

CIAT

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*years in
Latin American taxation*

CIAT
50
years





CIAT: Fifty years in Latin American taxation

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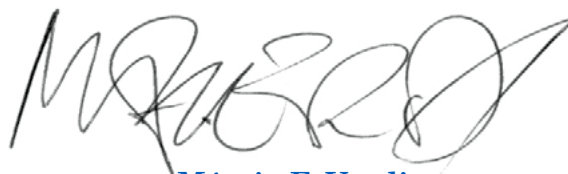
Foreword

Upon turning half a century old, CIAT's Executive Secretariat proudly presents the book "CIAT: Fifty years in Latin American taxation" aimed at making a significant contribution to the knowledge on tax history of its member countries and the international tax community.

The book is a compilation of papers from a series of experts on tax policy and tax management who have maintained a professional relationship with CIAT. The papers review the most significant changes in the region's tax systems and influence tax management topics.

We are sure that this book will become a benchmark for generations of tax administrators for it provides a clear idea of the past scenario, the present reality and future trends in Latin American taxation.

Finally, we wish to thank the authors of each paper contained in the book for their selfless contribution. Together with the Executive Secretariat, they have completed a book of great historic value.



Márcio F. Verdi
CIAT Executive Secretary

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Abbreviations

AIX	Advanced Interactive eXecutive (IBM operating system)	GIZ	German Cooperation Agency
APA	Advanced Pricing Agreements	GDP	Gross Domestic Product
ATAF	African Tax Administration Forum	HNWI	High net worth individuals
CAN	Andean Commonwealth of Nations	SAR	Honduras Revenue Administration Services
BCRA	Argentine Republic Central Bank	AIT	Ibero-American Association of Fiscal or Administrative Justice Courts
PLC	Arm's Length Principle	AS400	IBM midrange computer platform
ADB	Asian Development Bank	IPTU	Imposto sobre a Propriedade Predial e Territorial Urbana
ATM	Asynchronous Transfer Mode	ICTs	Information and Communication Technologies
BEPS	Base Erosion and Profit Shifting	SITER	Information System of Relevant Economic Transactions
DIPRES	Budget Directorate of Chile	IEF	Institute of Fiscal Studies of Spain
CRA	Canadian Revenue Authority	CITAF	Inter-American Center of Financial Taxation and Administration
CARTAC	Caribbean Regional Technical Assistance Centre	CIAT	Inter-American Center of Tax Administrations
CSS	Cascading Style Sheets (language to describe document presentation)	IDB	Inter-American Development Bank
COBOL	Common Business Oriented Language	IGA	Inter-Governmental Agreements
CRS	Common Reporting Standard	IAS	International Accounting Standards
COMJIB	Conference of Ministers of Justice of Ibero-American Countries	FIAPP	International Foundation of Public Administration and Policy for Ibero-America
CFC	Controlled Foreign Corporations	IMD	International Institute for Management Development
COSEFIN	Council of Finance Ministers of Central America, Panama and the Dominican Republic	ILO	International Labour Organization
CBCR	Country-by-Country Reporting	ITD	International Tax Dialogue
CSP	Cross System Product (IBM software product)	LAFTA	Latin American Free Trade Association
DB2	Database 2 (IBM data base manager)	LATINDADD	Latin American Network on Debt, Development and Rights
Oracle	Database Manager from Oracle Corporation.	LUISS	Libera Università Internazionale degli Studi Sociali
DFID	Department for International Development – United Kingdom Government	MNEs	Multinational Enterprises
DEC	Digital Equipment Corporation	SENASA	National Agrifood Health and Quality Service of Argentina
DIAN	Directorate of Tax and National Customs of Colombia	pcPPP	Per Capita Purchasing Power Parity
DOS	Disk Operating System (IBM operating system)	RGPS	Regime Geral de Previdência Social
DTA	Double Taxation Agreements	CAPTAC-DR	Regional Technical Assistance Center for Central America, Panama and the Dominican Republic
EITC	Earned Income Tax Credit	RA-FIT	Revenue Administration Fiscal Information Tool
ECLAC	Economic Commission for Latin America and the Caribbean	SAFIRA	Sistema Integrado de Emissão de Auto de Infração
EPF	Equivalent Fiscal Pressure	ACL	Software product from ACL Services Ltd.
ESAF	Escola de Administração Fazendária	ADABAS	Software product from Software Ag
EC	European Commission	MERCOSUR	Southern Common Market
EC	European Community	AECID	Spanish Agency of International Cooperation for Development
EEC	European Economic Community	SOD	Supply and Demand System
DEI	Executive Directorate of Revenues of Honduras	TA	Tax Administration
EET	Exempted-exempted-taxed	TADAT	Tax Administration Diagnostic Assessment Tool
AFIP	Federal Administration of Public Revenue of Argentina	AEAT	Tax Administration State Agency of Spain
FATF	Financial Action Task Force against Money Laundering	TAs	Tax Administrations
FIU	Fiscal Intelligence Unit	TJN	Tax Justice Network
PRONAFISCO	Fiscal Management Modernization Program	TFT	Tax on Financial Transactions
FATCA	Foreign Account Tax Compliance Act	TRP	Tax on Rural Property
GATT	General Agreement on Tariffs and Trade	ICMS	Tax on the circulation of goods and on inter-state and inter-municipal transport and communication services
DGII	General Directorate of Internal Revenues of the Dominican Republic	ARCO	Taxpayer Benchmarking
DGI	General Tax Directorate of Argentina	USA	United States of America
DGI	General Tax Directorate of Panama	WB	World Bank
DGI	General Tax Directorate of Uruguay	WEO	World Economic Outlook
DGT	General Taxation Directorate of Costa Rica	WTO	World Trade Organization

ADP	Automatic Data Processing	SIN	National Tax Service of Bolivia
ICEFI	Central American Institute of Fiscal Studies	OSF1	Open System Foundation (Digital Equipment Corporation's operating system)
IRPF-CD	Comprehensive Due Personal Income Tax	SUN/OS	Operating System developed by SunMicrosystems.
Sybase	Database Manager developed by Sybase	OCR	Optical Character Recognition
EU	European Union	OECD	Organization for Economic Cooperation and Development
UNIX	Family of operating systems originally developed by Bell Labs	OAS	Organization of American States
FRBT	Flat Rate Business Tax	PIT	Personal Income Tax
FGTS	Fundo de Garantia do Tempo de Serviço	PKI	Primary Key Infrastructure
IGV	General Sales Tax	PL/I	Programming Language 1
SAT	Guatemala Tax Administration Superintendency	RFB	Receita Federal do Brasil
HP	Hewlett Packard	SEFIN	Secretary of Finance of Honduras
HP/UX	HP Unix (HP operating system)	SET	Selective Excise Taxes
HTML	HyperText Markup Language	RUC	Single Taxpayer Registry
IT	Income Tax	SET	State Undersecretariat of Taxation of Paraguay
IRD	Inland Revenue Division of Trinidad and Tobago	XML	Structured Markup Language
SENIAT	Integrated National Service of Customs and Tax Administration	SQL	Structured Query Language
SII	Internal Revenue Service of Chile	UNDP	United Nations Development Program
SRI	Internal Revenue Service of Ecuador	UN	United Nations Organization
IRS	Internal Revenue Service of the USA	USAID	United States Agency for International Development
IBM	International Business Machines	LINUX	Unix-type Open Source Operating System
IMF	International Monetary Fund	VAT	Value Added Tax
ITC	International Tax Compact	SIVIT	Venezuelan Tax Information System
JAVA EE	Java Platform, Enterprise Edition	VT	Video terminal
RedHat	Linux distribution	VMS	Virtual Machines (Digital Equipment Corporation's operating system)
SAT	Mexico Tax Administration Service	VSAM	Virtual Storage Access Methods (IBM software product)
MSSQL	Microsoft's Database Manager	XSD	XML Schema Definition
MVS	Multiple Virtual Storage (IBM operating system)		
INDEC	National Institute of Statistics and Censuses of Argentina		
INEGI	National Institute of Statistics and Geography of Mexico		
SUNAT	National Superintendency of Customs and Tax Administration of Peru		





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**TAXATION OVER
THE LAST FIFTY
YEARS**

1 TAXATION OVER THE LAST FIFTY YEARS

*Dalmiro Morán and Miguel Pecho*¹

Younger generations often wonder how certain political, economic and social conditions are even possible in some countries. The answer has to be traced back in time many years –or even decades.

Taxation in Latin America also demands this kind of approach because the specific characteristics identified at present are “modelled” in line with several ideological trends which, to a greater or lesser extent, have influenced tax system reforms in most countries of the region and resulted in varying outcomes over the past decades. The fact that VAT and IT are now the two fundamental pillars² in the region serves to illustrate this statement.

Additionally, it should be recalled that the creation of the CIAT –conceived by 1965 and materialized in 1967– occurred in a period of far-reaching changes in Latin America, both from a political and also economic perspective. In fact, in the early 60s a long process of tax-related changes was already underway which have had several effects on tax collection levels and on the tax structure of the countries until today. Therefore, it is particularly interesting to gain some insight into the development of these indicators in response to the principal matrix of political and tax administration reforms since then and until today.

In this respect and to illustrate the effects resulting from those changes, this paper is intended to give a synthesis of the quantitative changes observed in the tax level and structure in Latin America over the past fifty years. To achieve this, we have used a large and detailed tax statistics base, especially created for these purposes, for the 1960-2014 period and for a wide sample including 18 countries of Latin America. Further, we will describe the main changes that Tax Administrations of the region have simultaneously undergone, where CIAT has played a fundamental role from the exchange of experiences among the countries. Our analysis will embrace the various regional contexts within which those trends developed, regardless of the particular circumstances of each country the consideration of which –except for certain particular cases and for exemplification purposes– is beyond the scope of this paper.

¹ The authors would like to thank Julio López, member of the Tax Studies and Research Directorate of CIAT, for his ongoing and accurate statistical assistance, and to Juan Carlos Gómez Sabaini for his valuable commentaries and suggestions during the writing of this paper. Likewise, the authors are grateful to Jorge Cosulich and Ceferino Costa for their contributions.

² In many countries, Social Security contributions might be included as a taxation pillar (Argentina, Brazil, Costa Rica, Panama, Uruguay, among others), but this is again a highly heterogeneous element in the region due to diverse operation mechanisms and the specific financing methods of such systems (Gómez Sabaini and Morán, 2016).

a. Historical Evolution of the Level of Tax Resources in Latin American Countries: Main Stylized Facts and Leading Cases

Even if one could go as far back in time as records and –particularly– available statistics would allow, many specialists agree that the 70s are indeed a turning point in terms of tax policy and management, especially for Latin American countries, given the deep changes that took place during those years.

In academia, this was a transition period for the at the time traditional approaches on public finance. The focus was on the “public economy” test and a selective use of taxes. In addition to its classical role in the financing of government property, tax policy was given the fundamental mission of adjusting the unequal distribution of wealth and income prevailing at the time, particularly in developing countries such as those of Latin America (Kaldor, 1962).

In the political field, the launch of a foreign aid program known as the “Alliance for Progress” – signed at the well-remembered Conference of Punta del Este in August, 1961– provided a favourable context for the countries of the region to embark in ambitious economic and social development projects. Among other measures, one of the milestones of this initiative was a tax reform aimed at strengthening revenues and provide financial support to the several development plans of the region.

Within this context, the Joint Tax Program was created as a set of governing recommendations by the OAS, ECLAC and IDB. This initiative was one of the first steps in building consensus on the general guidelines³ that would bring about fundamental changes in the tax systems of the region, with consequences that would last until today. Thus, a novel stage commenced in the economic history of Latin America which fostered the reform, simplification and update of the indirect tax system and, above all, the strengthening of direct taxation through a generalized progressive income tax and an increase in the rates applied to individuals and companies in a search for improved vertical equity of the tax systems in effect.

Chart 1 below presents the evolution of the average tax burden⁴ for 18 countries in Latin America from 1960 through 2014. It must be said, at this point, that consideration of tax statistics for such a long period is as novel as it is complex.

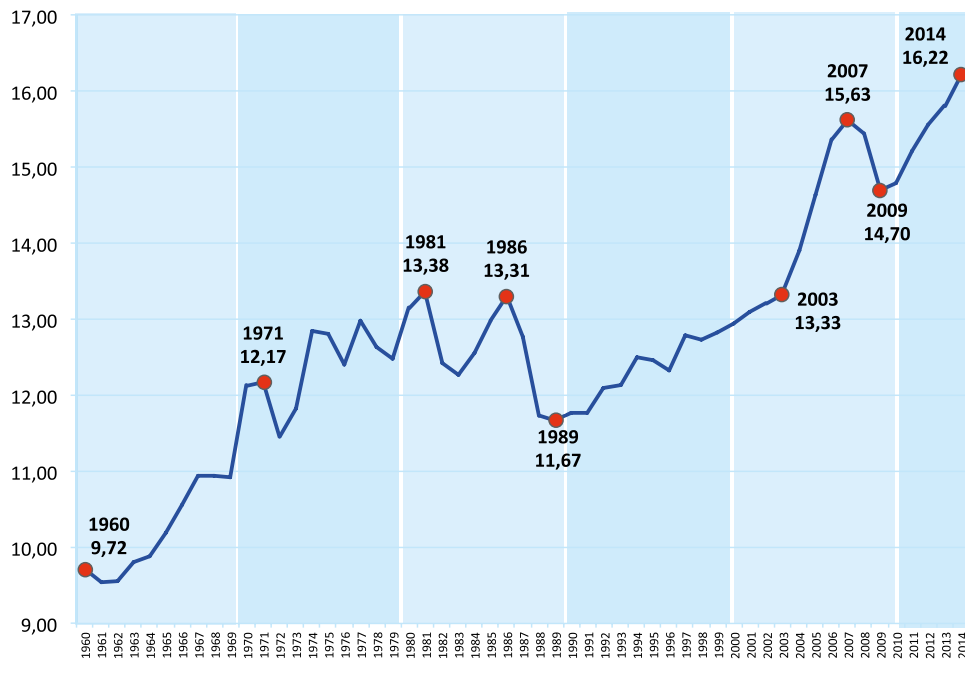
At present, the most renowned tax databases available provide comparable information (this is, tax revenues expressed as percentages of GDP) for the countries in the region only from 1990 onwards.⁵ Accordingly, for purposes of this analysis, we have chosen to build a database starting from 1960 (as per availability in each country) and through 2014. This has demanded conscientious efforts to gather historical data and validate such data with the various official bodies. The Statistical Annex at the end of this paper provides a detailed explanation of the methodology and of the sources of information used in each case.

