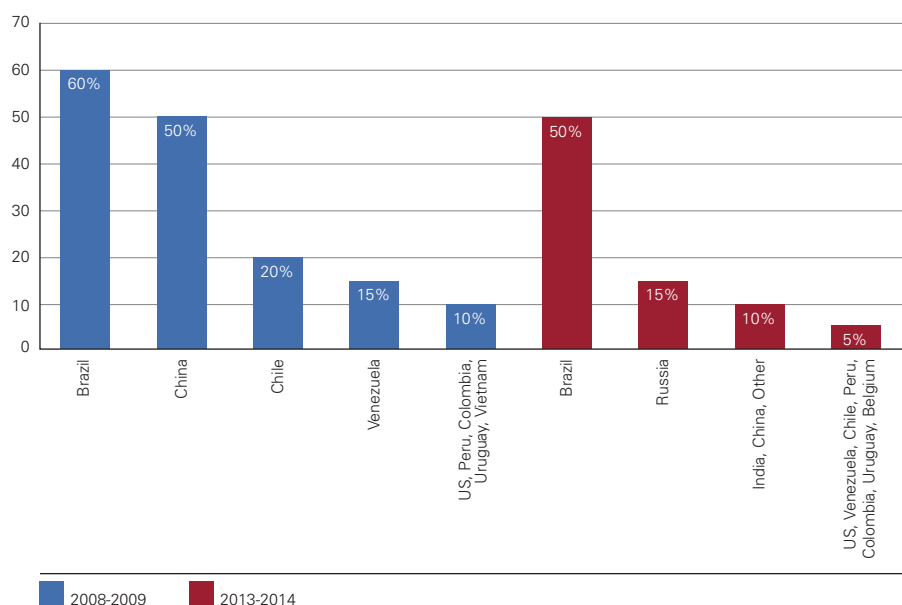
Argentina shares third place with Chile in the list of countries receiving investment in the next year, with 15 percent of respondents planning a deal. But looking ahead Argentina's share of investments falls to 10 percent. This is nevertheless enough to give it third place in the 2013/14 table, alongside Mexico and Peru. It is a good indication of the wider spread of investments in the later table.

In manufacturing, although Argentina's 15 percent share puts it in fourth place behind Brazil, China and Chile for this year, the country's share holds up well in the next five years and by 2013/14 it is in second place behind Brazil, with 14 percent. In services, Argentina goes from third with 15 percent of investments, to joint 6th, with a 6 percent share, alongside a mixture of South American and European countries.

In their own investment plans, Argentinean businesses follow the trend in putting Brazil first, for this year and looking ahead. But unlike many they show a strong preference for investments in China this year, followed by the rest of South America. Russia and India appear in plans for 2013/14, but the dominant country remains Brazil.

Argentinean business is the most skeptical of those in our survey on the possibility of improving relationships with the tax authorities, but even so, 55 percent think this would be possible, and 70 percent would be prepared to provide more information in return for light touch regulation. Nevertheless, 60 percent said that their revenue authorities had a poor understanding of tax policies in other countries, inside and outside Latin America.

## Investment intentions – Argentina



Source: Latin American Capital Flows Survey 2008, KPMG International

# Chile

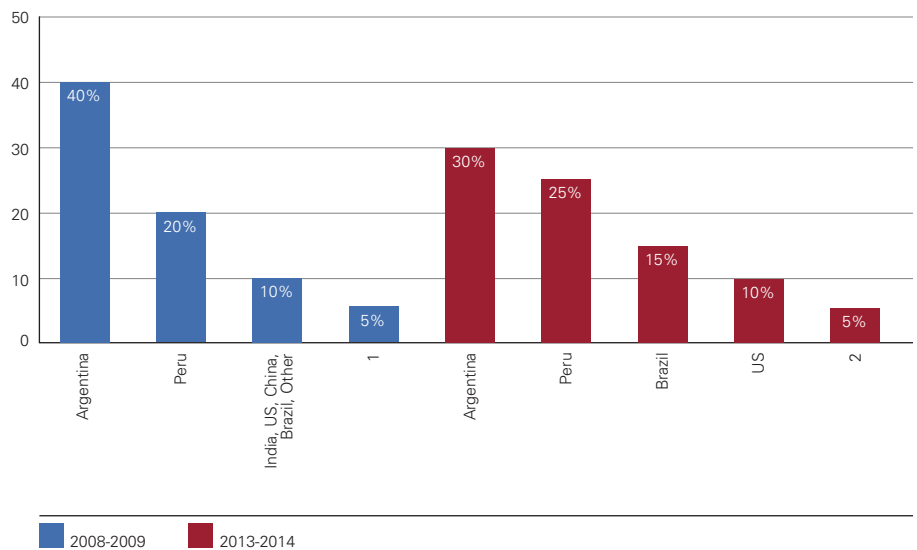
Chile scores well in plans for the coming year, third with Argentina at 15 percent. But investment drops to 4 percent over the next five years, giving Chile the largest decline of any country in our survey.

