

BANCO INTERAMERICANO DE DESARROLLO

Three drivers for taxation change in LAC countries

Alberto Barreix (IDB) and Ángel Melguizo (OECD)
Wilson Center – April 20th 2018



Topics

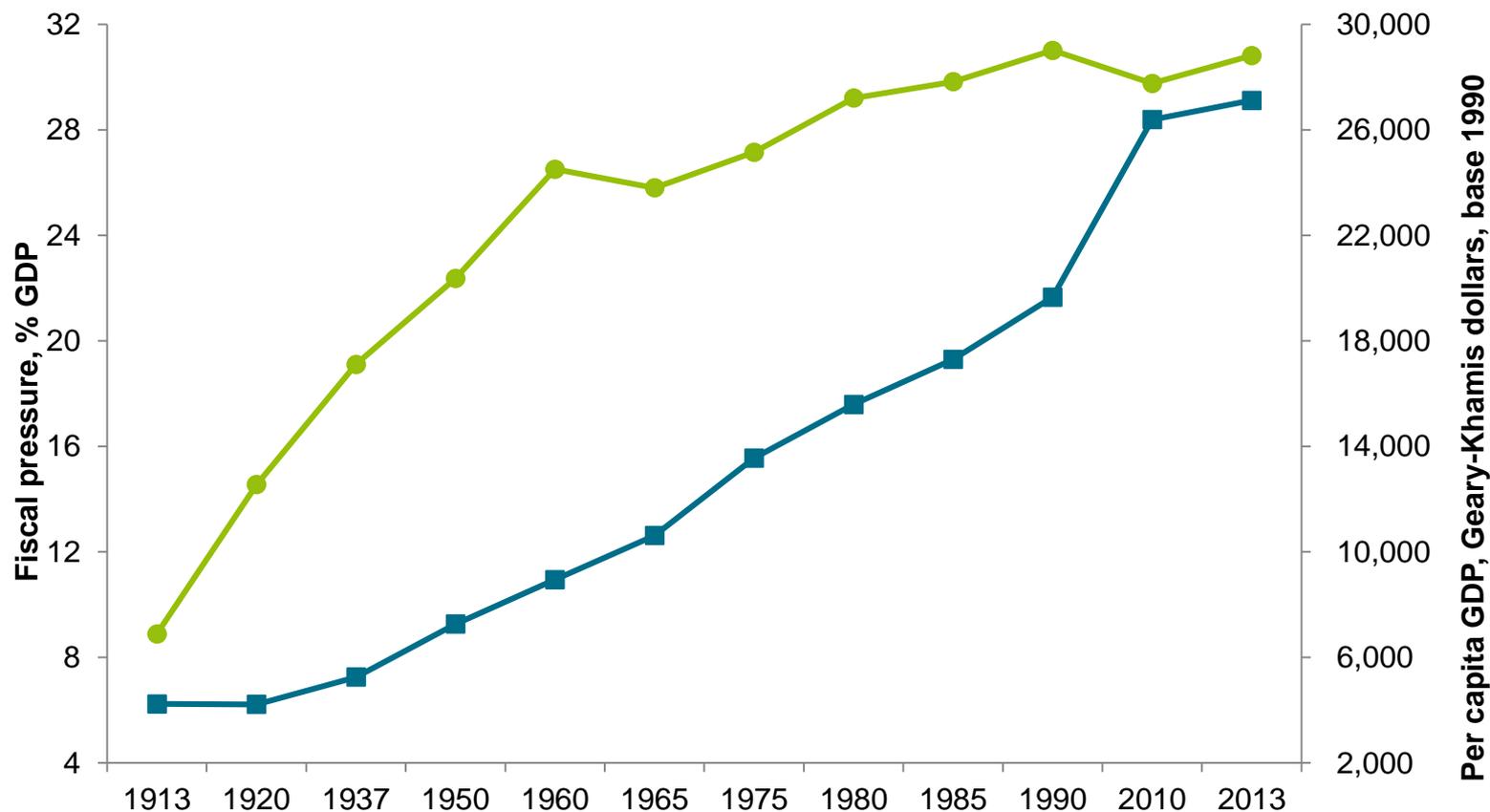
- **Tax transparency and BEPS**
- **Electronic Invoicing (EI)
(Digitalization)**

**Tax
Administration**

- **Tax Reform (TRA17) in the US**

**International
Taxation**

Comparison of the Equivalent Fiscal Pressure (EFP) and Per Capita GDP of Selected Developed Countries¹