3 As significant milestones under this process we may identify three conferences that set the basis for the discussion at the regional level: the first one was held in Buenos Aires in 1961 (on tax administration), the second one in Santiago de Chile in 1962 (on fiscal policy) and the third conference took place in Mexico Federal District in 1972 (on tax policy).

4 Please note that the values presented for the 18 countries of the region do not include, in any case, tax revenues on account of Social Security contributions. Also, the numbers shown apply to the central, national or federal government level, except, given their relative importance in state funding, in the cases of Argentina –this case includes the tax resources of the provinces– and Brazil– where tax revenues of the States and the Municipalities are also considered.

5 Some of the most renowned databases include: (i) CIATdata, prepared by CIAT, presents statistics with broken down tax information; (ii) Revenue Statistics in Latin America and the Caribbean, prepared jointly by the IDB, ECLAC, CIAT and OECD, adopts the OECD methodology and allows making highly accurate regional and international comparisons; (iii) Equivalent Fiscal Pressure, produced by the joint efforts of CIAT and the IDB, consists of the traditional tax revenue information, but also statistics on compulsory social security contributions, mostly to private health and pension systems, and on revenues derived from the exploitation of natural resources, i.e. royalties and other levies on extracting enterprises).

Chart 1: Central Government Tax Revenues in Latin America, average 1960-2014 ^{1/} (As a percentage of GDP)



Source: Prepared by the authors on the basis of the information contained in the Statistical Annex.

^{1/} Given their relevance, tax revenues of the provinces (not of municipalities because there is no information available) are included in the case of Argentina, and tax revenues of the states and municipalities are included in the case of Brazil.

ideological, political and macroeconomic changes mentioned in the paragraphs above. Among other causes, this owes to profound changes in the tax structures with heavy emphasis on direct taxation to serve distributive purposes and on the first attempts to introduce VAT following the European countries' model.⁶

The 1973 oil crisis marked the beginning of a sub-period that was very different from the one described above. Although it is true that the tax burden continued to rise and reached a high of 13.38% in 1981, the progression of this burden witnessed high volatility throughout the decade. The international macroeconomic context, characterized by a long recession, coupled with a significant inflationary process and the growth of the fiscal deficit in several developed countries, adversely affected the Latin American economies. In addition, this impacted tax collection levels which exhibited material changes over those years to varying extents according to the specific characteristics of each country. Both excise tax and IT were affected by the international and also the regional contexts, and this led to a series of tax (and, generally, also economic) reforms in the framework of what would ultimately be the Washington Consensus.

In the early 80s, the “neoliberal revolution in fiscal policy” brought about a change in the main purposes that guided tax policy in subsequent years as the tax design emphasized efficiency, horizontal equity and the capture of new tax resources. Following the recommendations on the matter made by international organizations such as the WB and the IMF, fiscal policy makers in Latin America promoted a marked

Back to Chart 1, it is evident that there is an increasing long-term trend in the level of tax revenues in terms relative to GDP. Pursuant to the data collected, while still volatile –particularly throughout certain sub-periods– the average tax burden in Latin America grew from 9.72% to 16.22% between 1960 and 2014.

The image was divided into ten-year periods to show some of the trends observed in such variable, even if we decided to highlight some reference years throughout the series. Thus, the period from 1960 to 1971, for instance, exhibits a marked increase in tax collection levels mostly justified by the

⁶ VAT was first introduced in France with the 1953-1955 fiscal reform, and was then adopted by the other countries members of the European Community in April, 1967.

reduction in tax rates⁷ applied to international trade, the introduction and generalization of VAT, a decrease in the level and number of IT rates both for individuals and companies, a substantial cutback in the number of taxes in force (abolishing most of the taxes whose contribution to revenue was not significant) and continued efforts to streamline TA and evasion control, though not always successfully.⁸

However, the policies proclaimed by the Washington Consensus and supported by the “supply-side economics” approach, regardless of the fundamental changes these policies brought to the economies of the region, failed in conducting a stable and sustained economic growth process that would translate into improvements in people’s general well-being. Sovereign debt crises in many of the Latin American economies early in the 80s, a period known as “the lost decade for Latin America”, represented a turning point in the upward trend that, at varying speeds, had been observed since 1960 for the average tax burden in the region.

Thereafter, tax (and fiscal) revenues plummeted, economic growth stagnated, foreign indebtedness increased (restricting growth even further), and unemployment and inequality rose. After a slight recovery⁹ in 1985-1986, the serious inflationary processes worsened, thus diminishing the purchasing power of the middle class, and, through the Olivera-Tanzi¹⁰ effect, eroded the tax base in Latin American countries. To sum up, the regional average tax burden touched its lowest value in 20 years by the end of the decade (11.67% in 1989).

In this scenario, it is possible to distinguish a new stage in Latin American taxation from the mid-90s, especially along the last decade, where tax collection in GDP percentage terms has shown an upward trend both for the regional average and for the vast majority of countries in Latin America. In the 90s, based on a continuation of the main taxation trends derived from the Washington Consensus, this growth was inhibited by the negative impact of the successive financial crises in emerging countries (first in **Mexico** in 1994, then in several Asian countries in 1997, and finally in Russia in 1998). Even so, the average level of tax revenues for the region rose by a bit over one percentage point with certain fluctuation throughout the decade.

Instead, from 2003, the collection level rapidly increased from 13.33% to 15.63% in only four years. Partly, this was possible thanks to the progress made in the administration of VAT and IT –which translated into a sharp increase in tax collection– and to the reduction of a long list of tax benefits which had been awarded on prior decades to attract foreign investments and which had not always yielded the expected results. Furthermore, new taxes were levied on financial operations as well as minimum taxes that helped increase resources, raised the level of compliance and expanded the range of tax policy instruments.

However, it must be said that a number of factors that go beyond the tax framework properly contributed to this promising outcome. In a regional macroeconomic context with high growth rates and a significant reduction in the deficit in public finances and the countries’ indebtedness level, State action regained importance in terms of redistribution through taxes or transfers. Precisely, diminished levels of inequality allowed for an increase in private consumption that was reflected in the evolution of the taxes levied on goods and services, together with new domestic policies to initiate a process to re-formalize the economy, which contributed to broadening the tax bases.

7 According to Lora (2007), the average rate levied on imports in South American countries dropped from 49% in 1985 to approximately 10% in 2000, while in Central American countries the decline was even greater, from 66% to 6% on average.

8 Mahon (2004) analyzes the causes that favored this set of reforms in further depth.

9 This effect, on average, could have been lower if we consider that during the 1983-1987 period, Nicaragua shows a tax burden above 25% (with a maximum of 32.35% in 1984). This tax burden is not in line with the level of development of the country’s economy and, according to several specialists, these numbers have more to do with estimation issues in the GDP calculation by the official bodies.

10 This phenomenon arises from the temporal delays observed between the taxable event and the actual time of tax collection, and may lead to a loss in the actual value of the tax revenues in inflationary contexts.

In some countries of the region, as emphasized by Cornia et al. (2011), the increase in the tax burden is also explained by contingent factors, such as: **(i)** a sustained increase in international commodity and mineral prices since 2002-2003, which boosted fiscal revenues (a portion of these being of fiscal nature) in certain countries of the region specialized in natural resources exploitation and trade, and **(ii)** an international context characterized by an acceleration in worldwide economic growth rates (particularly in emerging countries since 2002-2003). The countries of the region benefited from this through financial and trade liberalization strategies combined with successful monetary stabilization processes.

The 2008 international financial collapse had a clear negative impact on the economies of the region. Despite some exceptions like **Bolivia, Ecuador, Mexico** and **Paraguay**, in most cases there was a decrease –delayed, to a certain extent– in their tax revenues, and as a result the average tax burden went down to 14.70% of GDP in 2009 (Chart 1). Nevertheless, once the most direct effects of such crisis were overcome, the countries resumed the increasing trend in their levels of tax collection and rapidly reached a historical peak of 16.22% in 2014.

It is worth pointing out that the strength exhibited by public finances to deal with and outrun the last great financial crisis is a fact that stands out in the economic history of Latin American countries. This is in part connected with the maturity of the current tax systems attained through a series of reforms intended to consolidate, in recent years, the achievements of past decades (such as VAT generalization and progress in tax management) and deepen changes in direct taxation (particularly in IT) in order to increase the revenues obtained and improve the distributive impact derived from taxation (ECLAC, 2015).

This favourable development of the general level of the average tax burden in Latin America, nonetheless, conceals marked heterogeneity in terms of taxes that goes beyond the diverse political, social and economic realities. Table 1 presents five-year average values of this indicator for each of the 18 countries of the region subject to analysis.¹¹ Thus, it is observed that the highest tax burden for the most recent sub-period is that of **Brazil, Bolivia** and **Argentina** (between 23.4% and 25.9% for 2010-2014) but, in prior decades, this was only the case for **Brazil**. **Argentina** only became noticeable in the matter at the regional level in the second half of the 90s and, particularly, from 2002 when it reinstated export duties on commodities and saw VAT and IT consolidate thanks to the economic recovery. **Bolivia** reached this “tax podium” much later and as a consequence of the reform of the fiscal regime applied to natural resources exploitation by levying a Direct Tax on Hydrocarbons in 2005.¹²

Chile, Peru and **Uruguay** are in second place –regarding the 2010-2014 average. However, these countries show very different developments. In all the remaining cases, which are below the regional average for the five-year period, a variety of situations is observed. Thus, while in many of these countries there has been an increase –of varying degrees– as far as the average tax burden is concerned compared to the numbers obtained fifty years before (mainly in **Colombia, Honduras** or **Nicaragua**), it is possible to identify some exceptions to the regional trend where the growth has been of little significance (**Mexico, Panama, Venezuela**) or directly below the average values of the 60s (**Dominican Republic**).

Notice should be given to the fact that the regional heterogeneity in the tax dimension is not only linked to the level of revenues obtained or the reforms applied in each case along the period analysed. As a matter of fact, this regional characteristic –often underestimated– is related with the different tax structures and, more importantly, with the various public financing schemes of the Latin American States.

11 The annual database for the 18 countries is included in the Statistical Annex at the end of this paper.

12 Notice should be given to the fact that after a deep crisis, in 1985 there was an integral reform of the tax system that set the basis for the current tax structure. Between 1982 and 1986, the tax burden in Bolivia did not reach 4% of GDP, with a historical minimum of 2.1% in 1984 and 1985.

In the first place, we have already mentioned the case of natural resources, especially, non-renewable natural resources. Here, only a small group of countries holding vast hydrocarbon and mineral reserves derive most of their fiscal (tax and non-tax) revenues through specific schemes of state appropriation of income from economic exploitation of those resources.¹³ This fact may influence –and it certainly does so– on the degree of tax effort of a country and, consequently, on the level of such country's tax burden and the design of potential reforms to the tax system.¹⁴ In addition, as observed throughout the past decade, the high volatility of international commodity prices may bring about considerable instability to the flow of fiscal resources (including tax revenues) available at different times of the economic history of producing countries in the region.

Table 1: Central Government Tax Revenues in Latin America, five-year average (Percentage of GDP)

Countries	1960-1964	1965-1969	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004	2005-2009	2010-2014
Argentina 1/	10.39	12.93	12.25	10.94	11.39	12.67	14.80	16.62	19.36	23.23	23.44
Bolivia	7.50	8.87	8.39	9.47	4.50	5.67	10.34	12.14	13.00	20.66	23.45
Brazil 2/	...	...	19.60	18.34	18.89	18.18	20.72	21.40	25.61	26.96	25.85
Chile	13.26	14.74	16.96	19.23	19.81	16.53	15.41	15.68	15.64	16.33	16.85
Colombia	6.76	8.39	8.88	9.08	7.88	8.95	9.42	9.63	11.41	13.11	13.73
Costa Rica	10.77	11.15	12.36	12.28	12.05	11.03	11.24	11.79	12.71	14.13	13.14
Ecuador	8.33	10.48	10.64	8.85	6.94	8.51	7.71	7.80	10.86	11.58	13.73
El Salvador	...	...	10.45	13.33	11.43	11.98	9.81	10.43	10.91	13.07	14.41
Guatemala	7.03	7.78	7.77	9.23	6.99	7.54	7.70	8.69	10.83	11.05	10.55
Honduras	9.64	9.98	11.02	12.27	12.64	13.10	15.32	15.97	13.94	15.29	15.16
Mexico	7.01	7.94	8.73	11.06	10.38	10.98	11.08	9.98	10.47	8.67	9.42
Nicaragua	9.51	9.36	10.19	10.54	24.94	25.19	9.89	10.23	10.85	13.27	14.71
Panama	10.33	10.80	12.47	12.88	13.13	11.53	11.84	10.91	9.78	10.67	11.08
Paraguay	...	...	8.65	9.11	7.61	7.52	8.49	10.20	9.07	10.55	12.33
Peru	8.31	12.88	13.67	14.66	14.99	11.71	11.97	13.81	13.12	15.50	16.20
Dominican Republic	13.80	13.36	14.39	12.85	9.11	11.41	10.48	11.41	12.95	14.24	13.09
Uruguay	...	9.56	11.88	12.93	14.03	15.14	15.69	15.60	16.45	18.81	18.67
Venezuela	13.12	12.30	17.17	20.90	22.85	17.27	15.04	15.05	12.39	15.71	13.54
Promedio AL-18	9,70	10,71	12,09	12,66	12,75	12,50	12,05	12,63	13,30	15,16	15,52

Source: Prepared by the authors on the basis of the information contained in the Statistical Annex.