Virtually all of this decline comes from a significant drop in manufacturing investment, which goes from 17 percent next year, putting Chile in joint second place with China, to zero in five years' time. Service industry investment goes from 12 percent to 9 percent.

Chile's own investment plans favor Argentina now and in five years' time, followed by Peru. Brazil features in a mixed group of countries in this year's plans, but its share grows to 15 percent in five years' time, giving it third place.

65 percent of Chilean respondents thought their country's tax policy gave them a competitive advantage in international markets, and that their tax authority was helpful in developing international business. Three out of four thought that they could develop an enhanced relationship with their authority, but only 60 percent were prepared to release more information to do so and 55 percent said this relationship would make no difference to their tax policies.

Investment intentions – Chile



1. UK, Germany, Spain, Russia, Venezuela, Columbia, Mexico, Panama  
 2. Russia, India, China, Colombia, Mexico, Panama, Central America, Other

Source: Latin American Capital Flows Survey 2008, KPMG International

# Peru

Between next year and 2013/14, Peru rises from 6th place to joint 3rd alongside Mexico and Argentina in the table of investment intentions. But despite this rise, the percentage of investors planning an investment falls from 11 percent to 10 percent, a further indication of the extent to which investments patterns are changing.

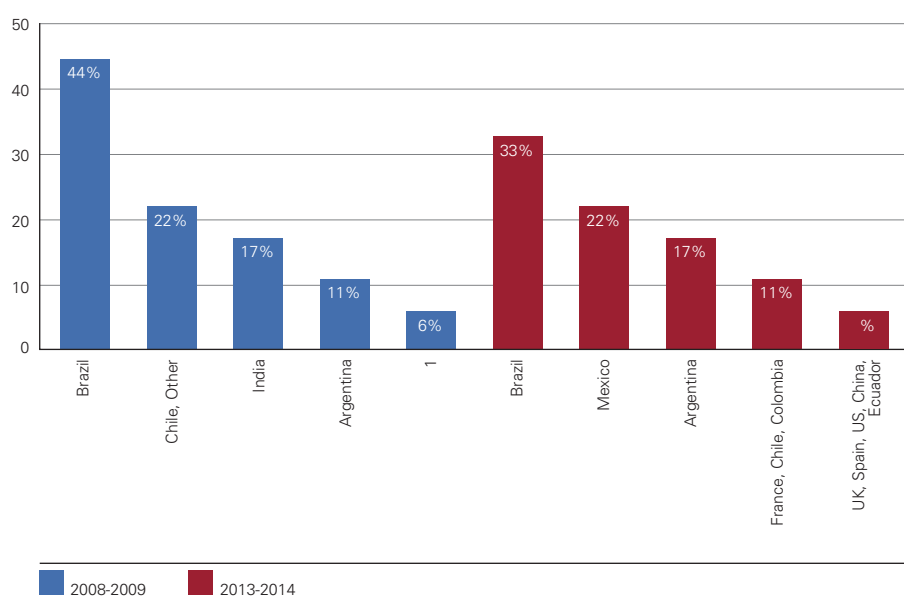
There is a move in favor of Peru's manufacturing sector, with investment intentions here rising from 10 percent to 11 percent. Service industry investments fall from 12 percent to 8 percent.

Peru's own investment intentions favor Brazil both in the year ahead and in five years, but an initial enthusiasm for India in the next year disappears in the five year table in favor of Argentina. Overall, the future focus seems to be on the larger Latin American economies, with a few bolder investors testing the opportunities in other countries.

Peruvian business gives the highest approval ratings for their country's tax law in our survey, with 72 percent saying that Peru's tax policy provides a competitive advantage in international markets, and 56 percent saying that the tax authority is helpful.

But by contrast, 67 percent say they would not be prepared to provide more information to the authorities in exchange for light touch regulation, and 50 percent say a move in this direction would make no difference to their tax policies. Peru thus seems to be one of the most skeptical countries in our survey of views on the OECD proposals, but this may be because business feels that the Peruvian tax system is already well run.