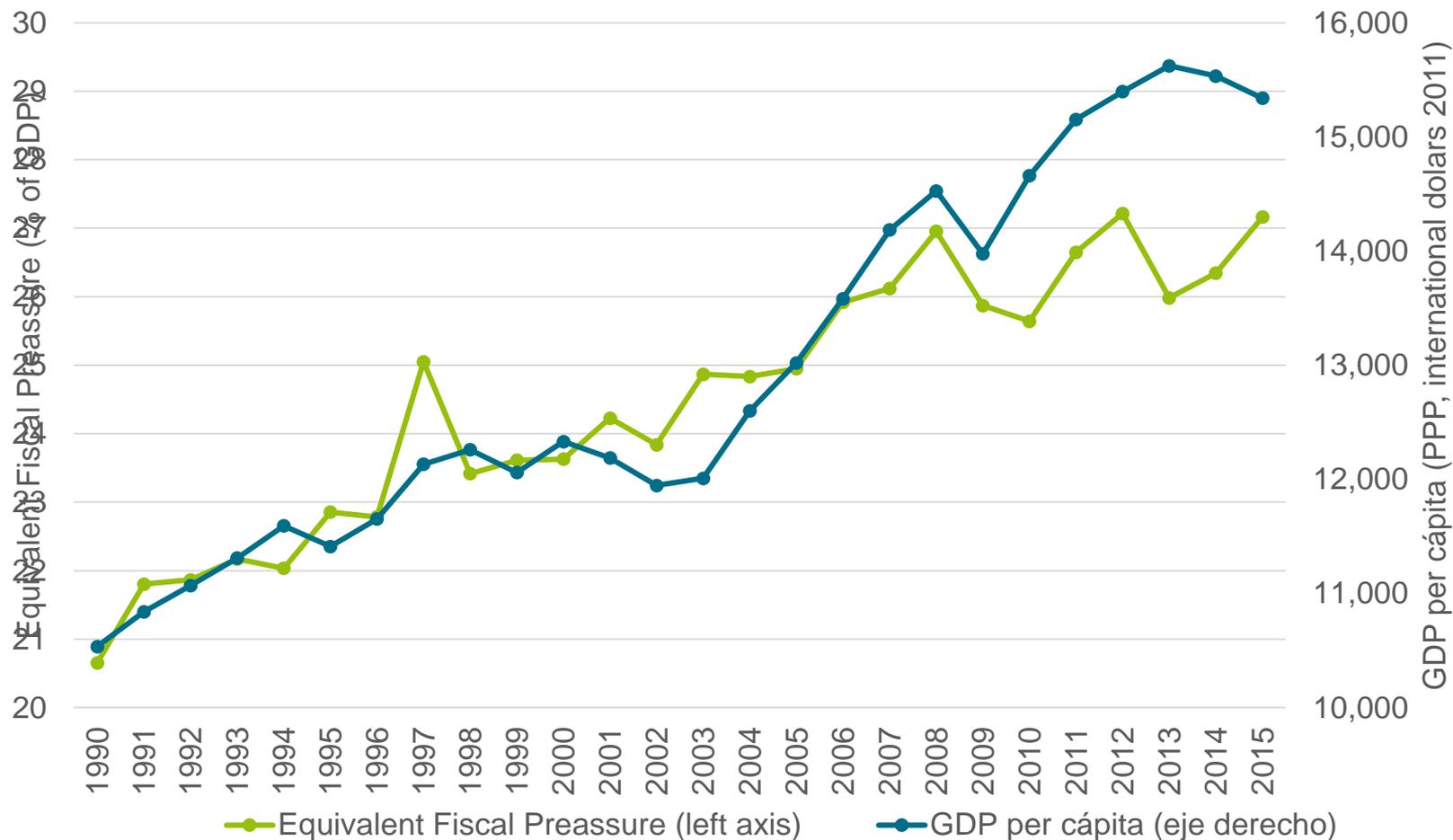


—●— Fiscal pressure, selected devd. countries (left axis) —■— Per capita GDP, selected devd. countries (right axis)

^{1/} Fiscal pressures (OECD Tax revenues, various issues) and average per capita GDP weighted by GDP in Geary-Khamis dollars of each country (base 1990; Maddison, 2010). From 2010 onwards, using per capita PPP and GDP from World Bank Indicators. Countries (11): Australia, France, Germany, Italy, Japan, New Zealand, Norway, Portugal, Spain, United Kingdom, United States.

Source: Maddison Database (2010); Mitchell (1998, 2003); Tanzi (2000); Statistical Yearbook of the League of Nations, World Bank.

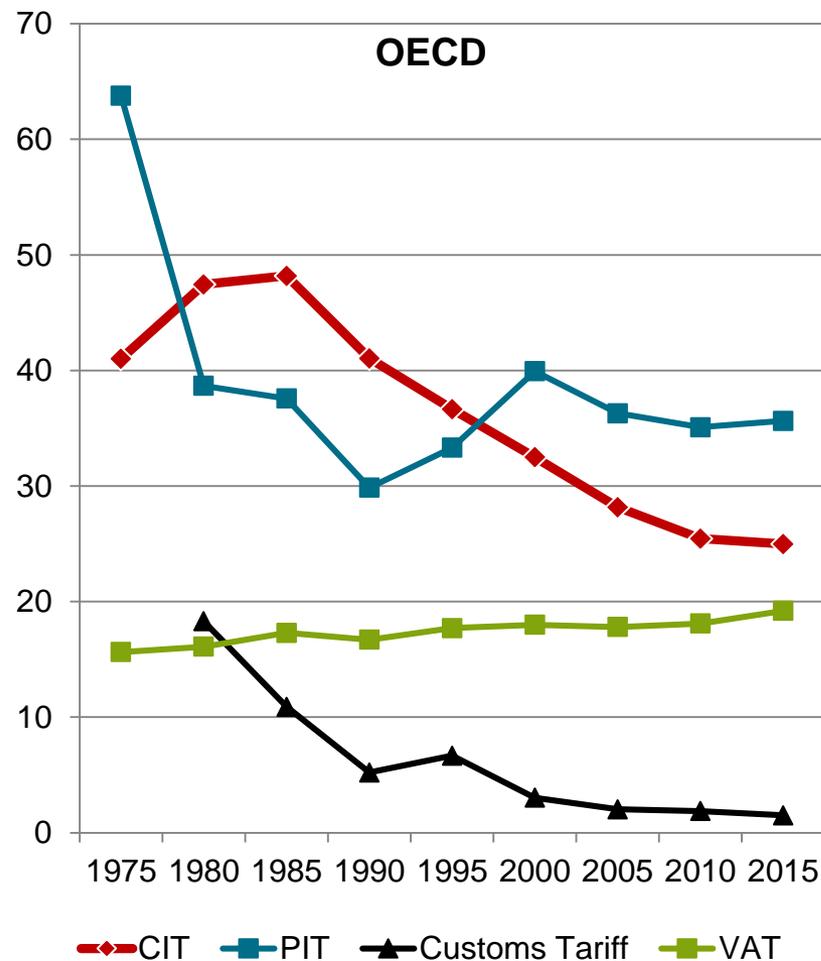
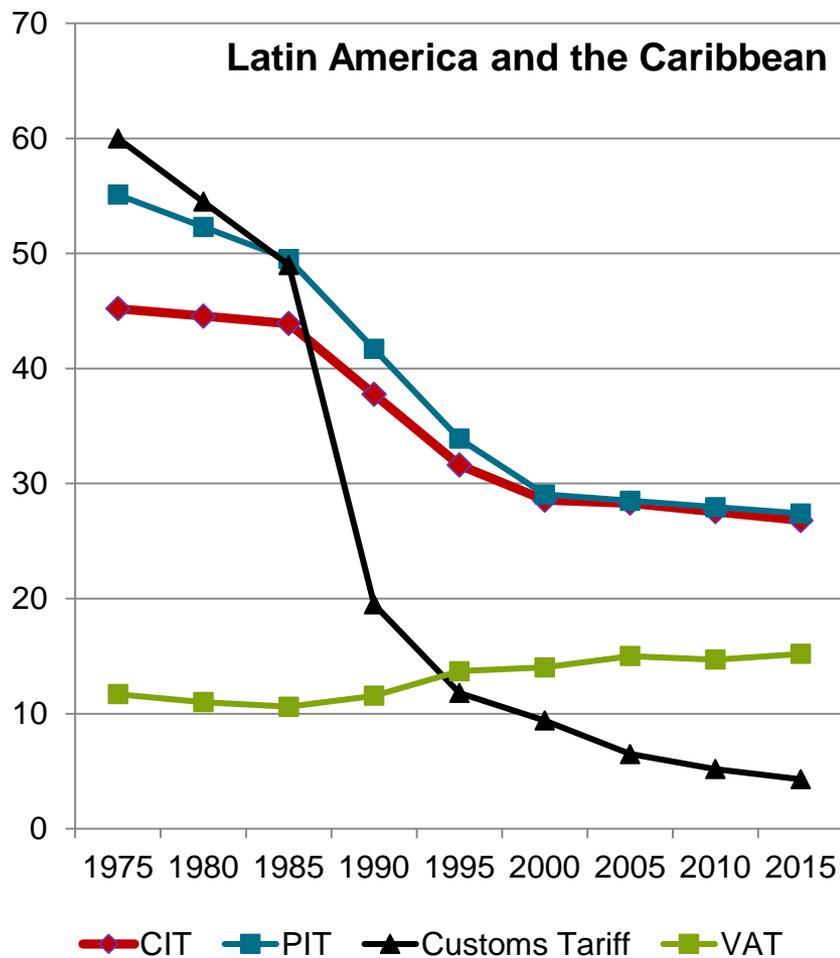
Comparison of the Equivalent Fiscal Pressure (EFP) and Per Capita GDP in PPP (US\$ 2011) of Latin American Countries^{1/}