1/ Given their relevance, tax revenues of the provinces (not of municipalities because there is no information available) are included in the case of Argentina.

2/ Given their relevance, this also includes tax revenues of the states and municipalities.

Other factors that demonstrate Latin America's heterogeneity include the political organization of the countries and the degree of fiscal decentralization of the various government levels. In most of the countries, allocation of tax revenues seems to be strongly biased towards central governments, with subnational entities being highly dependent on the transfers received from the former. However, according to the most recent data gathered (OECD/ECLAC/CIAT/IDB, 2016), **Argentina** (with 21.7% of tax revenues in 2013, excluding Social Security contributions) and **Brazil** (with 42.7%) show considerable degrees of fiscal decentralization towards their subnational governments which have exclusive jurisdiction to apply a limited set of taxes that account for a significant portion of the total tax burden. Well behind these countries, **Colombia** (17.0%), **Chile** (7.7%) and **Mexico** (5.1%) exhibit limited revenue collection capacity by their respective subnational governments.

13 In their paper, Gómez Sabaini, Jiménez and Morán (2015) provide an updated description of the various fiscal regimes applied to resource exploitation in producing/exporting countries of the region, and an analysis of the recent tax reforms applicable to such sectors.

14 In this regard, Ossowski and Gonzales-Castillo (2012) found that the ample availability of this type of fiscal revenue has a negative impact on the rest of the public revenues in the region's commodity exporters, which display a lower relative yield, not so much of VAT or IT, but of other taxes such as selective taxes.

Moreover, there are many and diverse public Social Security systems in the region based on the payment of mandatory contributions that clearly constitute a key factor differentiating Latin American countries. In some cases, these schemes bear a superlative fiscal dimension, such as those of **Argentina, Brazil, Costa Rica, Panama and Uruguay**, while in other cases these schemes were transformed, displaced or supplemented by private capitalization regimes in the 80s and 90s following the Washington Consensus recommendations.

In this paper we have decided to exclude these resources as an integral element of the countries' tax burden (mainly because of the diversity of existing systems). However, we must acknowledge the influence they have on the remaining fiscal revenues, especially if we take into consideration their significance as an instrument to support several government social spending policies which would otherwise require financing through higher taxes or additional contributions.

b. Changes in Tax Structure and Reform Matrixes in the Countries of the Region

One can quite safely state that tax policies in the Latin American countries have been determined in part by the various macroeconomic contexts faced by these economies throughout the past five decades. Nonetheless, the evolution of the tax revenue levels conceals a number of relative changes regarding the composition of the tax systems; i.e., the group of taxes applied at specific times, which were “modelled” according to different ideological and academic schools of thought, and sought to meet, primarily, public financing needs in addition to other objectives such as efficiency, equity and revenue stability.

As pointed out by Cornia et al. (2011), at the beginning of the last century, the tax systems of both developed and under-developed countries were denominated almost exclusively by taxes on international trade. The drop in the international demand for commodities during the Great Depression of the 1930s, the high concentration of wealth and the protectionist import-substitution industrialization schemes implemented in several countries of the region put an end to this era and forced the countries to look for alternatives to increase the level of fiscal resources.

However, as already discussed, it was only in the 60s that a reformulation of the role of taxes as instruments for economic development, apart from the pure generation of fiscal resources, gathered strength. From an academic perspective, the “revolution of public finances” favoured consensus on the advisability of levying a global and highly progressive tax on personal income –together with a proportional tax on corporate income also with high rates amounting to around 50%– to meet distributive needs and to strengthen the tax resources available. Indeed, almost every country using schedular taxes –taxes levied individually on the income earned from different sources– turned them into global taxes or simplified the schedules and increased the relative significance of the “supplemental global tax” levied on individual income on an aggregate basis (OAS-IDB-ECLAC, 1973).

These guidelines did in fact contribute to strengthening the relative weight of direct taxation in tax structures, which at the start of the century was almost insignificant¹⁵ but in the above mentioned period reached, on average, one third of the at the time still low tax burden in Latin America. The remaining resources consisted of lower taxes levied on goods and services (some cumulative and general taxes on sales and, most of them, selective excise taxes) and of taxes on international trade (principally,

15 Sokoloff and Zolt (2007) explore the historical roots of these public financing patterns which are confirmed for a large group of countries of the region. In fact, we must recall that it was only between 1920 and 1935 that the IT was spread and included in the tax systems of the region. Nonetheless, it was not until the 50s and, especially, the 60s that this tax became significant from the revenue perspective thanks to the expansion (or, at least, the attempted expansion) of its scope to include different types of income.

tariffs on imports) plus a smaller –albeit not insignificant– portion comprising several very specific ad hoc taxes. This typical makeup, especially for the 1965-1969 period, is shown in Chart 2 below.

Yet, application of this “redistributive” taxation approach, which commenced in developed countries in the years following the Second World War, faced several obstacles in Latin American countries mainly due to the rural and informal structure of their economies, the high inequality levels, the weak governance and institutional quality, the limited capacity of tax administrations and the resistance offered by elites.¹⁶

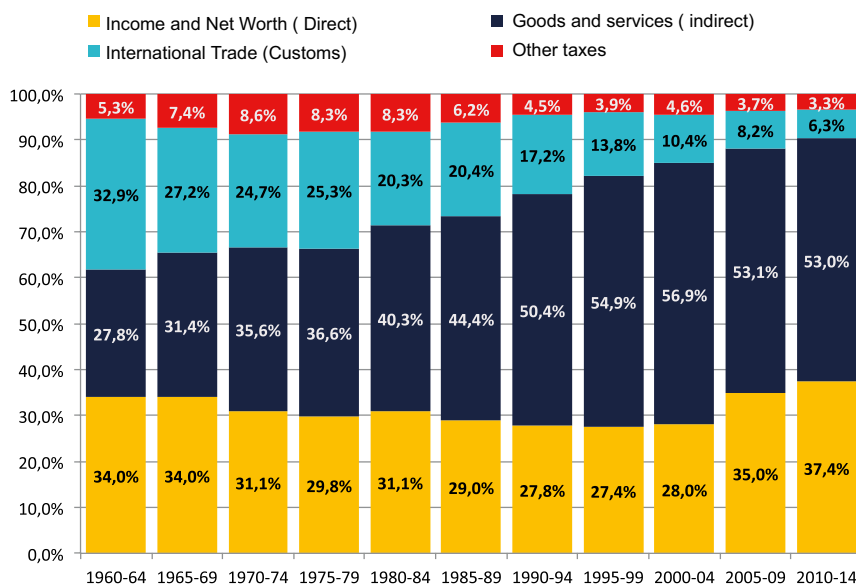
The success of these reforms was limited in many cases and this often led to the introduction of alternatives such as supplemental taxes for different types of income (given the intrinsic complexity in applying a global IT). In view of this scenario, the countries tended to levy general sales taxes or replace cascade or cumulative taxes for one-stage or value added taxes, in addition to other selective taxes (on sumptuary consumption, for instance) which severely impaired the redistributive capacity of the tax systems by the end of the 60s.

Even if it is distinguished as a period of high volatility in tax revenue, the 70s did not see, on average, significant changes in terms of the relative components of the tax systems in the region. The only changes worth mentioning could be a slight improvement in the share of taxes on goods and services –with the first attempts to introduce VAT– and a progressive decline of direct taxes and customs duties as a primary source of fiscal resources.

The counter-revolution was shaped by the well-known Washington Consensus, which on the basis of a series of regional trends it managed to establish amongst tax policy makers, brought about deep changes in the countries’ tax structure –rather than in the tax level, as discussed before– from the beginning of the 80s and through the late 90s.

In the first place, seen as the cause of inefficiencies in local production and in international allocation of resources, the level and dispersion of import duties were reduced (as will be shown in Chart 3) in order to achieve a flatter tariff protection structure, in both nominal and real terms. Likewise, in a context of increasing financial and commercial globalization, progress was made in eliminating export duties effective in many countries of the region which essentially taxed primary production.

Chart 2: Evolution of the tax structure in Latin America, Five-Year Average (Percentage of Tax Burden)



Source: Prepared by the authors on the basis of the information contained in the Statistical Annex.

¹⁶ In 1972 the Third Inter-American Conference on Taxation was held and one of the central ideas of the conference, carrying certain self-criticism on past actions, consisted in reformulating a tax reform as an instrument of development taking into account the actual conditions of Latin America, with all of its limitations and potential, and the position of the region compared to other more developed centers worldwide (OAS-IDB-ECLAC, 1973).

This resulted in a strong and progressive drop in tax revenue derived from customs duties in absolute terms and, especially, in relative terms, from an average value close to 25 % of revenue in the 70s to slightly over 10 % in the 2000-2004 period.

Table 2: Evolution of general rate for VAT in Latin American countries (Percentages)

Countries	Year Introduced	Initial Rate	1975	1985	1995	2005	2015
Argentina	1975	13.0	13.0	18.0	21.0	21.0	21.0
Bolivia 1/	1973	5.0	5.0	5.0	14.9	14.9	14.9
Brazil 2/	1967	15.0	n.a.	n.a.	20.5	20.5	20.5
Chile	1975	20.0	20.0	20.0	18.0	19.0	19.0
Colombia	1975	10.0	10.0	10.0	14.0	16.0	16.0
Costa Rica	1975	10.0	10.0	10.0	15.0	13.0	13.0
Ecuador	1970	4.0	4.0	6.0	10.0	12.0	12.0
El Salvador	1992	10.0	-	-	13.0	13.0	13.0
Guatemala	1983	10.0	-	7.0	7.0	12.0	12.0
Honduras	1976	3.0	-	5.0	7.0	12.0	15.0
Mexico	1980	10.0	-	15.0	15.0	15.0	16.0
Nicaragua	1975	6.0	6.0	10.0	15.0	15.0	15.0
Panama	1977	5.0	-	5.0	5.0	5.0	7.0
Paraguay	1993	10.0	-	-	10.0	10.0	10.0
Peru	1973	15.0	17.0	11.0	18.0	19.0	18.0
Dominican Republic	1983	6.0	-	6.0	8.0	16.0	18.0
Uruguay	1973	14.0	20.0	20.0	23.0	23.0	22.0
Venezuela	1993	10.0	-	-	12.5	14.0	12.0
Latin America		9.8	11.7	10.6	13.7	15.0	15.2

Source: Prepared by the authors on the basis of the information provided by ECLAC and CIAT.

n.a.: Not available.

1/ Approved in 1973, became effective in 1974. Tax rate calculated on a net basis.

2/ ICMS average rate which varies under the laws of each State. This is a tax applied at the subnational level whose tax base, except for transport, does not include services (this is covered by the ISS, a cumulative tax of municipal nature).

category “Other Taxes” presented in Chart 2. It is worth noting that eliminating many of these small taxes whose revenue contribution was insignificant and which in certain countries were quite numerous, far from amounting to a tax waiver, translated into a transfer of small taxable bases into the scope of VAT.

In turn, there was a progressive increase of the general rate for VAT in almost every country of the region from an initial average of 11.7 % (where only half of the countries levied the tax) to 10.6 % in 1985 (not due to a reduction in the level but because other countries were included in the average) to 13.7 % in 1995 and to 15.0 % in 2005, and the rate remained close to this percentage until present with 15.2 % in 2015 (Table 2).¹⁸ Thanks to these changes and the improvements made in the administration

To set off the loss in revenue resulting from such fall, the countries of the region were encouraged to use VAT as the most efficient alternative.¹⁷ Back then, general rates for VAT ranging from 10 % to 20 % (and a 0 % rate for exports) was considered to be a reliable and relatively stable source of revenues with few lags in collection. Additionally, the countries contemplated a tax exemption on goods in the basic food basket to reduce the regressive effects VAT often generates on income distribution (Cornia et al., 2011).

Nonetheless, the strengthening of VAT revenues at the regional level became evident at the time (which varies by country, but in the 80s and 90s in all cases) when the tax base was extended to include intermediate and end services. Initially, VAT had been applied almost exclusively to physical goods.

In fact, another tax trend of the period is the gradual reduction in the number of duties –for purposes of simplifying the tax systems of the region– and, therefore, of the relative weight of the

17 Brazil was a pioneer in the region with ICMS, a state-managed tax introduced in 1967, even though the country already had a federal tax, the Tax on Industrialized Products (IPI) levied on industrialized products by means of a fiscal debit-credit system. Since 1968, Uruguay has applied a tax on sales and services by means of a value added system although VAT was legally enforced in 1973. By 1980, when VAT was established in Mexico, there were twelve countries where VAT was already in force.

18 Even in recent years, some countries of the region have increased the general rate for VAT. These countries include Mexico in 2010 (from 15 % to 16 %), Dominican Republic in 2012 (from 16 % to 18 %), Panama in 2010 (from 5 % to 7 %) and Venezuela in 2009 (from 9 % to 12 %), while the rate decreased only in Peru in 2012 (from 19 % to 18 %).

of the tax, VAT became –as from the beginning of the past decade– the main tax revenue-generating instrument in Latin America.