## Investment intentions – Peru



1. Russia, China, Venezuela, Colombia, Ecuador, Bolivia

Source: Latin American Capital Flows Survey 2008, KPMG International

# Mexico

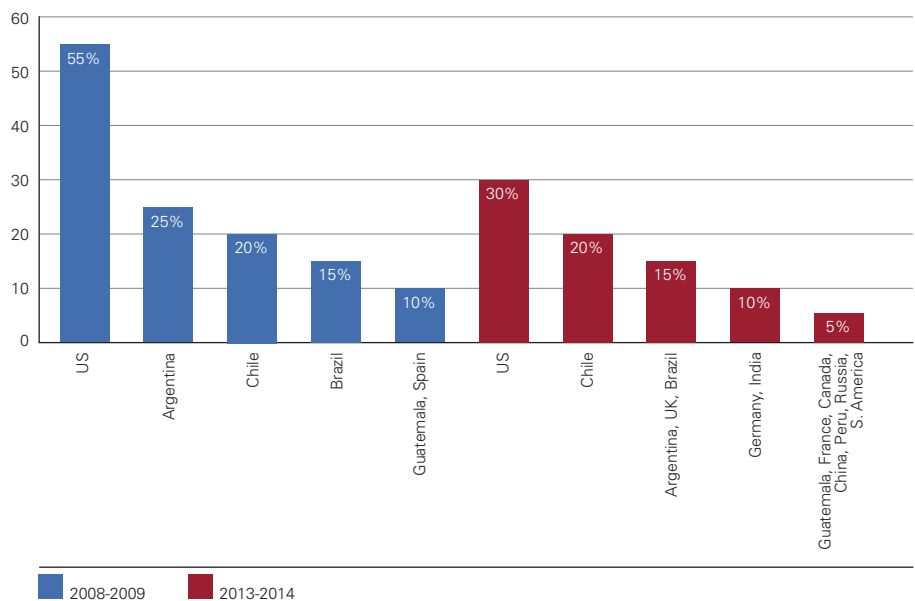
Mexico is the only Latin American country in our survey to increase its share of investment. In the next year, 8 percent of investors plan to invest in Mexico, rising to 10 percent by 2013/14. Investment in the services sector stays steady at 8 percent, but there is a rise in manufacturing investment from 8 percent to 13 percent.

Among Mexican investors, the US is the clear favorite for investment in the next year, followed by Mexico's Latin American neighbors. But looking ahead, there is a move in favor of the larger European economies, particularly the UK and Germany, and India, Russia and China begin to feature.

In a sharp contrast with Peru, 86 percent of Mexican respondents said that their country's tax policy does not give a competitive advantage in international markets, and 52 percent felt that the tax authority was not willing to help in developing international business.

But there was marked enthusiasm for the OECD's proposals, with 71 percent saying that an enhanced relationship could be developed, and 86 percent saying they would be prepared to provide more information to the authorities. A clear majority, 52 percent, would use the opportunity to make their tax policies simpler and more transparent.

Investment intentions – Mexico



Source: Latin American Capital Flows Survey 2008, KPMG International

# Colombia

Colombia stays eighth in the table of investments for the year ahead and for five years ahead, but its overall share falls from 7 percent to 5 percent. Investment in services stays steady at 3 percent, but investment in manufacturing falls from 11 percent to 7 percent.

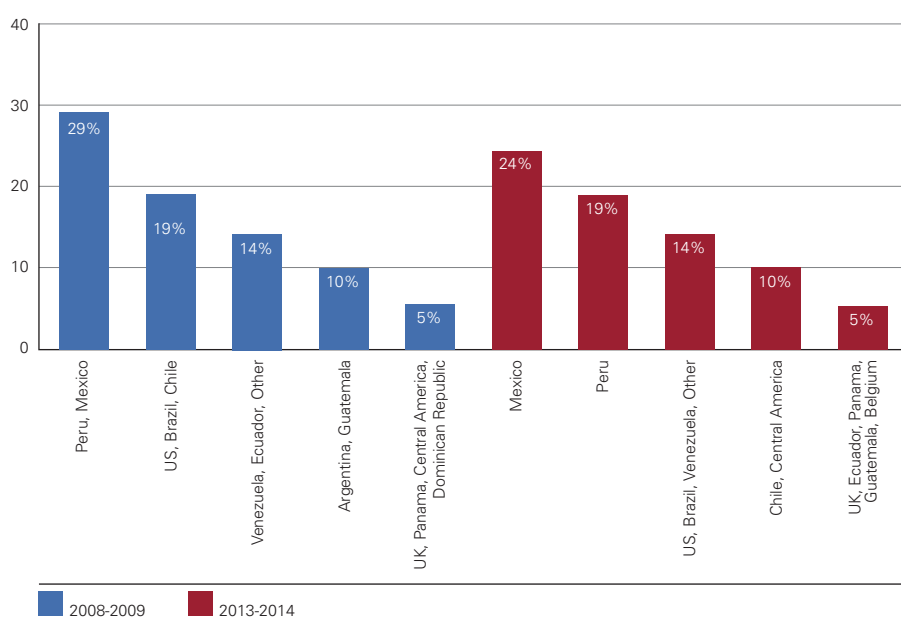
Colombia's own investors favor Peru and Mexico this year, but Mexico overtakes Peru in the next five years to become the investment destination of choice for nearly a quarter of respondents. Investments outside Latin America seem to be focused mainly on the US and UK.