* Weighted averages.

Source: BID-CIAT (2017), World Bank Indicators

General Tax Rates in LAC y OECD 1975-2015 (%)



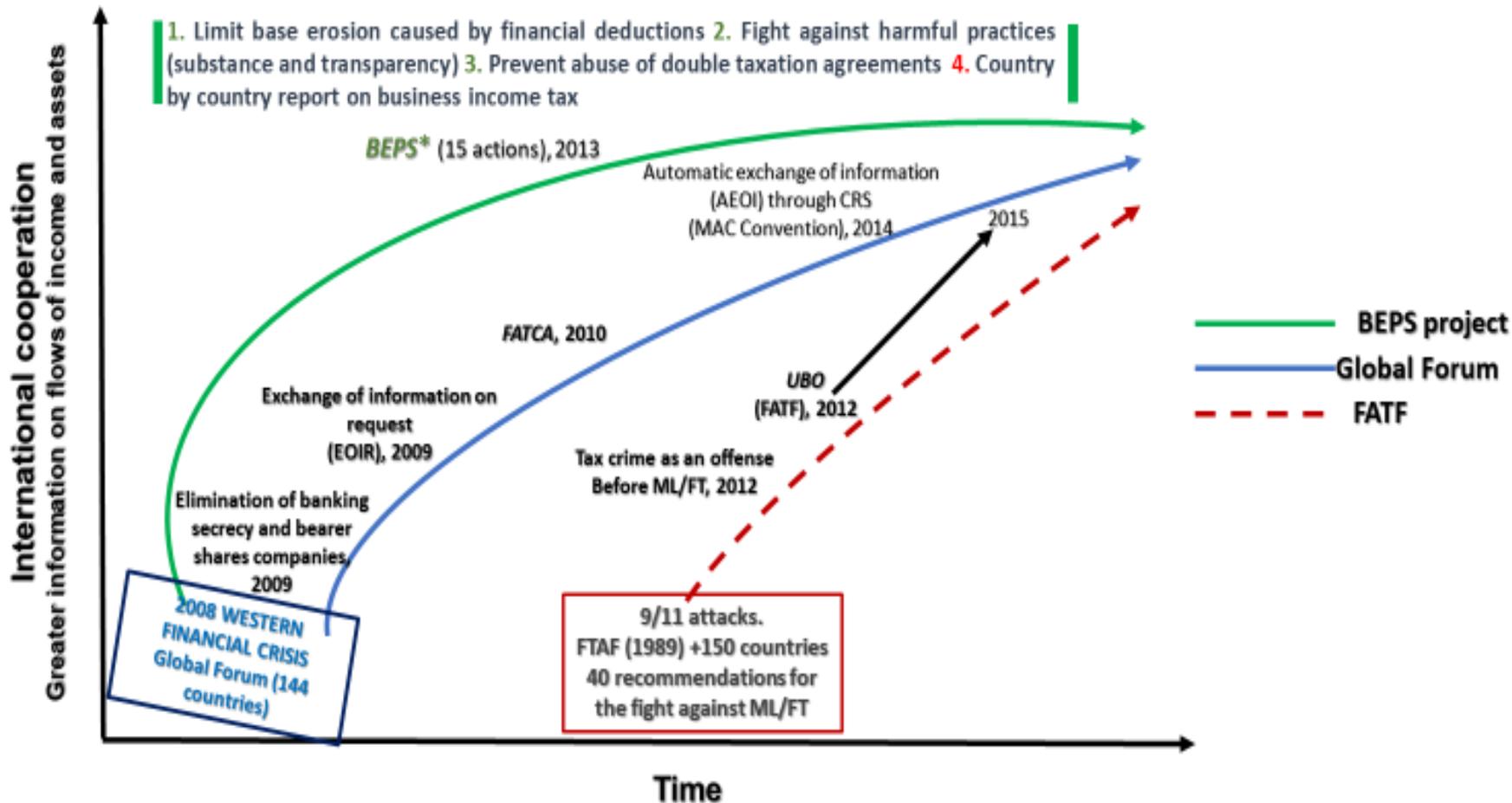
Source: Barreix, Roca and Velayos (2016) and (Pecho and Morán, 2016)



Tax Transparency and BEPS



Tax Transparency: What and Why



*BEPS – Inclusive framework (100+ countries): 1. Tax planning (actions 2 to 5 and 12); 2. abuse of agreements (actions 6, 7 and 14); 3. Transfer pricing (actions 8 to 10 and 13); 4. Political agreements (all actions + 15)

Tax Transparency

Tax transparency gives governments, taxpayers, and the public knowledge and confidence in the administration and effectiveness of a tax system by the identification of the flows and stocks on international transactions.