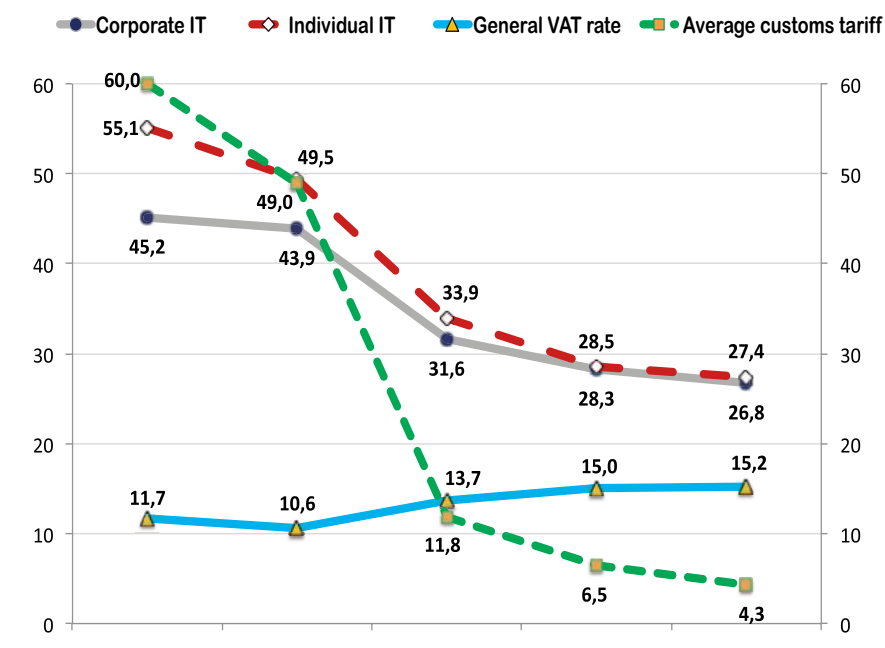
The steady expansion of VAT, even though the relative weight of selective taxes progressively decreased to apply almost exclusively to inelastic demand goods (alcoholic beverages, tobacco, fuels) and motor vehicles–, boosted a rise in internal indirect taxation at the regional level. Thus, this set of taxes went from an average of 37.4% in 1975-1979 to 56.9% at the beginning of the new century in the 2000-2004 period (Chart 2).

The neoliberal tax reforms fostered by the Washington Consensus pushed IT –and direct taxation generally– away from the centre of the tax and fiscal scene. During those years, most analysts and country authorities held the belief that high tax rates, apart from being unpopular, not only discouraged economic activity but were also ineffective in improving the distribution of income and wealth (Bird and Zolt, 2005).

This led countries to reduce the number and levels of IT legal rates applicable to individuals and companies. Thus, contrary to what was observed for the general rate for VAT, the marginal maximum rate for individuals dropped on average from 55.1% to 28.5% between 1975 and 2005, and continued to decline slightly to reach 27.4% in 2015 (Chart 3).¹⁹ Also, in some extreme cases, personal IT was eliminated altogether (**Uruguay** in 1974 and **Paraguay** in 1992) while other countries adopted a flat rate (**Bolivia** at a 10% rate, which was later increased to 13%). In addition, the simplification of corporate income tax favoured convergence with the general rates levied on legal entities; therefore, the regional average value dropped from 45.2% in the 70s to 28.3% in 2005 and witnessed a further slight decline in recent years to an average 26.8% in 2015.²⁰

We must mention that, like in the case of the sharp decrease of the average charge for the countries of the region (Chart 3), the drop of IT rates for legal entities in Latin America was in line with international trends and, over the past years, the general rates have equalled the levies charged in developed countries.

Chart 3: Evolution of IT maximum marginal rates in Latin America (Simple averages for selected years) (Percentages)



Source: Prepared by the authors on the basis of information provided by ECLAC, CIAT and the WB.

¹⁹ Most recent changes include an increase in the maximum applicable rate of this tax in Mexico (from 30% to 35%) in 2013 and the reduction of such maximum rate from 40% to 35% in Chile during the 2014 tax reform (ECLAC, 2015).

²⁰ The most recent changes in this respect were in Ecuador, where the rate went from 23% to 22% in 2013; in Colombia, where the rate was reduced from 33% to 25% in the same year; in Guatemala, where the general regime rate (net yield) has dropped from 31% to 28% since 2014 while the maximum rate under the optional regime (gross income) rose from 6% to 7%; in Chile, where the reform prescribed a gradual increase for the subsequent years that would take the rate from 20 to 25-27% in 2018; in Dominican Republic, where the general rate decreased from 29% to 28%; and Honduras, where the surcharge in force (Solidarity Contribution) decreased from 10% in 2011 to 6% in 2012, to 5% in 2013 and to 4% in 2014.

However, IT maximum marginal rates for Individuals in force in Latin American countries are in the range of 25%-35%, well below the rates applied in OECD countries (especially in European countries), which are 47.5% in Germany, 50% in the **United Kingdom** and even higher in **Spain, Denmark** and **Sweden**. Please note that the revenue effects of this trend have not been offset by an expansion in the tax base. Rather, the rates in force have continued to be applied basically, and most strongly, to taxation on all labour income, without incorporating capital gains in the tax base.

The scant progress made during this period in tax collection is associated with certain reforms in the tax specific design. For instance, in the last two decades, with rare exceptions, the income level subject to the top marginal rate has been substantially reduced (Table 3), although it is still applied to relatively few taxpayers who make, on average, nine times the per capita income for the country.

However, despite the Washington Consensus emphasis on improving horizontal equity, there were no achievements, at least during the 80s and 90s, in terms of the required reduction of a long list of exemptions and deductions in Personal IT which accounted for big losses of tax revenues. As shown in Table 3, in recent years countries have managed to reduce the level of average Personal IT exemptions to approximately 1.4 times per capita GDP. Nonetheless, as described by Barreix et al. (2012), at present the exempted minimum income is higher in Latin America than in other regions, particularly compared to the OECD countries, where the average is a little over 0.2 times per capita GDP.

All in all and as a result mainly of the changes in IT, during the 80s and 90s there was a slight but significant retreat of direct taxation in Latin American tax structures, settling around 28% of total tax revenues through the first years of the new century (see Chart 2). So this reference value may technically be read as a “floor value” for the relative weight of the duty with respect to the situation observed in the 60s, following the initial erosion of the revenue collected in the subsequent decade both due to the specific reforms already discussed and to a highly volatile macroeconomic context and elevated inflation levels. But also as years passed (more than twenty) such reference value became a “ceiling value” mainly in view of the sharp climb of VAT and the cutback on levies to international trade.

As discussed in the previous section, a new tax era commenced for the Latin American countries in 2003; a stage that would not only become evident in the level of available resources but also through a renewed emphasis on distribution issues associated with fiscal policy and, in line with this, with a revalorization of the potential of IT for this purpose and for the generation of public revenues.

Indeed, a significant IT revenue increase, especially in the case of businesses and given the greater economic dynamism and the boom in international commodity prices until 2008, favoured a recovery of the average relative weight of direct taxation in the region’s typical structure reaching 35.0% in 2005-2009 and an all-time high of 37.4% in the last five-year period analysed (Chart 2).

At this point, some explanation is warranted. The other component of what is commonly known as “direct taxation” is property taxes and, in this respect, it is well known that these have historically been fairly insignificant in Latin American countries.

This type of taxation often covers a wide range of taxes including, among others, recurrent taxes on real estate property and motor vehicle licenses, levies on net wealth and even Taxes on Financial Transactions. With regard to the latter, there is no consensus as to their classification as a direct tax (according to the IMF methodology);²¹ although in this paper we have decided to exclude these instruments (and their revenue) from “Direct Taxes” and include them under “Other Taxes”, we will

21 In fact, Cetrángolo and Gómez Sabaini (2007) have classified this tax as a special selective tax applied to a specific activity consisting in the use of bank checks.

briefly discuss this kind of “heterodox” tax in the last paragraphs given the relative significance they have recently gained in some countries of the region.

Traditionally, when property taxes are analysed the logical point of reference, at least in the countries of the region, is the tax on real estate. Bearing great potential to supplement the distributive effects of personal income taxation, this duty is also recognized worldwide as the most significant source of own revenues for subnational governments. Nevertheless, the revenue yield of these taxes has been and continues to be limited in all the Latin American countries which apply them. This is explained by a combination of factors that restrict their ability to function as a source of subnational revenues (Gómez Sabaíni and Morán, 2016).

In this respect, the low operational capacity combined with inefficient TA by local governments play a key role in Latin America. In many cases, billing and collection of real estate taxes are adversely affected by the low coverage ratio of the land registry, the high levels of delinquency, and a considerable undervaluation of real estate property derived from the systematic lack of reassessment of cadastral values. Reasons for the high tax delinquency vary largely, including the lack of information to make payments, the lack of payment facilities, a generalized perception of low risk for those who fail to comply with their tax obligations and the scarce information and transparency regarding the use of resources.

Despite all these limitations, the relative weight of direct taxation grew substantially during the last decade and the impact of IT in this respect has been decisive. On the one hand, VAT shows an increasing trend for the 1970-2014 period, which accelerated in the early 90s, when the relative share of the tax in the tax systems moved from 25 % (maximum cap for the 70s and the 80s) to over 35 % of total tax revenues, remaining close to 40 % in recent years (see Chart 4).

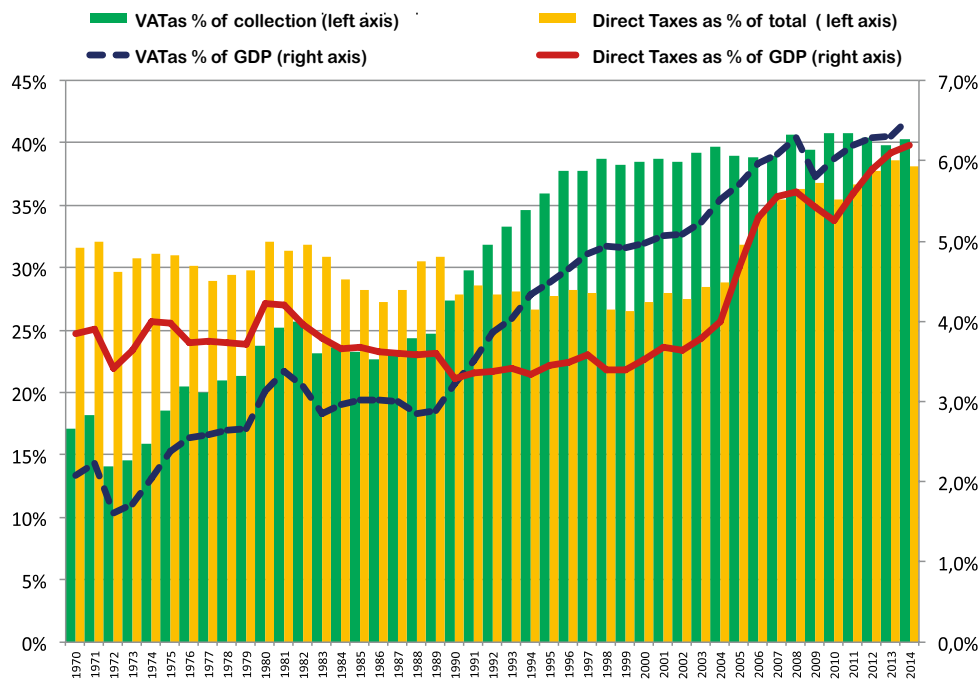
On the other hand, direct taxation (on income and wealth) shows, at least until the first years of the past decade, certain stability (and even a small decline both with respect to GDP and in terms of its relative weight in the tax structure over a long period). The increase observed for the 2003-2004 period and onwards is notable, which was only temporarily restrained by the effects of the 2008-2009 crisis. It is also worth noting that, as shown in Chart 4, the current values for direct taxation represent historical peaks (6.2% of GDP and 38% of revenue) consolidating direct taxation as a tax pillar for the majority of the systems in the region.

Table 3: Income levels for the application of minimum and maximum Personal IT Rates in selected Latin American countries (Times per Capita GDP)

Countries	Application of minimum Personal IT rate (level of exemption)			Application of maximum Personal IT rate		
	1985	2001	2010	1985	2001	2010
Argentina	0,8	1,4	0,3	21,4	16,5	3,7
Bolivia	1,0	...	0,2	10,1	...	0,2
Brazil	0,3	1,5	1,1	10,1	3,1	2,7
Chile	0,2	0,1	1,0	2,8	1,2	11,2
Colombia	0,0	4,1	2,8	20,5	16,6	10,7
Costa Rica	1,2	0,8	1,9	1,4	3,7	2,9
Ecuador	0,4	2,4	2,2	29,2	8,3	22,3
El Salvador	...	1,2	0,4	171,7	11,0	3,4
Guatemala	0,9	5,0	1,6	356,0	22,5	14,4
Honduras	0,0	3,6	2,9	600,4	36,0	13,1
Mexico	0,7	0,1	0,5	21,3	44,0	3,4
Nicaragua	1,7	7,7	2,1	56,9	61,2	20,7
Panama	0,3	0,9	1,4	89,0	57,8	4,1
Peru	...	2,9	1,7	...	22,3	14,7
Dominican Rep.	1,1	2,3	1,8	413,5	5,8	3,8
Uruguay	...	...	0,7	...	...	10,3
Venezuela	...	0,0	1,5	...	0,0	12,7
América Latina	0,7	2,3	1,4	128,9	20,7	9,1

Source: Prepared by the authors on the basis of information from Stotsky and WoldeMariam (1997) and Barreix et al. (2012).

Chart 4: Evolution of VAT and direct tax revenues in Latin America (Annual data, 1970-2014) (Percentages)



Source: Prepared by the authors on the basis of the information contained in the Statistical Annex.

Peru and the Central American countries approved –with variations– tax reforms aligned with the foregoing (ICEFI, 2011). Recently, other countries of the region, such as **Argentina**, **Mexico** and **Uruguay**, also decided to apply, though not strictly with dual systems, Personal IT on certain capital income (dividends) which had been exempted from the tax in the past.

With regard to Corporate IT, some satisfactory results were also obtained in several countries by limiting tax incentives that had been granted in the framework of economic promotion regimes (free trade zones) and implementing minimum taxes on corporate income.²³ In addition, international taxation rules have been adopted (transfer pricing, tax havens and non-resident income) and agreements on information exchange have been fostered among countries to fight tax evasion.

However, behind this encouraging wave of tax reforms in IT and the increase in revenues from this tax, there is another long-dated stylized fact that distinguishes the Latin American countries from other more developed countries. In this respect, at least over the past three decades the structure of IT revenue has been strongly biased towards legal entities over individuals. In most countries more than two thirds of IT revenues are collected from companies while one third (or less) derives from

Certainly, this rise of direct taxation in absolute and relative terms over the past decade also responds to the progress made in expanding the Personal IT base by incorporating dual or semi-dual systems. **Uruguay** adapted a model originally applied by several Nordic countries,²² and it was the pioneer in the region by reintroducing, in July 2007, the tax that had been repealed some decades before. The country began to apply separate taxes for labour income with progressive rates, and capital income with a proportional rate (Barreix and Roca, 2007). Subsequently,

22 Denmark (1987), Sweden (1991), Norway (1992) and Finland (1999) were pioneers in the application of a dual income tax system. More recently, Spain followed suit in 2006.