Colombian business rates its tax authority very highly for its understanding of the tax policies of other countries, but only 52 percent believe that the authorities are willing to help develop international business.

It is, perhaps, not surprising then that Colombians are second only to the Brazilians in their belief that relations with the tax authority can be enhanced. 86 percent thought this was possible, and 90 percent would be willing to provide more information in return for lighter regulation.

But only 29 percent thought that this would allow corporate tax policies to be made simpler and more transparent, and a third thought it would make no difference at all.

Investment intentions – Colombia



Source: Latin American Capital Flows Survey 2008, KPMG International

# Venezuela

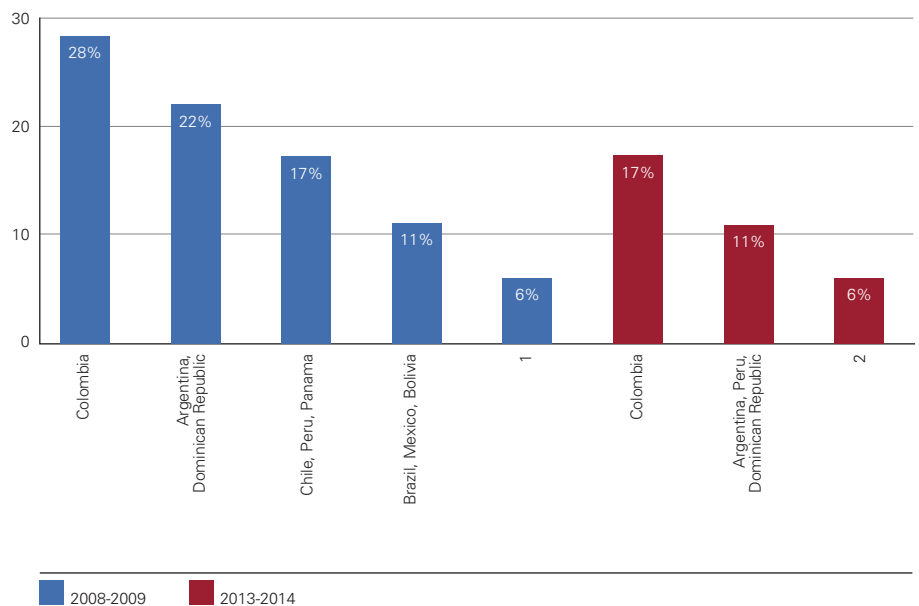
Venezuela is not a particularly popular destination for investment among our Latin American sample, moving from 9th position and 6 percent of investments in the next year, to 14th position and 3 percent of investments in five years' time. Investment in services moves from 3 percent to zero, and in manufacturing it moves from 8 percent to 6 percent.

Venezuelan investors prefer Colombia both in the year ahead and in five years' time. But the number planning to invest in the neighboring country declines from 28 percent to 17 percent in favor of a wider spread of investments in a range of countries.

It is also clear that relatively few investors were willing to declare where their investment plans might take them in five years' time, which suggests a larger element of uncertainty in their planning than we found elsewhere in the study.

Although less enthusiastic than businesses in Brazil, Colombia and Chile about proposals for an enhanced relationship with the tax authorities, 61 percent of Venezuelan respondents thought it would be possible to move in this direction. The same proportion would be willing to provide more information to the authorities and would review their tax policies to ensure compliance. Only 11 percent, the same proportion as in Peru, would go further and make their tax policies simpler and more transparent.

Investment intentions – Venezuela



- 1. Spain, Saudi Arabia, US, China, Ecuador, Central America, Uruguay, Cuba, Canada, Costa Rica, Trinidad and Tobago, Puerto Rico
- 2. Spain, Saudi Arabia, India, Singapore, United Arab Emirates, US, Brazil, Mexico, Panama, Guatemala, Cuba, Ecuador, Bolivia, Canada, Puerto Rico

Source: Latin American Capital Flows Survey 2008, KPMG International



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