As a result of tax transparency, tax administrations can collect due taxes, benefiting the public welfare.

Tax transparency promotes:

1. The end of bank secrecy and transparency of legal entities (elimination of the bearer shares).
2. Automatic and by request exchange of information using Common Reporting Standard (CRS).
3. (Ultimate) Beneficial Ownership UBO: who ultimate owns or controls a firm/asset or on whose behalf a transaction is being conducted, or who exercise effective control over a legal entity

Overview of BEPS Actions

Definition: Base Erosion and Profit Shifting refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.

Inclusive Framework: Over 100 countries and jurisdictions, coordinated with G20 and OECD, jointly delivered 15 Actions to tackle tax avoidance. Also, “Country by Country” report of operations and profits.

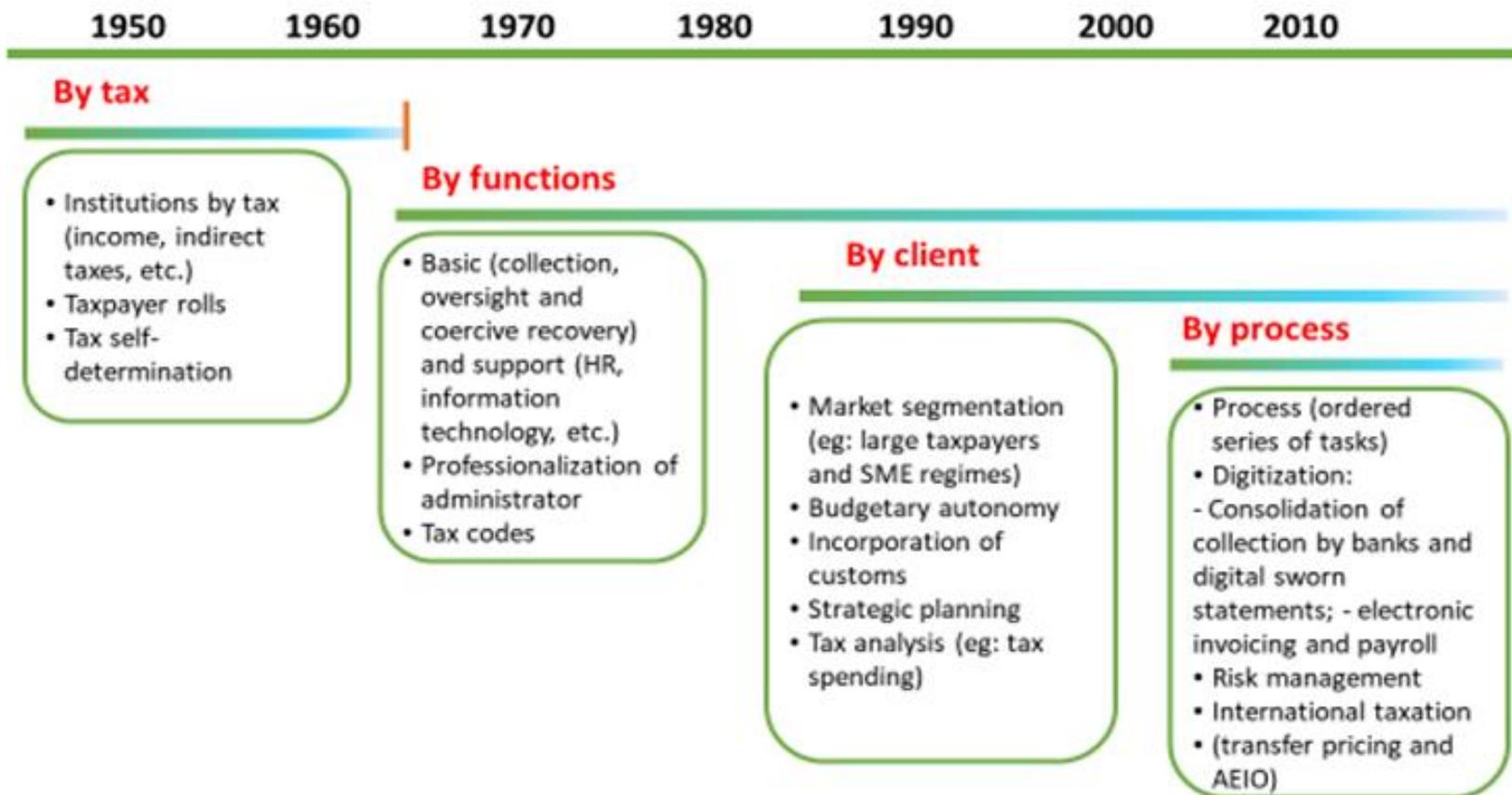
Minimum standards	Reinforced international standards	Common approaches & best practices	Analytical reports & measuring BEPS
Coherence	Substance	Transparency	
Action 2 Neutralise the effects of hybrid mismatch arrangements	Action 6 Prevent treaty abuse	Action 11 Data analysis	Action 1 Digital economy
Action 3 Strengthen CFC rules	Action 7 Prevent the artificial avoidance of PE status	Action 12 Mandatory disclosure rules	Action 15 Develop a multilateral instrument
Action 4 Limit interest deductibility	Actions 8 - 10 Aligning transfer pricing outcomes with value creation: Intangibles; Risk and capital; and Other high-risk transactions	Action 13 Re-examine transfer pricing documentation	
Action 5 Counter harmful tax practices		Action 14 Dispute resolution	