23 The tax reform approved in Chile in 2015 has been the most resounding case: in addition to providing for a gradual increase in the general Corporate Income Tax rate (from 20 % to 25 %), the reform replaced the Taxable Income Fund system –which allowed deferring Personal IT to non distributed profits as an incentive to investment– by two new alternative tax systems effective as from 2017. Taxpayers are now entitled to opt for one or the other of those systems which can be described as follows: the “earned income system” which is based on the accrued income and will use a 25 % rate, which allows the use of 100 % of the tax amount paid by the business as a tax credit to shareholders (totally paid up shares); and the “partially paid in shares” system which is governed by the received income criterion but will apply a higher rate (25.5 % in 2017 and 27 % as from 2018) with a top cap (65 %) for the specified tax credit.

personal IT, contrary to what happens in OECD countries. This imbalance in the IT structure has several implications for income distribution and justifies, to a large extent, the small redistributive capacity of the tax systems effective in the region (Gómez Sabaíni and Morán, 2014).

Just as we mentioned in our discussion on the tax burden level, we can now affirm that there is a wide variety of cases within the region in terms of the evolution and current condition of the tax structure. While this reality does not invalidate the general trends discussed, it does compel us to be careful when assessing the strengths and weaknesses of each particular tax system. This is observed, for instance, under the “Other Taxes” category where, despite the generalized decline in its relative weight—resulting from the decrease in the number of taxes—this category is still considerably relevant in **Brazil** (more than 20%) and, to a lesser extent, in **Ecuador**, **Panama** and **Colombia**.

Despite their dramatic reduction in the region, taxes on international trade continue to be relevant in countries such as **Argentina**—ever since export duties were reinstated for commodities in 2002—, **Ecuador**, **Paraguay** and **Venezuela**. In turn, direct taxation showed a downward trend over the first part of the period subject to analysis (1960-2000) and a strong recovery as from 2003. However, this trend was not followed by **Panama** or **Mexico** (where these taxes did not decrease in the 80s and maintained a significant relative share) or by **Venezuela**, which showed a particular case where direct taxes were linked to the IT applied to oil companies (including state-owned company *Petróleos de Venezuela S.A.*) and were extraordinarily high—in relative terms—between the 60s and the 90s, and then worked their way back to the regional reference values.

The relative weight of internal taxes on goods and services (VAT and selective taxes) is higher than that of direct taxation in most countries. This imbalance is also a determining factor in the regressive or slightly progressive impact of Latin American taxation systems.²⁴ **Panama** (where the VAT rate is 7%, well below the regional average) and **Mexico** (where the taxable base has been historically limited by exemptions applied to food products and medicines) are the only cases where direct taxation is not predominant.

Last, and going back to the tax trends observed in the region over time, in the past two decades several countries have attempted to overcome existing deficiencies in the level of the tax burden by creating unconventional taxes that can provide additional tax revenues to finance growing public spending. By giving preference to revenue and administrative purposes over an efficient and egalitarian tax system, the tax reforms introduced have chosen the “easy way out” in tax matters without sufficiently considering the economic costs of these decisions.

In general, emergency taxes allow for simpler tax administration than traditional taxation, as the former leave little space for evasion or avoidance. Also, some of these taxes have proved to be optimal instruments to collect a significant amount of revenues in the short term. However, these non-conventional taxation mechanisms are often subject to a number of objections related to their negative impact on the allocation of resources and the distributive implications derived from their application.

As a first example, we can mention the simplified tax regimes for small taxpayers, which are widely spread in Latin American countries. In contexts of extensive informality and high levels of evasion, these instruments are a clear example of the adaptation of TAs at the regional level and address the need to secure voluntary tax compliance of a large number of taxpayers who are difficult to audit and control, minimizing the implicit cost to the smallest companies and reducing the associated work load for Tax Administrations, which increase in less developed countries.

24 Available studies on fiscal policy incidence in the region coincide in showing that VAT has a modest though regressive redistributive impact and that Personal IT is highly progressive but has a very limited redistributive impact given its scarce revenue contribution (Gómez Sabaíni and Morán, 2014).

These regimes generate a few revenues, bringing in less than 1% of the total in the majority of the countries where they are applied (except for **Brazil** and **Argentina**). However, we must highlight the possibility given by these instruments for freeing up resources that may then be re-oriented towards auditing other taxes of higher yield such as VAT, or to auditing the IT of larger taxpayers. So, as Gómez Sabaíni and Morán (2012) noted, the success of these regimes is to be measured by their ability to include informal workers in the formal sector, while ensuring that this does not become an artificial tax shelter for evasion but rather a transition mechanism towards the general taxation regime.

Each of these schemes has had to be adapted to the framework of the local tax system, taking into account the characteristics of the taxpayers to be included and the concrete possibilities of each Tax Administration. The system then varies in terms of the taxes contemplated, the taxpayers covered and the presumptive techniques applied to determine the taxable income, among other features. The regimes implemented in **Argentina** (Monotributo), **Brazil** (SIMPLES Nacional and SIMEI²⁵) and **Uruguay** (Monotributo and Monotributo Social MIDES) are quite special. These regimes, apart from replacing a group of taxes, include a basic pension allowance and, in some cases, (optional or compulsory) health insurance through the payment of contributions for funding purposes (Cetrángolo et al., 2013).

In turn, many countries of the region have adopted taxes that operate as minimum IT, based on the asset value or the aggregate amount of the company's gross sales or gross income. For example, **Argentina** applies the minimum tax on the value of gross assets and this, assuming capital mobility, is a substitute for corporate income, while **Costa Rica** opted for taxing companies' fixed assets. Equity or net assets are also widely used in **Colombia**, **Ecuador**, **Panama** and **Uruguay**, although at different tax rates. **Guatemala** applies the Solidarity Tax which assesses a 1% rate on 25% of either net assets or gross income, whichever is larger. **Mexico** is a special case: from 2008 through October 2013 (when it was repealed), there was a tax known as the flat-rate business tax (FRBT), which applied a "flat tax" (17.5%) to the residual flow of resources used to compensate the factors of production (Gómez Sabaíni and Morán, 2014).

Finally, a considerable group of countries has introduced –or re-introduced– some form of TFT. Although these taxes were implemented at times of crisis, on a temporary basis and given the urgent need of increasing fiscal revenues, at present they are included amongst the permanent components of several tax systems of the region. In general, there are two lines of arguments in favour of using this tax as a source of revenue: on the one hand, this tax may be introduced in a relatively short term, since it is based on a simple withholding operation by the financial intermediaries, it demands little preparation and no cooperation from the taxpayer; on the other hand, a small tax rate can generate substantial revenues, particularly in countries with high levels of use of banking services, as bank debits are a multiple of GDP.

According to González (2009), this kind of tax applied in many countries of the region may be classified into two different groups: (i) taxes on debits of financial transactions (**Colombia**, **Dominican Republic** and **Venezuela**); and (ii) taxes on debits and credits in checking accounts and other operations of the financial system (**Argentina**, **Bolivia**, **Brazil** and **Peru**). In addition, for the purposes of preventing tax avoidance manoeuvres, in **Argentina**, **Brazil**, **Peru** and **Venezuela**, the movement of funds through organized payment systems that operate outside of financial institutions are also taxed.

Table 4 shows that in **Argentina** the Tax on Debits and Credits in Checking Accounts has achieved good results, accounting for 1.5% to 2% of GDP over the past years, and which in 2014 represented almost 7% of the country's total tax burden (as per the value considered for this paper which is exclusive of Social Security contributions). The tax on financial movements (GMF) in **Colombia**

25 SIMPLES Nacional for Individual Micro Entrepreneur.

is quite relevant in the current tax structure as it accounted for 0.85 % of GDP and 5.95 % of total revenues in 2014. In this respect, Act 1739/2014 provided for a gradual reduction of this tax rate starting in 2019 (at present, the rate is 0.4% on debits) and planned to completely eliminate the tax by 2022.

In the other countries where these duties are applied, the results obtained have not been as satisfactory, at least as far as revenues are concerned. For example, in **Bolivia** and the **Dominican Republic** tax revenues from this source were close to 0.2 % of GDP and below 2 % of total revenues, while in **Peru**²⁶ revenue from this tax is hardly significant (Table 4). In **Honduras**, the yield is quite higher as a result of the high productivity of these taxes given the low reduced rates applied.²⁷

A recent report prepared by Pecho Trigueros (2013) revised the experience of countries in Latin America in the application of these taxes over the 1990-2012 period and argued that these instruments –in contrast to the related literature– are not as harmful as traditionally presented, especially in the short term. In this respect, data show that these taxes have generated revenue which, even if limited and generally decreasing in time– has contributed to the recovery of tax-derived resources in times of fiscal crisis and has exceeded the proceeds from Personal IT in the countries under analysis. Moreover, the available information further suggests that this tax has a milder impact on lower income groups, but affects people in higher income brackets, who have a more inelastic demand and carry out many financial operations.

c. Transformation in Tax Management

In the field of tax management, the institutional development that TAs underwent over the past 50 years is one of the main stylized facts at the regional level, regardless of the differences that may be identified at performance level in each country.²⁸

In the 60s and 70s, the difficulties faced by Tax Administrations were already the object of extensive debate. The OAS/IDB/ECLAC Conference on the Joint Tax Program, held in Argentina in 1961,

Table 4: Rates, revenues and productivity of TFT in Latin America - Year 2014

Countries	Rate and tax base	Collection		Productivity (without general rate)
		% of GDP	% of total	
Argentina	0.60% / debits and credits	1,73	6,87	1,44
Bolivia	0.15% / debits and credits	0,18	0,69	0,59
Colombia	0.40% / debits	0,85	5,95	2,13
Honduras	0.20% / debits	0,45	2,69	2,25
Peru	0.005% / debits and credits	0,03	0,16	2,65
Dominican Republic	0.15% / debits	0,20	1,43	1,34

Source: Prepared by the authors based on Pecho Trigueros (2013), updated pursuant to the data used in this paper (Total tax revenues and GDP) and CIAT (TFT Collection).

Note: In countries where the tax is applied on credits and debits, the productivity (tax receipts times per percentage point of rate) is calculated on the aggregate rate.

²⁶ The TFT was implemented in 2004 and has gradually reduced its rate from an original 0.15% to 0.005% on credits and debits.

²⁷ Note that until 2007, these Taxes on Financial Transactions stood out in Brazil and Venezuela for their high levels of productivity. In the case of Brazil, the Provisional Contribution on Financial Movements (CPMF) generated tax resources equal to 1.4% of GDP in 2007, while TFT in Venezuela allowed for revenues amounting to 0.9% of GDP (Coelho, 2009).

²⁸ To review the evolution described, this section uses the TADAT (Tax Administration Diagnostic Assessment Tool) as reference, which provides an assessment of the strengths and weaknesses of TAs against international good practices.

brought to light the difficulties in tax management in Latin America. Some of the challenges faced by the TAs at the time include the following: complex tax laws, deficient tax organization, insufficient accounting records of taxpayers, limited legal power of TAs, inappropriate use of automatic data processing techniques and the impact of these elements on tax evasion (OAS/IDB/ECLAC, 1961).

To see how the different countries tackled this issue, it is interesting to revise the findings of a study presented by Mr. Roberto Hoyo d'Addona –representative of Mexico's Under-secretariat of Revenue– during the CIAT General Assembly held in Mexico City in 1981. The study includes an analysis of the evolution of TAs from 1961 to 1980 in key areas such as organization, human resources, aid and education for the taxpayers, administrations of tax revenues and resulting costs, audits, automatic data processing, international technical assistance, among others (CIAT, 1981).

At the organizational level, countries gradually moved away from a “tax by tax” approach and adopted a structure defined by functions. To this end, collection agencies were created as standardized as possible. Until then, it was quite common to see several tax offices coexisting, each of which was in charge of one specific tax. Likewise, the countries started to see a trend towards tax specialization, separating customs management from TAs. This strategy was opposite to what would happen in the 90s, a period where tax and customs management would be integrated under one single entity. In the end, countries committed to operational decentralization and created regional offices.

It was throughout this period that ADP systems were introduced and replaced manual and mechanical systems. At the above-mentioned 1961 meeting, Stanley S. Surrey –the U.S. Assistant Secretary of the Treasury– already forecasted that the “creative use” of ADP would have a significant impact on tax management. However, it is clear that at that time there were no applications integrated with the entire organization as we see today, but there were isolated applications for specific tax processes. For instance, the rise in the number of taxpayers due to the application of VAT derived in the creation of individual administration accounts which would ultimately result in taxpayers registries. Moreover, applications were created to schedule audits for control purposes. Also in this period there were significant investments in IT hardware, teleprocessing, data transmission and multiprogramming.

At the time Tax Codes were also established to regulate **legal and tax** relationships. With the publication of the OAS/IDB Tax Code Model in 1967, countries started to implement organic tax codes, that is, codes providing fundamental principles and basic definitions²⁹ (Table 5). Almost five decades after that crucial point in time, the advantages of tax codes are now widely recognized. In this regard, according to Plazas Vega (2012) the most outstanding advantages of the use of tax codes are the following: **(i)** they lead to a more stable tax system, which in turn contributes to legal certainty and taxpayers' trust; **(ii)** they help prevent contradictions often arising between the laws associated with each tax; **(iii)** they tend to reduce legal and administrative controversies often arising around tax matters, and this makes administration of justice more efficient; and **(iv)** they respect the changing nature of tax laws, ensuring at the same time that legislative changes do not impact on the basic structure of the tax system.³⁰

Finally, it is widely known that self-determination of taxes leads to more assistance, guidance and education for taxpayers. Indeed, in the 60s and 70s it became apparent that it was necessary to give taxpayers more information regarding their tax obligations. With the widespread development of mass media, advertising, motivational and reminder campaigns were launched. Telephony

29 When a codification process systematizes fundamental tax concepts that will be repeated in every specific tax, it is said that codification is based on principles. The paradigm of this type of code is the German Tax Ordinance of 1919.