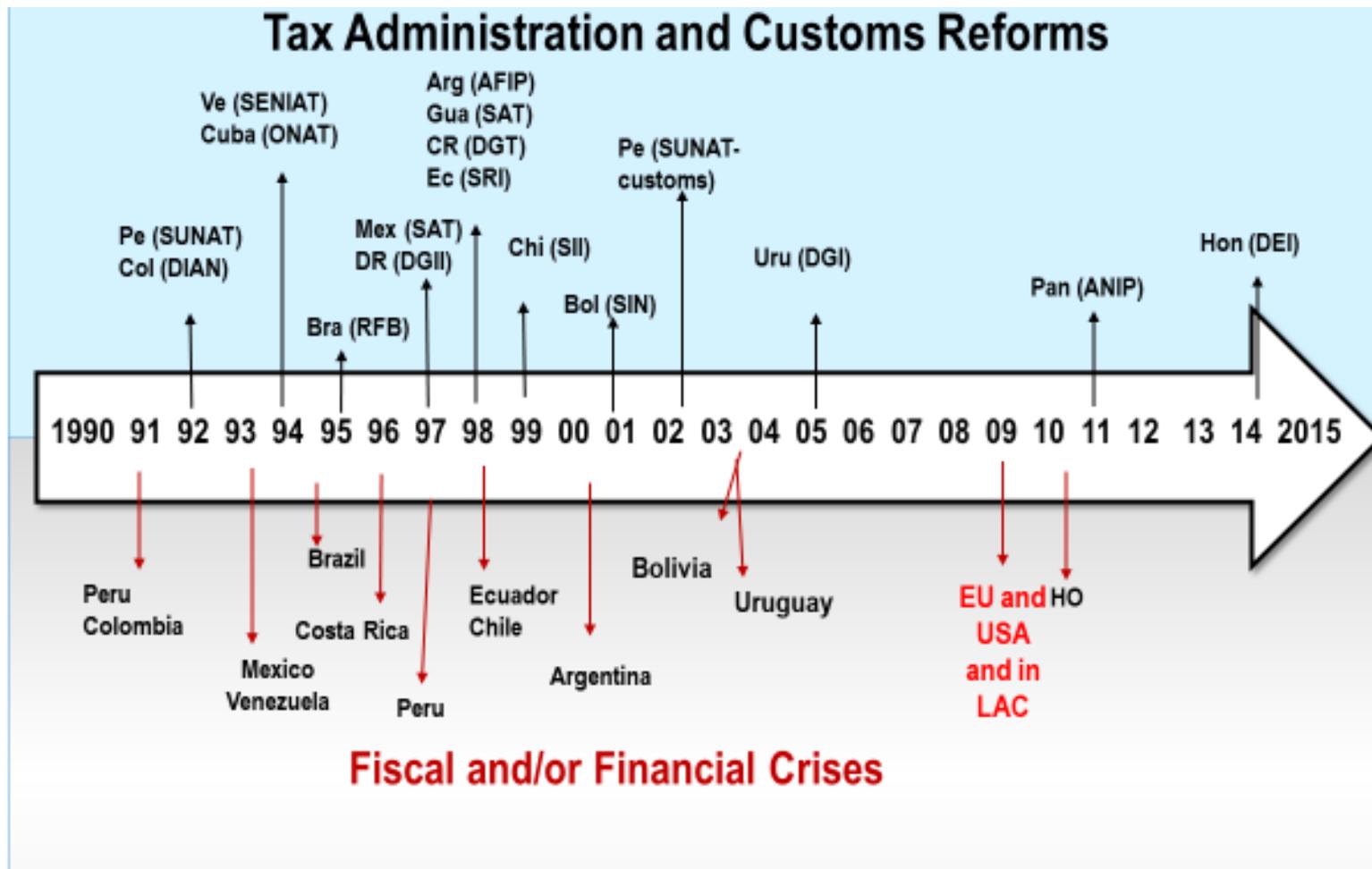
Electronic Invoice (Digitalization)



Tax Administration: Institutional Arrangements in Major Milestones, 1950–2017



Fiscal Crises and Reforms to Tax Administration and Customs in Latin America, 1990–2015



Source: Barreix and Zambrano (2018).

Advantages of Electronic Invoice (EI) (Flagship for Digitalization)

1. Tax control and auditing activities :

- a) Controls by opposing different interests, and it makes it unlikely that taxpayers will collude.
- b) Helps detect unusual or irregular behavior on the part of taxpayers.
- c) Identification of the moment of tax causation (VAT, income and so on).
- d) Assists to make the employee-employer relationship more transparent (Electronic Payroll).

2. Economic dynamics:

- a) Makes commercial operations more efficient because physical registers of transactions can be eliminated completely.
- b) Boots e-commerce and its interaction with clients.
- c) Lowers compliance costs of accounting, internal control, and tax compliance.

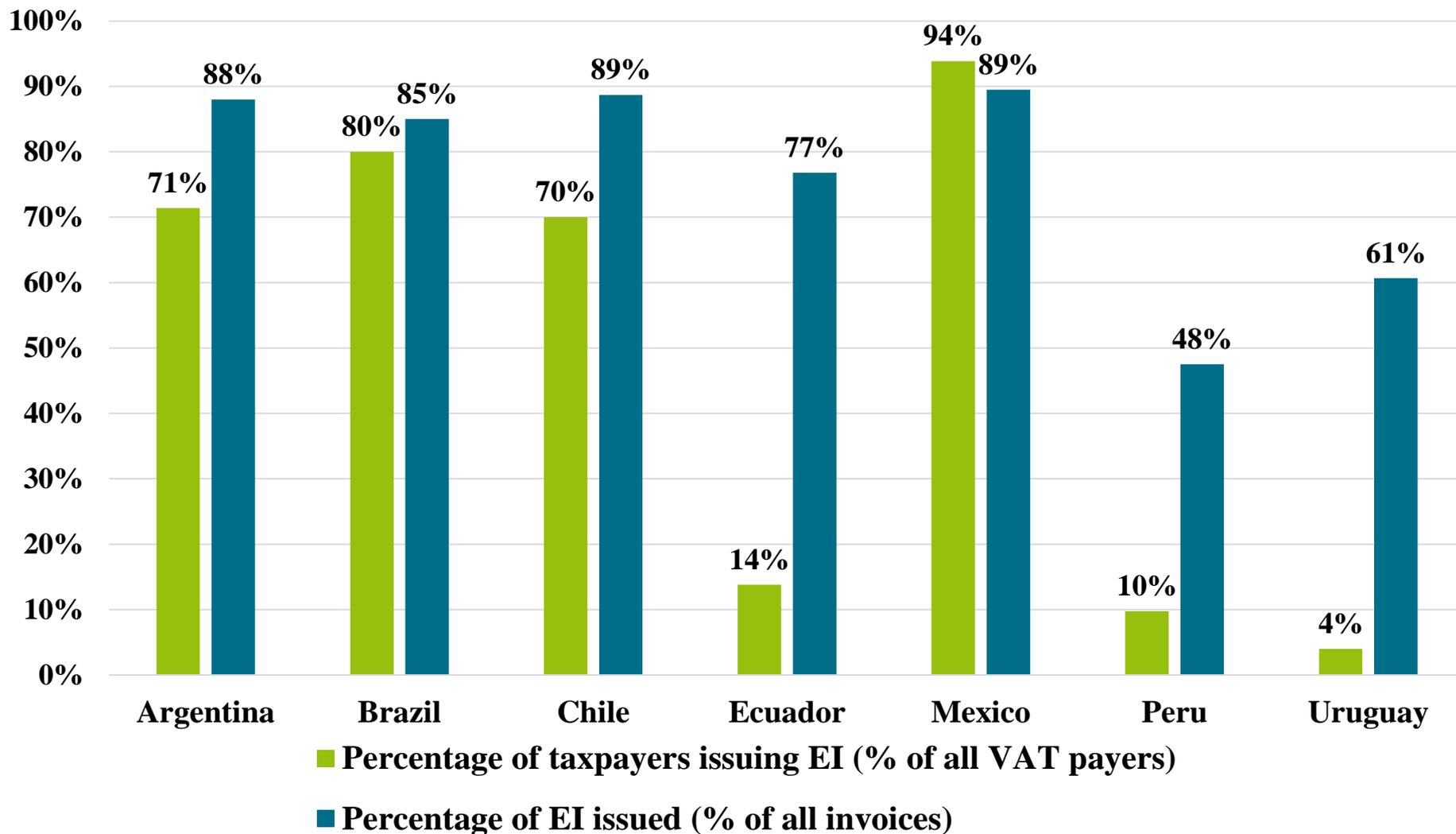
3. Accounting benefits:

- a) Has the potential to become an accounting system for taxpayers.
- b) Reduces invoicing costs since it does away with paper and with the costs of storing paperwork.

4. Information security:

- a) Preservation of taxpayers' accounting information with sufficient guarantees as required by law.
- b) Use electronic signatures or other security mechanisms (such as *blockchain*) for all kinds of systems.

Percentage of Taxpayers That Issue Electronic Invoices (EI) as a % of all VAT Payers and % of EI Issued among All Issued Invoices, 2016



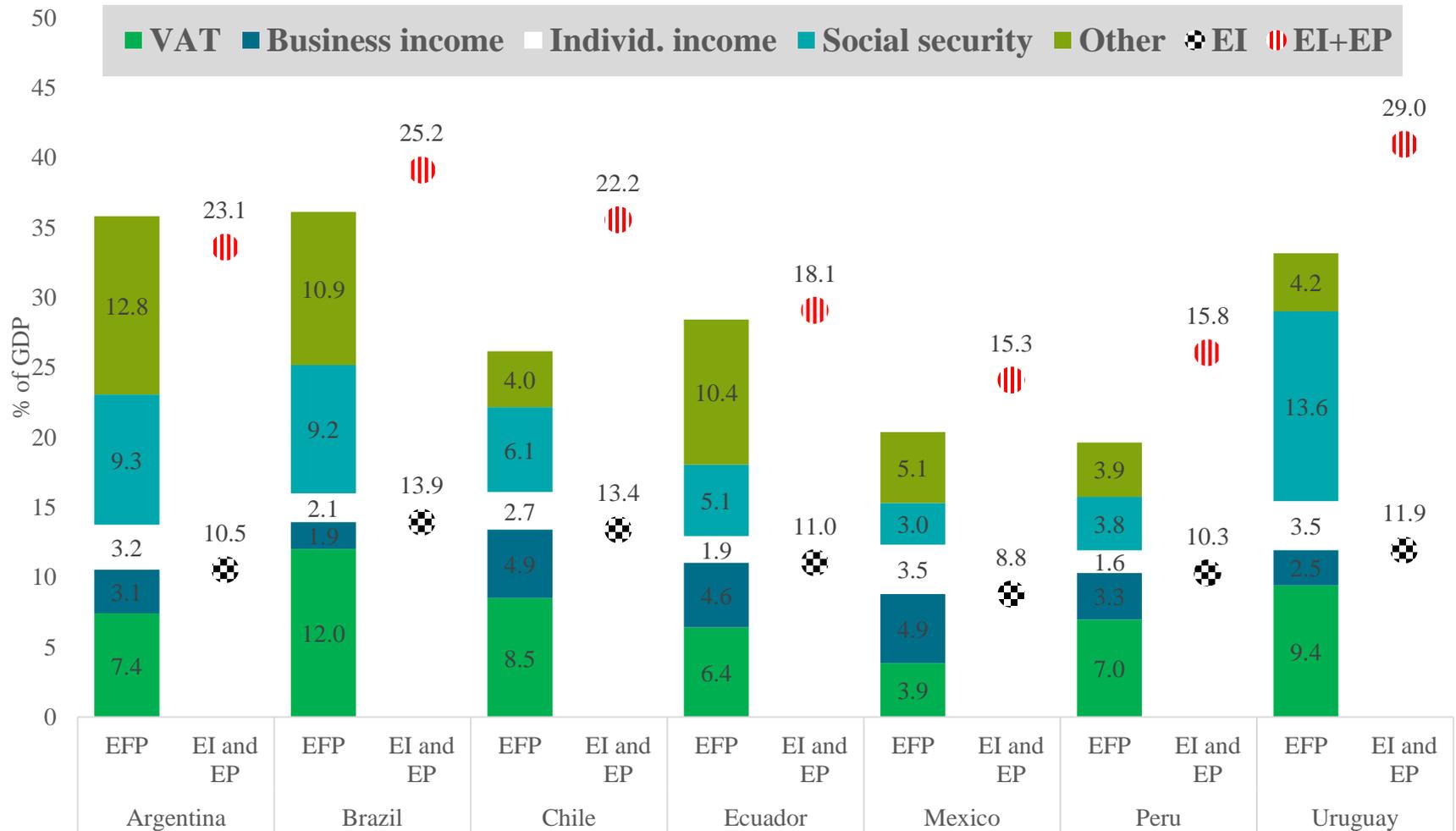
Source: Barreix and Zambrano (2018).