30 The CIAT Tax Code Model is a significant contribution made by CIAT which, since its publication in 1997, has highlighted the need to provide TAs with legal powers to properly fight against tax evasion as it represents, considering all actions contrary to the principle of equality, the most blatant and reprehensible form of tax injustice. The latest version of the Model was published in 2015.

services further brought the possibility of implementing assistance programs such as advisory and consultation services. Another generalized practice is publishing and distributing magazines, flyers, newsletters and instructive material. Finally, there are educational initiatives (conferences, courses and meetings) on tax matters and some school syllabi start to include tax topics.

In the 1980s, given the large fiscal deficits and the use of the scarce governmental resources for the payment of the government debt, any modernization of TAs seemed unfeasible. In spite of this, during that period there was a qualitative improvement in TAs. As part of the fiscal adjustment programs implemented in those years, a clear interest to strengthen TAs was seen in order to bring the proposed tax reforms into effect. The renowned tax specialist from Argentina, Carlos Silvani, defined the 80s as “a won decade because several CIAT countries took very important qualitative steps in their TAs”.³¹

Progress made in ICT has been much quicker than the efforts to modernize the TAs. In this respect, the effectiveness derived from an increased capacity and the speed in data processing which were seen as a breakthrough in previous decades, turned out to be useless due to poor data feeding or lack of technology integration throughout the organization. However, as emphasized by Edison Gnazzo during the 1991 General Assembly in Washington D.C., this changed radically in the 80s. In this decade, truly integrated information systems were conceived, using a taxpayer registry and a checking account as fundamental pillars (CIAT, 1991).³²

In turn, technological innovations were supplemented by an adjustment of Tax Codes “which changed or adjusted criteria and procedures in various areas of the fiscal authority-taxpayer relationship”. In particular, it is worth mentioning the standardization of withholding and advance payment regimes to facilitate tax collection and the strengthening of penalty systems, which became dissuasive but realistic and were in accordance with the new tax obligations.

Systems to obtain guidance in connection with audit programs, case selection and specific audits were also developed during this period. Among these, cross information systems for extensive VAT controls are worth mentioning as they allowed for corroborating taxpayers’ data cross-checking the data against external sources. Some examples include SITER in Argentina, SAFIRA of PRONAFISCO in Río de Janeiro, Brazil, ARCO System in Chile; among others.

The perhaps most significant milestone of the 80s in terms of tax management may have been the creation of large taxpayer units in several countries of the region. Creation of these units was based upon a series of solid arguments in connection with such taxpayers’ special economic nature: **(1)** the complex way in which they transact businesses; **(2)** they account for a large portion of tax revenues, not only as taxpayers but also as withholding agents; **(3)** from the perspective of potential losses of

Table 5: History of tax codification in Latin America

Period	Countries (year approved)
1939	Mexico
1961-1965	Chile (1960), Ecuador (June 1963)
1966-1970	Brazil (October 1966), Peru (August 1966), OAS/IDB Tax Code Model (1967)
1971-1975	Bolivia (1970), Costa Rica (May 1971), Uruguay (1974)
1976-1980	
1981-1985	Venezuela (1982)
1991-1995	Guatemala (October 1991), Paraguay (1992), Dominican Republic (1992)
1996-2000	Honduras (May 1997), CIAT Tax Code Model (1997)
2001-2005	El Salvador (2001), Nicaragua (November 2005)
2006-2010	CIAT Tax Code Model (2006)
2011-2015	CIAT Tax Code Model (2015)

Source: Prepared by the authors based on CIAT and Plazas Vega (2012).

³¹ CIAT Technical Conference, Madrid, Spain, 1990: Technological Innovation and Tax Management.

³² CIAT has, since 1983 and with the financial assistance of the IDB, supported the countries of the region in implementing information systems of this kind, with a view to improving the control of taxpayers and the services offered to them.

revenue, the risks of noncompliance associated to large taxpayers are quite significant; **(4)** they have access to specialized tax advisors who handle a great deal of information both at the local and the international levels and are able to offer highly sophisticated fiscal planning tools; and **(5)** they are very influential in the media, the government and society at large. Today, these units are an integral part of most modern TAs.

In the 1990s, the countries of the region became committed to pursuing the integration of the organizations responsible for collecting domestic taxes and customs duties. In Latin America, there were seven TAs who opted for this strategy. Additionally, there was interest in jointly managing social security resources as it occurs in many OECD countries. Such was the case with AFIP in Argentina and RFB and SUNAT in Peru. Although there is no evidence conclusively linking the integration efforts with improved performance, there is no doubt that such efforts have actually contributed to streamlining intergovernmental coordination and the exchange of information to facilitate a more efficacious enforcement of tax obligations (Pita, 2007).

Since then, Latin American countries have also seen a surge of interest in the proper performance and institutional organization of their TAs. Pursuant to the joint work of IDB/CAPTAC-DR/CIAT (2012), most of these institutions have gone through an intense modernization and transformation process which has proven to be fully beneficial for the region's public finances. As a result, many countries in the region now have mature TAs comparable to those of more developed countries. As a matter of fact, the main challenge today is to spread this progress throughout the region and maintain it in time so as to prevent these successful tax reform and modernization processes from being abandoned or dismantled.

In recent years, almost every TA has aligned with a modern strategy for the promotion of voluntary compliance, thus improving the balance between enforcement actions and services to the taxpayers. It is interesting to see how in the 1990s the traditional directives –collect taxes so that the State may perform its duties, enforce the law and fight against noncompliance– gave way to other actions that are more geared towards guidance and aid for the taxpayers and the observance of their rights.

Either formally or tacitly, many TAs of the region adopted a compliance model based on the tax behaviour of the taxpayers, where TAs may give differentiated treatment to taxpayers based on an assessment of compliance risks. The logical argumentation behind this model was as follows: “TAs must cooperate with and trust those taxpayers who voluntarily comply as they account for the largest portion; those who fail to comply need to be dissuaded or punished and those who hesitate or try to take advantage of the law need to be assisted or persuaded.”

Additionally, TAs have laid greater emphasis on management planning and control in line with the trend seen in the 90s towards reinventing government entities. Thus, TAs progressively introduced strategic plans with medium- and long-term goals, focused on an institutional mission and vision. Though not the case in all countries, the increased stability of Directors in their TA offices has been of help in implementing the structural changes defined in the plans. As to management control, new indicators of TAs' performance were added to the traditional revenue goals. For instance, much attention has been paid to the cost of tax collection as society has become more concerned about the efficiency of public entities. Indeed, over the past two decades tax collection costs in Latin America have been decreasing notably although they are still slightly above OECD levels.

As discussed above, countries have made substantial progress in the 70s in automatic data processing covering basic areas of tax management (taxpayers' registry, receiving tax returns and payments, audit and collection, etc.). But it must be said that progress in ICT, particularly the spread of Internet access, has redefined the relationship model between TAs and taxpayers. Therefore, since the 90s, a myriad of new applications have made their way in this area opening up multiple channels to

interact with citizens. Thus, a strategy to promote voluntary compliance has been defined based on facilitation and cost reduction, and giving way to the so-called “virtual offices” that offer tailored guidance and assistance.

As economic operations became digitalized and powers to access taxpayers’ information for tax purposes increased, TAs now handle a great volume of information. This new scenario allowed for the implementation of risk management models based on taxpayers’ profiles. Risk profiles are based on quantitative and qualitative analyses which take into consideration the probability of occurrence and the possible impact of identified risks. Most of the TAs have sought to integrate these models to their oversight processes. IT platforms upon which risk models are developed use state-of-the-art statistical techniques. These are times for predictive analysis involving modelling, automated learning and artificial intelligence and “data mining”. The idea is to identify taxpayers’ behaviour patterns and, consequently, potential risks for tax management.

There has also been a need to adapt tax strategy to taxpayers’ characteristics, and therefore, since the early 90s, there has been much talk about segmentation in Latin American countries. For example, special attention has been given not only to large taxpayers but also to micro and small companies. New tools have been made available to this segment of taxpayers mainly to give incentives to these companies to employ formal mechanisms, especially, as pointed above, through special regimes for small taxpayers in many countries of the region.

Likewise, TAs are now more concerned about the risks posed by cross-border operations by taxpayers. From the year 2000, many TAs have created international taxation units which are in charge of control of transfer pricing manipulation, exchange of information among different agencies and other forms of mutual administrative assistance, DTA management, etc. Given the new fiscal transparency standards gradually adopted worldwide, it becomes more realistic, or at least possible, to actually collect taxes from higher income individuals. Therefore, many TAs have lately created units in charge of this segment of taxpayers.

A considerable portion of these administrative transformations has been viable thanks to a firm decision by the governments of many countries of the region to award their TAs significant autonomy and flexibility to manage their budgetary resources (in some cases, this has included a financing system that is different from the one applied to the other governmental areas) and to apply their personnel policies (Table 6). Several countries created semi-autonomous revenue authorities (SAARs) hoping for more effective tax management. Although there is no conclusive evidence showing that the creation of SAARs has been a determining factor, some authors like Taliencio (2004), assert that a higher degree of autonomy and stability did in fact, over time, result into a general improvement in the performance of Tax Administrations.

Such greater autonomy has made it possible to emphasize the development of human resources. In general, there are streamlined processes for staff selection and training, career plans, compensation and benefits more consistent with the duties performed and an adequate promotion of ethical behaviour. All this has translated into highly professional TAs, thus increasing the technical level of the relationship with the taxpayers. The average staffing growth since the 1990s is also significant, particularly among young university graduates. In spite of this, the TA staff to population ratio is much higher in Latin America than in OECD countries. Salary levels, are, in general, higher compared to the rest of the government areas.

Finally, today there is a clear decision to move towards increased transparency and accountability to society. This trend responds to a more general strategy to build a relationship with the community in an attempt to promote voluntary compliance by engaging the citizens in institutional management.

Many statements of vision or mission, for instance, emphasize justice, ethics, autonomy and transparency as fundamental principles of behaviour. In democratic times with increased citizen participation, the current strategies are based on the premise that tax administration should be highly credible for the community and that it should take actions to achieve the so longed-for social cohesion.

Table 6: Degree of autonomy of TAs in Latin America

Countries	Degree of autonomy: Description
Argentina (AFIP)	Self-regulatory entity within the scope of the Ministry of Economy and Public Finances. AFIP has administrative and financial independence.
Bolivia (SIN)	An entity within the Ministry of Economy and Public Finances. SIN is a self-governed entity organized under public law, which has administrative, operational, technical and financial independence, with legal personality and its own capital resources.
Brazil (RFB)	Organization within the Treasury Department. RFB does not have absolute administrative or financial autonomy.
Chile (SII)	Organization within the Treasury Department.
Colombia (DIAN)	Entity established under the scope of the Ministry of Finance and Public Credit. DIAN is a special federal administrative unit, with legal personality, its own capital resources, and administrative and budgetary autonomy.
Costa Rica (DGT)	An office of the Vice Ministry of Revenue of the Treasury Department.
Ecuador (SRI)	SRI is a technical and autonomous entity, organized under public law, with legal personality and its own capital resources.
El Salvador (DGII)	A body within the Treasury Department.
Guatemala (SAT)	A decentralized state entity with exclusive jurisdiction throughout the entire territory of the country to exercise tax administration duties as provided by law. It has operational, economic, financial, technical and administrative autonomy, with legal personality and its own capital resources.
Honduras (DEI) ^{1/}	Decentralized entity of the Department of Finance. DEI is autonomous in terms of operational, technical, financial, administrative and national security matters.
Mexico (SAT)	Decentralized body of the Ministry of Finance and Public Credit.
Nicaragua (DGI)	Decentralized body of the Ministry of Finance and Public Credit. It has autonomy in terms of technical administrative and human resources management matters.
Panama (DGI)	Office of the Ministry of Economy and Finance.
Paraguay (SET)	Office of the Treasury Department.
Peru (SUNAT)	Decentralized public institution of the Ministry of Economy and Finance, with legal personality under public law and its own capital resources. It has operational, administrative, economic, financial, budgetary, and technical autonomy.
Dominican Republic (DGII)	Decentralized institution of the Treasury Department.
Uruguay (DGI)	Executory unit under the Ministry of Economy and Finance.

Source: IDB/CAPTAC-DR/CIAT (2012).

1/ At the time of writing this paper, DEI had been terminated and a new unit was about to be created.

Statistical Annex³³

To prepare the tax burden and tax structure series by group of taxes we worked with nominal revenue data (excluding revenues from Social Security contributions) expressed in the legal currency as of the relevant date. For the recent 1990-2014 period, the source of primary information we considered was the CIAT database (CIAT data) which presents amounts net of fiscal refunds (allocated to their respective taxes, in general VAT or IT) and, in some cases, differentiates payment of tax duties by means of fiscal documents. The data for the period were contrasted against information contained in other well-known databases such as those of ECLAC, OECD and the database jointly prepared by OECD, ECLAC, CIAT and IDB (OECD/ECLAC/CIAT/IDB database).

For the 1972-1989 period, we used the values included in the IMF database, Historical Government Finance Statistics (HGFS CD-ROM), whenever available, and these amounts were contrasted against those contained in other recognized historical tax databases such as the Montevideo-Oxford Latin American Economic History Database (MOxLAD) and the statistical compendium “International Historical Statistics 1750-1988” (Mitchell, 1993).

In the cases where official information from 1960 and onwards was obtained, this information was given priority and was also submitted to the relevant TA of each country for validation purposes.

As for GDP, we used nominal data expressed in legal currency as of the relevant date and at current values in all cases. There was official information available for many countries and for some cases long-term backcasted series were considered; however, in most cases we took overlapping series for different reference years always considering the last updated data as valid. When official information was not available, the primary source of information for this variable was the ECLAC database and also the OECD/ECLAC/CIAT/IDB database (which goes as far as 2014) contrasted against IMF information and the MOxLAD database.