Extensions of EI in practice

There are already 5 relevant uses of Electronic Invoice:

1. Electronic payroll in Argentina.
2. Factoring in Chile.
3. Control of ground-vehicle freight (Brazil).
4. Public System of Digital Accountability (Brazil).
5. Expansion of services in Mexico (3rd party services to taxpayer and TA).

Yield of Taxes Controlled by Electronic Invoicing and Electronic Payroll, and as % of Total Tax Revenue, 2015



Source: Barreix and Zambrano (2018).

Preconditions for implementing EI

“chaque heure pour la minorie”

1. Minimum operational processes in the tax administration:
 - a. Taxpayer registration number.
 - b. Electronic payments and returns. Taxpayer current account.
 - c. The frequent and routine receipt of information from third parties through electronic media.
 - d. Efficient examination and effective coercitive collection.
2. The tax administration’s technological capacity(digital signature, cyber security, confidentiality, etc.).
3. Positive attitude to change and innovation.
4. Credibility of the tax administration.
5. Communications infrastructure (nationwide).

Impact of Electronic Invoicing, Selected Countries

Study	Country	Period	Empirical strategies	Dependent variable	Percentage effect on revenue
Artana and Templado (2017)	Argentina	2005-2016	<ul style="list-style-type: none"> 2007-2015 Difference in differences In 2016, discontinuous regression 	Revenue	Increase in revenue of between 0% in 2008 to 10.7% in 2013
Naritomi (2015)	Brazil-SP	2004-2011	Difference in differences	Reported earnings	The program increased the firms' reporting of earnings by 22% in four years
Ramírez et al. (2017)	Ecuador	2011-2016	Difference in differences, with selection of controls with Propensity Score Matching and Pipeline	Assessed tax	2015: Significant positive effect of 18% 2016: Significant positive impact of 25%
Fuentes et al. (2016)	Mexico	2010-2015	Discontinuous regression	Declared amount of cumulative income	Increase of 6.5% and 6.6% in the assessed business income tax for 2014 and 2015
Bergolo et al. (2017)	Uruguay	2010-2016	<ul style="list-style-type: none"> Study of events Difference in differences 	Revenue	An estimated 3.7% impact on firms' payment amounts

Source: Barreix and Zambrano (2018).



Tax Reform (TRA17) in the United States



Objective of TRA17

Restore **tax competitiveness** relative to the country's competitors through a series of measures in the corporate income tax (CIT), especially, an overall (3 new taxes) on international taxation. Also a secondary goal is to boost productive capacity.

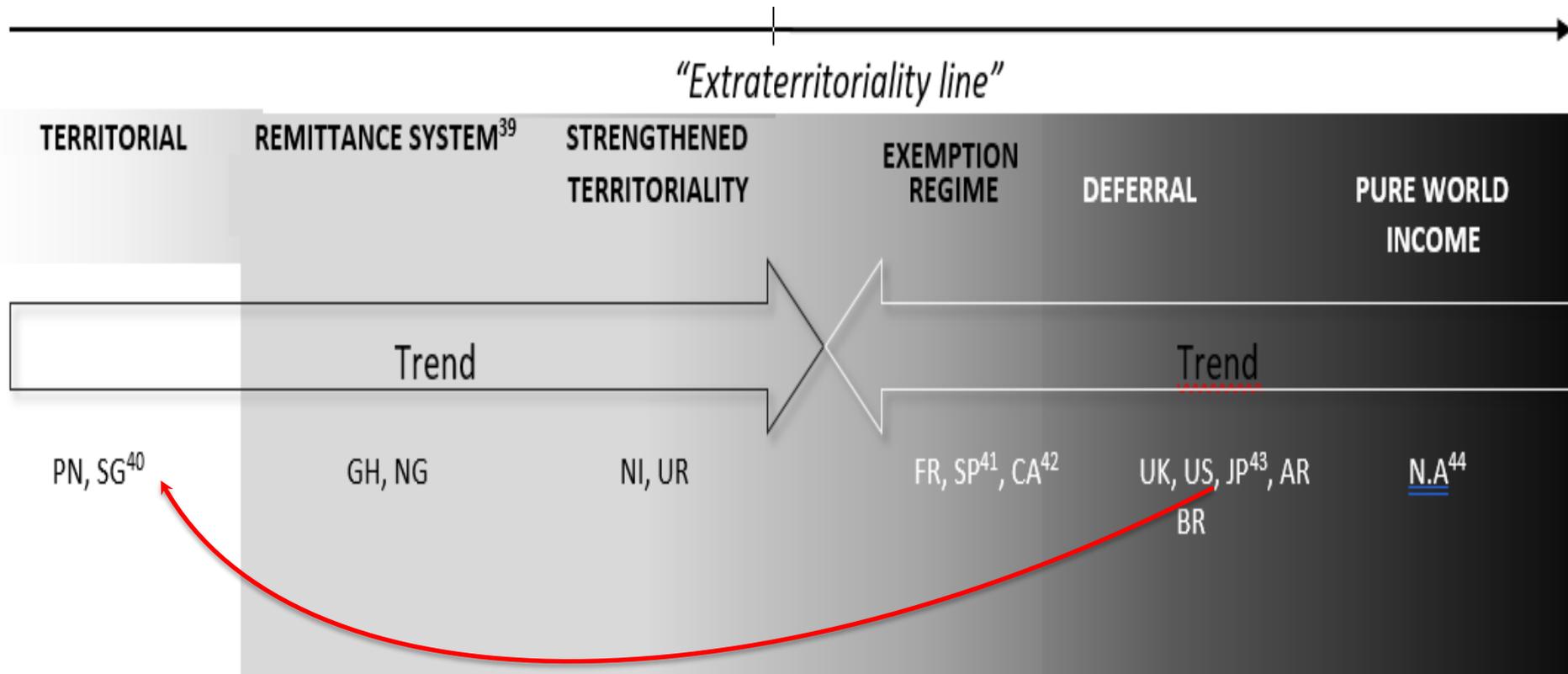
1. Significant **reduction in the rate** of corporate income tax.
2. Shift from **worldwide to territorial taxation** with substantial adjustments.
3. Opening a **gap between corporate rates and the upper marginal rate for personal income**, which tends to "dualize" the system.
4. **Expensing of fixed assets** during the next five-year period.
5. Reduction in rates on the **repatriation of profits held abroad**.

Changes to Corporate Tax under (US TRA17)

1. **100% expensing** of investments in fixed assets, in effect for five years and then phased out.*
2. Provisions on business activity:
 - **Reduction of the corporate rate from 35% to 21%**, without special provision for services companies.
 - Establishment of pass-through income, taking 80% of business income in personal global income.*
 - 30% limit on deductions for interest on EBIT and then EBITDA, and elimination of the alternative minimum tax.
 - **Repatriation of earnings held abroad** (cash and other – "investment", retained earnings, etc) at 8% or 15.5% obligatory for eight years (US\$2.6 trillion held) (**US\$340 billion**)

*1 and 2 automatically expire after 10 years (Byrd Reconciliation).

Spectrum of Territoriality and World Income Corporate Income Tax



Country codes: PN: Panama, SG: Singapore, GH: Ghana, NG: Nigeria, NI: Nicaragua, N.A: New Zealand, UR: Uruguay, FR: France, SP: Spain, CA: Canada, UK: United Kingdom, US: United States, JP: Japan, AR: Argentina, BR: Brazil.

Source: Barreix et al. (2017).

Changes to International Income under TRA17 (1)

1. End of the system of world income with deferral (repatriation) with a credit for tax payable at source; **exemption of repatriated dividends** only if they are firms (controlled foreign corporations, CFCs) in which at least 10% of the capital is owned (**cost -US\$223 billion**).
2. Creation of a “**low-rate tax on global intangible property**” to avert base erosion.

GILTI (Global Intangible Low-Taxed Income) tax levied on income from intangible property rights (royalties, services, etc.) and the 10% of "qualifying assets invested in the enterprise"—the tax value of the assets invested in the parent company in the US. Exemption of 50% (that is, a rate of 10.5%) allowed up to 2025, and 37.5% thereafter (rate of 13.125%). Credit granted for tax paid at source. *This deduction does not apply to interest or royalties with related companies (yields US\$112 billion).*

Changes to International Income under TRA17 (2)

3. As an anti-abuse measure, the **Base Erosion and Anti-Abuse Tax (BEAT)** is created to address purchases by businesses resident in the United States from related firms. *Applies mostly to interest and royalties, but not to goods imports*, except for depreciable fixed assets acquired by related businesses overseas. BEAT has a 5% minimum for 2018, 10% from 2019 to 2025, and 12.5% thereafter (a percentage point more for banks and securities dealers). *Operates together with the mentioned "thin capitalization" rule on deductible interest.* BEAT and GILTI complement each other (**yielding US\$150 billion and US\$112 billion**).
4. An **exemption on exports (foreign-derived intangible income, FDII)** includes income from the sale of assets, services and intangibles abroad. FDII is levied on returns above 10% of the yield on depreciable assets in the US derived from exports. *The rates stand at 13.125% and 16.406% from 2026 on "normal" earnings above 10%.* Disputable in the WTO because of the differential treatment relative to the domestic market (export subsidy)

Advisable Measures, Given TRA17

1. Accelerated depreciation (neutral, and only fiscal cost).
2. *Thin capitalization rule* on flows (30% of EBITDA).
Avoiding excessive indebtedness.
3. Increase in non-taxable minimums, together with the elimination of most personal deductions.
4. Preferential treatment for exports of goods and services, and the patent box for intangibles. Will FDII pass the hurdle of WTO on income tax rate differential treatment between export and domestic sales?
Finally, it is complex even for the IRS to administer.
5. Anti-avoidance measures and transfer prices.
6. Reduction of arbitrage through special regimes.
7. Capital gains: kept high (23.8%), and upper marginal rate for individuals at 35%.

References

- Barreix, A.D. & Zambrano, R. (2018). Electronic Invoicing in Latin America. Editors. Inter-American Development Bank and Inter-American Center of Tax Administrations.
- Barreix, A. D., Roca, J., & Velayos, F. (2017). Quo Vadis Income Tax?: Towards the PIT-CA. Inter-American Development Bank.
- Aviyonah, R., Barreix, A.D. & Diaz, S. (2018). Tax Reform (TRA17) in the United States. (in progress).
- Morán, D. & M. Pecho. (2016). “La Tributación en América Latina en los Últimos Cincuenta Años”. Working Paper N° 18/2016. Instituto de Estudios Fiscales.
- Barreix, A.D., Corrales, L.F., Díaz, S. and Garcimatín, C. (2018). Updating of Equivalent Fiscal Pressure in Latin America and the Caribbean. Inter-American Development Bank. Available at: <https://publications.iadb.org/handle/11319/8601#sthash.LofiucUG.dpuf>

¡Thank you!