The quotient between each variable values was a series of tax burden from 1960 through 2014 with a basic breakdown of the tax structure into four large groups of taxes according to the IMF international classification, except that TFTs were excluded (where applicable) from the property taxes group and, therefore, from the direct taxes subgroup; consequently TFTs were included under the “Other Taxes” category for purposes of maintaining their comparability to the fullest extent possible. This applies in different periods (some no longer effective) for the cases of Argentina, Bolivia, Brazil, Colombia, Ecuador, Honduras, Peru, Dominican Republic and Venezuela.

33 First and foremost, let us thank many specialists in this area for their invaluable contribution, as we would not have been able to gather and validate all the relevant statistics on tax revenues for Latin American countries without their assistance. In this respect, we especially thank Bruno Martorano (Institute of Development Studies, University of Sussex, United Kingdom), Daniel Vega (ECLAC Buenos Aires, Argentina), Stella Maris Pérez (National Directorate for Fiscal Research and Analysis, Ministry of Economy and Public Finances (Dirección Nacional de Investigación y Análisis Fiscal, Ministerio de Economía y Finanzas Públicas), Argentina), Juana Patricia Jiménez Soto (SIN, Bolivia), José Roberto Afonso (Instituto Brasileiro de Economia, Fundação Getúlio Vargas, Brazil), María Bernardita Moraga Armijo (SIN, Chile), Jorge Richard Muñoz Núñez (Ministry of the Treasury (Ministerio de Hacienda), Costa Rica), José Francisco Reyes (DGI, Nicaragua), Jonathan Menkos (ICEFI, Guatemala), Sebastián Carvajal (SRI, Ecuador), Edgar Morales (Ministry of the Treasury (Ministerio de Hacienda), Dominican Republic), Alberto Barreix and Agnes Rojas (IDB, for Uruguay), Gustavo González Amilivia (DGI, Uruguay), Michael Hanni (ECLAC) and our colleagues of the CIAT Tax Studies and Research Network. Nonetheless, any errors or omissions in this paper are solely attributable to the authors.

ARGENTINA

The tax revenues series (net of VAT and export refunds since 1970) was built on the basis of Yearbooks of the National Directorate for Fiscal Research and Analysis, Ministry of Economy and Public Finances (Dirección Nacional de Investigación y Análisis Fiscal, Ministerio de Economía y Finanzas Públicas). Given their relative significance, provincial tax revenues (not municipal revenues because there is no information available) were included in the case of Argentina. However, the relative structure is exclusively for the central government tax revenues as no information disaggregated by type of tax was available for the period under analysis for subnational levels of government. The GDP series was prepared by the authors on the basis of Central Bank (BCRA) and Census Bureau (INDEC) data for the 1960-2002 period, the "Alquimias Económicas" blog from 2003 through 2013 (<http://alquimiaseconomicas.com/2015/02/24/en-busca-del-denominador-perdido>); and INDEC 2014.

BOLIVIA

Tax revenue data were taken from statistical yearbooks published by the National Institute of Statistics (Instituto Nacional de Estadística) for the 1960-1989 period, and from CIATdata for 1990-2014 (revenues net of refunds). The structure was not available for the series of the institute, only for CIATdata; therefore, percentages were calculated for the 1990-2014 period (aggregate amounts of gross revenues were considered but without including payment through fiscal bonds, as it was not possible to allocate payment through fiscal bonds to each tax). For GDP, we used the data provided by the ECLAC database (1960-1962: 1958 baseline; 1963-1987: 1980 baseline; 1988-2014: 1990 baseline (amounts expressed in Bolivian Boliviano millions)).

BRAZIL

Data on tax revenues were taken from papers by Araújo (2001) "Carga Tributária. Evolução Histórica: Uma Tendência Crescente", Araújo (2005) "Análise Das Contribuições Sociais No Brasil", Afonso and Araújo (2000) "Tributação Das Vendas: Evolução Histórica (ou involução?)", Afonso and Araújo (2004) "A carga tributária brasileira: evolução histórica e principais características", updated as of 2014 by Brazilian economist José Roberto Afonso. It does not include tax revenues from Social Security (payroll) such as Previdência Social or FGTS, the disaggregation of which was only obtained from 1970 onwards (the gross tax burden is available as from 1947 but it is not comparable to the rest of the countries). The tax structure is taken from the same sources and refers to the aggregate of the Central Government, the States and the Municipalities. For the GDP series, the numbers calculated by the Instituto Brasileiro de Geografia e Estatística were taken with 2000 as the baseline year. These data should be considered as provisional in the light of the 2010 update of the National Accounts, even though there is still no backcasted series of GDP to 1960.

CHILE

For tax revenues: 1960-1972: Jofre, Lüders & Wagner (2000) "Economía Chilena 1810-1995. Cuentas Fiscales"; 1973-1986: HGFS CD-ROM by IMF; 1987-2014: DIPRES. Estadísticas de las Finanzas Públicas 1987-2014 (net of refunds). Some data were adjusted on the basis of information from the OECD/ECLAC/CIAT/IDB database and validated by SII officials. For GDP data: Chile's Central Bank (spliced series) and the series "Indicadores Económicos y Sociales de Chile" 1960-2000.

COLOMBIA

The tax revenues series for the central government was built on the basis of the following sources: 1960-1971 (gross revenues): Dirección Nacional de Planeación (National Directorate of Planning) - "Estadísticas Históricas de Colombia" (Public Finances); 1972-1989: HGFS CD-ROM by IMF; 1990-2014: CIATdata (revenues net of refunds, charged to each relevant tax). The GDP series was taken from ECLAC (1960-1964: 1958 baseline; 1965-1974: 1975 baseline), while for the 1975-2014 period we used 2005 as the baseline year backcasted by the Departamento Administrativo Nacional de Estadística (National Administrative Department for Statistics) (in billions of pesos).

COSTA RICA

The tax revenues series, together with the structure disaggregated by type of tax, was provided and validated by the División de Política Fiscal de la Dirección General de Hacienda (Fiscal Policy Division of the Treasury General Directorate). GDP data were also provided by the same agency (1960-1982: 1966 baseline; 1983-2011: 1991 baseline; 2012-2014 2012 baseline) and were consistent with those obtained by ECLAC.

ECUADOR

The tax revenues series (1961-1997) mostly derived from Paz and Miño Cepeda (2015) "Historia de los Impuestos en Ecuador", from the "Estadísticas Económicas Históricas 1948-1983" database published by Ecuador's Central Bank (BCE), and from SRI statistics; for 1998-2014: CIATdata (net of refunds). As for GDP, the backcasted series with 2007 as baseline year prepared by BCE was considered and supplemented by ECLAC data. The series is expressed in millions of Sucres from 1960 through 1964 (1975 baseline) and in millions of Dollars from 1965 through 2014 (2007 baseline).

EL SALVADOR

The tax revenues series was built on the basis of HGFS CD-ROM by IMF from 1977 through 1989, and the OECD/ECLACIDB/CIAT database for 1990-2014. The GDP series was obtained from ECLAC: 1960-1969: 1962 baseline; 1970-2013: 1990 baseline; 2014: El Salvador's Central Reserve Bank (Banco Central de Reserva).

GUATEMALA

The tax revenues series was built with data of ICEFI on the basis of statistics published by the Ministerio de Finanzas Públicas (Ministry of Public Finance), SAT, Guatemala's Central Bank (BANGUAT) and the Sistema Integrado de Administración Financiera (Integrated System for Financial Administration). The GDP series was obtained from ECLAC (1960-2000: 1958 baseline; 2001-2013: 2001 baseline) except for 2014 (BANGUAT).

HONDURAS

The tax revenues series was built on the basis of data from: "Estadísticas macroeconómicas 1960-2012" - Consejo Monetario Centroamericano (Central American Monetary Council) for 1960-1971; HGFS CD-ROM by IMF for 1972-1981; 1982-1989: "Memorias SEFIN"; 1990-2014: CIATdata (net of refunds). The GDP series was obtained from ECLAC for the 1960-1999 period (1978 baseline) and Honduras's Central Bank for 2000-2014 (2000 baseline).

MEXICO

The tax revenues series (central government) was built on the basis of data provided by Instituto Nacional de Estadística y Geografía (National Institute for Statistics and Geography - INEGI): "Estadísticas Históricas de México 2014"; for the 1960-1976 period the source was the Secretaría de Hacienda y Crédito Público (Treasury and Public Credit Secretariat - SHCP) - Cuenta de la Hacienda Pública Federal (Federal Treasury Account); for the 1977-2014 period the source was the Dirección General de Planeación Hacendaria (General Directorate of Treasury Planning), an office of SHCP. The GDP series was built upon data provided by ECLAC (1960-1969: 1960 baseline; 1970-79: 1970 baseline; 1980-87: 1980 baseline; 1988-2002: 1993 baseline and 2003-14: 2008 baseline. The amounts were consistent with those issued by INEGI.

NICARAGUA

Tax revenues data for the 1960-1990 period were taken from the Yearbooks of Nicaragua's Central Bank in accordance with Ministerio de Hacienda y Crédito Público (Ministry of the Treasury and Public Credit) (methodology of IMF, 1986), except for year 1979 which was prepared pursuant to HGFS CD-ROM by IMF as there was no official information available; and for the 1991-2014 period, data from CIATdata (net of refunds) was used. The GDP series was obtained from ECLAC (1960-1990: 1980 baseline; 1994-2014: 2006 baseline), all data were consistent with the publications by Nicaragua's Central Bank; for the 1991-1993 period data from the OECD/ECLAC/CIAT/IDB base were taken; these data reestimated official amounts.

PANAMA

The tax revenues series was built on the basis of data provided by ECLAC (year 1960, 1980 Statistical Yearbook); by Public Treasury and Finance Reports published by the General Controller for the Republic of Panama (Contraloría General de la República de Panamá) (1961-1989); CIATdata (1990-1998, revenues net of refunds including payment through fiscal bonds). For the GDP series, ECLAC data were used (1960-1969: 1960 baseline; 1970-1979: 1970 baseline; 1980-1995: 1982 baseline; 1996-2006: 1996 baseline); and also data by National Institute for Statistics and Census Bureau (Instituto Nacional de Estadísticas y Censos) for the 2007-2014 period, 2007 baseline.

PARAGUAY

The tax revenues series was built upon information from HGFS CD-ROM by IMF (1972-1989) and from CIATdata (net of refunds) for the 1990-2014 period. The GDP series was built upon the basis of ECLAC (1960-1990: 1982 baseline; 1991-2012: 1994 baseline), supplemented by data issued by Paraguay's Central Bank for 2013 and 2014 (1994 baseline).

PERU

The tax revenues series was built on the basis of several different sources: Peru's Statistical Compendium 1900-1990 (1960-1969); Peru's Central Reserve Bank (BCRP) for 1970-89 (1970-79: thousands of Intis; 1980-1987: Nuevos Soles; 1988-89: thousands of Nuevos Soles). These aggregate amounts issued by BCRP are exclusive of amounts on account of certificated securities. For the most recent period (1990-2014) we used the CIATdata base (revenues net of refunds) in millions of Nuevos Soles. As there was no disaggregated information available, we charged the aggregate amount of fiscal refunds to IGV (similar to VAT) between 1970 and 1997 (assumed). As from 1998, refunds were appropriately charged to IT and VAT and as from 2010 to selective excise taxes and other duties (customs). The GDP source was BCRP (expressed in millions of Nuevos Soles).

DOMINICAN REPUBLIC

The tax revenues series for the whole 1960-2014 period was taken from information provided by the State Secretariat for Finance (Secretaría de Estado de Finanzas) and Journals of the Dominican Republic Central Bank, National Government's Statements of Fiscal Operations (Estados de Operaciones Fiscales del Gobierno Nacional) (cash flow). The GDP series was built on ECLAC data (1960-1969: 1962 baseline; 1970-1991: 1970 baseline) and Central Bank data: 1992-2006 1991 baseline and 2007-2014 2007 baseline.

URUGUAY

The tax revenues series was built upon the basis of data issued by IDB's Division of Fiscal and Municipal Management for the 1966-1989 period and CIATdata (net of refunds, all allocated to assumed VAT) for the 1990-2014 period. With regard to GDP, the series was built upon the data provided by ECLAC (1960-1969: 1961 baseline; 1970-1982: 1978 baseline) and by Uruguay's Central Bank, for 1983-2004: 1983 baseline and for 2005-2013: 2005 baseline (data as from 1988 are not comparable to previous years).

VENEZUELA

The tax revenues series was built upon data provided by Statistical Tables published in the journal issued by Venezuela's Central Bank (BCV): 1960-1971; HGFS CD-ROM by IMF for 1972-1989 (matching BCV data); 1990-2013: CIATdata (net of refunds); 2014: OECD/ECLAC/CIAT/IDB database (amounts estimated by ECLAC). For the GDP series we used ECLAC data (matching BCV data), 1960-1967: 1957 baseline; 1968-1983: 1968 baseline; 1984-1996: 1984 baseline; 1997-2014: 1997 baseline.

**Table 7: Central Government³⁴ Tax Revenues as percentages of GDP
(Social Security Contributions not included) 1960-1979 period**

Countries	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Argentina 1/	10,55	10,77	10,18	11,05	9,42	10,50	12,39	13,92	14,01	13,83	14,41	12,06	10,88	11,04	12,88	7,53	9,73	12,90	12,74	11,82
Bolivia	5,94	6,95	7,89	8,16	8,57	8,72	9,40	8,78	8,84	8,62	9,43	8,24	6,82	7,56	9,89	10,57	9,84	9,65	8,92	8,39
Brazil 2/	...	...	...	...	...	...	...	...	...	...	20,30	19,57	20,13	18,90	19,08	18,53	18,44	18,63	18,51	17,58
Chile	13,24	14,03	13,81	12,65	12,59	14,97	14,19	14,66	14,96	14,91	15,36	18,43	16,57	17,84	16,61	20,96	18,77	19,14	19,01	18,27
Colombia	7,21	6,53	5,70	6,91	7,46	6,91	8,42	8,21	8,74	9,65	9,48	10,29	8,23	8,31	8,10	9,62	9,25	8,81	9,06	8,63
Costa Rica	11,12	9,63	11,41	10,43	11,27	11,09	11,11	10,74	11,19	11,63	12,36	11,80	11,52	12,43	13,71	12,55	12,20	12,45	12,59	11,59
Ecuador	8,14	8,31	7,63	8,20	9,35	12,09	11,69	12,35	8,24	8,03	10,07	10,59	11,50	11,58	9,45	8,86	8,48	8,78	9,44	8,71
El Salvador	...	...	...	...	...	...	...	...	...	...	...	...	9,62	10,64	11,09	11,69	13,36	15,50	12,59	13,50
Guatemala	7,69	7,28	6,53	6,54	7,12	8,11	7,75	7,58	7,62	7,83	7,76	7,78	7,79	7,47	8,06	8,25	8,48	10,16	10,23	9,00
Honduras	10,46	10,06	9,69	8,79	9,19	9,61	9,90	9,73	10,36	10,30	11,42	11,04	10,67	10,83	11,12	11,09	11,66	13,09	12,68	12,81
Mexico	6,77	6,70	6,84	7,13	7,62	6,99	7,68	8,11	8,37	8,55	8,25	8,15	8,57	8,91	9,78	11,25	10,97	10,69	11,10	11,32
Nicaragua	9,31	9,20	9,32	10,23	9,49	10,20	9,93	9,53	8,72	8,44	9,45	9,80	9,89	10,94	10,86	10,55	10,70	10,68	10,22	10,56
Panama	10,82	10,27	10,72	9,83	10,01	10,56	10,87	10,89	10,68	11,00	12,69	12,53	12,33	12,00	12,78	12,31	11,41	13,54	13,05	14,07
Paraguay	...	...	...	...	...	...	...	...	...	...	...	...	8,63	8,34	8,98	8,57	8,35	9,25	9,91	9,46
Peru	7,58	8,49	7,04	8,89	9,53	10,38	10,94	14,65	14,35	14,07	14,27	13,75	13,52	13,26	13,58	14,65	13,55	13,74	15,13	16,24
Dominican Republic	14,73	12,52	13,28	14,07	14,42	10,79	12,98	13,77	14,58	14,66	14,76	14,97	14,03	13,63	14,57	16,10	13,26	12,53	11,34	11,03
Uruguay	...	...	...	...	...	...	8,70	8,26	11,00	10,28	12,20	11,34	11,10	12,75	12,01	11,68	12,74	13,87	13,21	13,13
Venezuela	12,46	12,80	13,74	14,38	12,23	11,67	12,34	13,02	12,55	11,91	11,81	14,47	14,40	16,47	28,72	25,81	22,17	20,09	17,83	18,63
LA average-18	9,72	9,54	9,56	9,80	9,88	10,18	10,55	10,95	10,95	10,91	12,13	12,17	11,46	11,83	12,85	12,81	12,41	12,97	12,64	12,49

1/ Given their relevance, tax revenues of the provinces are included (not of municipalities because there is no information available).

2/ Given their relevance, this also includes tax revenues of the states and municipalities.

34 Except for Argentina and Brazil, where subnational government tax revenues are included (whenever available).

Table 7: Central Government Tax Revenues as percentages of GDP (Social Security Contributions not included) 1980-1999 period (Continued)

Countries	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Argentina 1/	12,89	12,97	11,17	9,97	9,95	13,55	13,77	12,31	11,30	12,41	12,06	13,73	16,07	16,05	16,06	15,52	15,79	16,83	17,35	17,62
Bolivia	7,27	6,69	3,80	2,60	2,14	2,13	3,92	6,36	7,82	8,13	8,04	8,98	10,80	11,73	12,15	12,31	11,94	11,95	12,64	11,83
Brazil 2/	18,56	18,82	18,77	20,07	18,23	18,22	19,59	17,88	17,14	18,09	22,22	19,58	19,32	19,34	23,16	21,07	20,68	21,33	21,19	22,71
Chile	19,34	20,33	19,94	19,12	20,34	18,42	18,29	17,11	14,63	14,18	13,50	15,46	15,93	16,44	15,73	15,20	16,23	15,94	15,85	15,16
Colombia	8,58	8,06	8,01	7,30	7,45	8,48	8,79	9,34	9,09	9,04	8,24	9,27	9,73	9,94	9,90	9,37	9,58	10,05	9,62	9,55
Costa Rica	11,29	12,14	12,60	12,16	12,05	11,10	11,56	11,17	10,59	10,75	10,58	11,01	11,59	11,29	11,74	11,35	11,87	12,05	12,13	11,55
Ecuador	7,80	7,31	6,20	6,30	7,07	7,53	9,07	8,85	8,41	8,70	7,82	7,91	7,25	7,60	8,00	8,76	7,20	7,03	7,26	8,74
El Salvador	11,07	11,66	10,94	11,13	12,36	12,66	15,32	12,36	10,72	8,83	9,13	9,53	9,64	10,30	10,43	11,19	10,48	10,16	10,07	10,23
Guatemala	8,61	7,57	7,18	6,33	5,26	6,08	7,02	8,08	8,73	7,78	6,89	8,16	8,41	8,10	6,93	7,94	8,71	8,75	8,72	9,35
Honduras	13,63	12,40	12,32	11,55	13,28	13,54	13,12	13,52	12,79	12,54	14,69	15,50	15,98	15,58	14,84	16,26	14,66	14,11	17,00	17,81
Mexico	10,85	10,56	9,87	10,28	10,35	10,26	11,34	10,77	11,38	11,14	10,73	10,71	11,26	11,40	11,29	9,27	8,95	9,83	10,51	11,35
Nicaragua	19,83	21,45	22,59	28,45	32,35	29,37	29,23	26,20	19,44	21,70	13,92	8,38	9,13	8,82	9,17	9,33	9,49	10,59	11,03	10,72
Panama	13,30	13,49	12,90	13,53	12,43	12,75	13,42	14,01	9,09	8,39	11,50	12,16	12,21	11,68	11,66	12,18	10,54	10,64	10,33	10,85
Paraguay	8,63	7,81	8,51	6,42	6,68	7,14	7,01	7,41	7,22	8,84	8,95	7,76	7,83	8,10	9,83	11,13	10,30	10,30	10,13	9,15
Peru	18,59	15,52	15,20	12,24	13,40	15,59	13,95	10,45	10,19	8,38	11,01	11,31	12,42	12,14	12,98	13,48	13,91	14,11	14,14	13,43
Dominican Republic	10,30	9,72	8,00	8,49	9,05	9,73	11,33	11,25	12,23	12,50	10,51	9,28	10,86	11,17	10,56	10,84	10,52	11,79	11,82	12,09
Uruguay	15,16	15,21	13,37	13,34	13,07	14,88	15,61	16,02	15,08	14,13	14,94	15,49	16,11	15,92	15,99	15,62	16,24	15,45	15,59	15,12
Venezuela	20,97	29,07	22,21	21,44	20,55	22,33	17,24	16,93	15,38	14,50	17,18	17,57	13,07	12,97	14,43	13,49	14,84	19,46	13,75	13,72
LA average-18	13,15	13,38	12,42	12,26	12,56	12,99	13,31	12,78	11,74	11,67	11,77	11,77	12,09	12,14	12,49	12,46	12,33	12,80	12,73	12,83

1/ Given their relevance, tax revenues of the provinces are included (not of municipalities because there is no information available).

2/ Given their relevance, this also includes tax revenues of the states and municipalities.

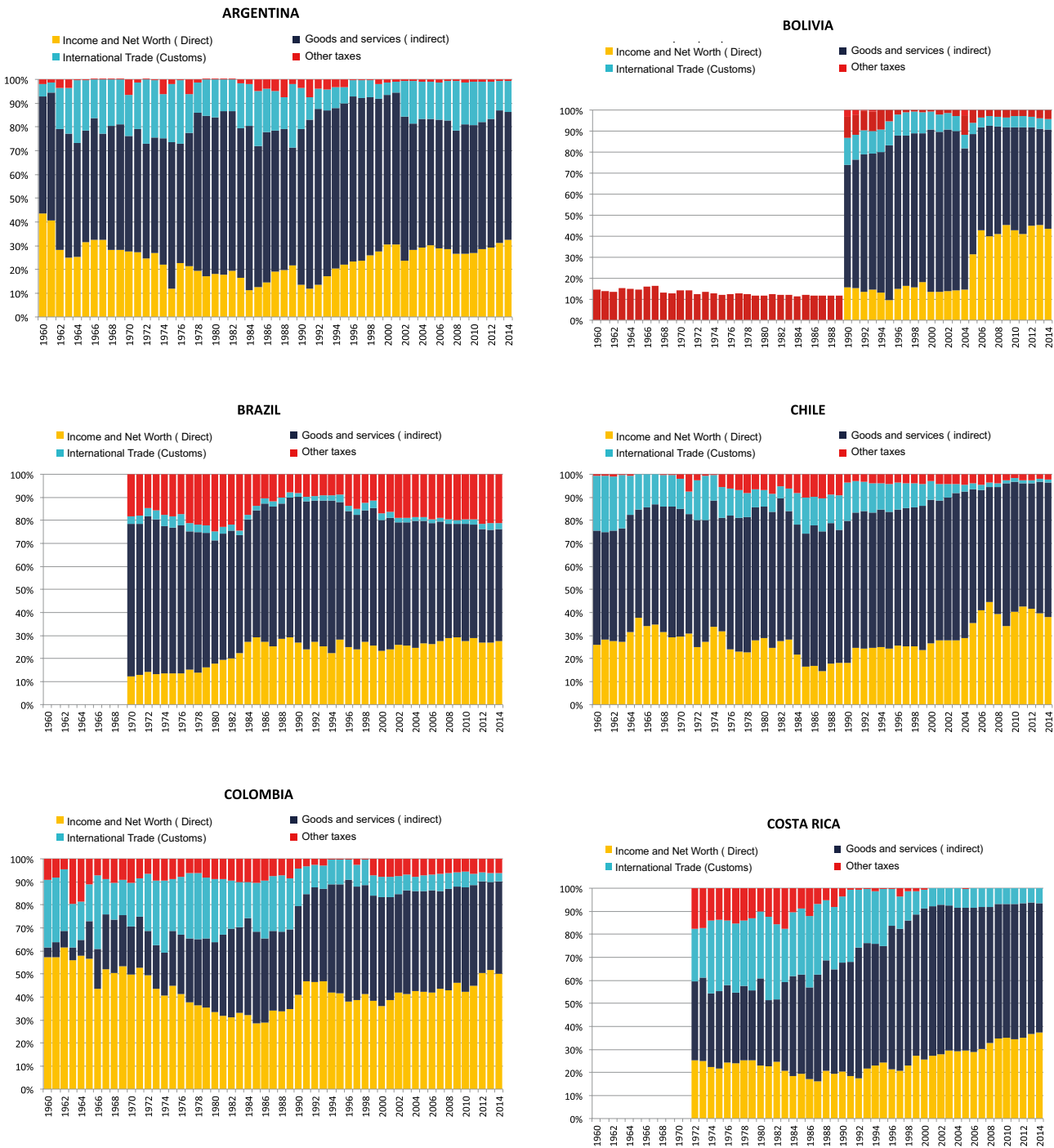
Table 7: Central Government Tax Revenues as percentages of GDP (Social Security Contributions not included) 1980-1999 period (Continued)

Countries	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Argentina 1/	18,09	17,71	17,08	20,60	23,32	23,59	23,65	22,69	23,42	22,77	22,87	23,04	23,06	22,97	25,24
Bolivia	13,51	11,87	13,18	12,07	14,34	17,92	20,74	21,55	20,30	22,81	21,38	22,43	22,76	25,34	25,32
Brazil 2/	24,20	25,16	26,41	25,75	26,56	27,53	27,10	27,21	27,44	25,55	25,62	26,31	26,13	25,83	25,35
Chile	15,72	16,05	15,95	15,42	15,05	16,24	16,12	17,88	17,55	13,84	15,84	17,39	17,65	16,75	16,64
Colombia	10,00	11,58	11,56	11,78	12,14	12,43	13,36	13,42	13,40	12,92	12,26	13,52	14,32	14,20	14,34
Costa Rica	11,90	12,82	12,84	12,98	12,99	13,27	13,70	14,92	15,34	13,43	13,05	13,28	12,87	13,29	13,19
Ecuador	10,99	11,34	11,22	10,37	10,40	11,02	11,23	11,70	11,54	12,41	13,07	12,47	13,98	14,58	14,53
El Salvador	10,23	10,49	11,15	11,36	11,32	12,28	13,41	13,55	13,47	12,63	13,51	13,86	14,44	15,35	14,92
Guatemala	9,20	10,64	11,64	11,36	11,28	10,94	11,56	11,74	10,86	10,14	10,23	10,55	10,58	10,75	10,66
Honduras	13,80	13,82	13,77	13,84	14,49	14,53	15,24	16,39	16,13	14,16	14,43	14,79	14,75	15,07	16,75
Mexico	10,59	11,27	11,63	9,98	8,85	8,60	8,46	8,80	8,11	9,36	9,50	8,91	8,43	9,69	10,60
Nicaragua	10,40	9,67	10,37	11,66	12,14	12,90	13,59	13,75	13,17	12,94	13,61	14,43	14,98	15,16	15,39
Panama	10,61	9,68	9,54	9,61	9,47	9,55	11,32	10,92	10,66	10,90	11,41	10,77	11,76	11,22	10,23
Paraguay	9,32	9,02	8,02	8,75	10,24	10,15	10,45	10,10	10,50	11,55	11,99	12,53	12,71	11,78	12,63
Peru	12,96	12,88	12,65	13,43	13,68	14,40	15,92	16,38	16,40	14,42	15,37	16,09	16,55	16,39	16,58
Dominican Republic	12,42	13,83	13,64	11,95	12,89	14,55	14,84	14,92	14,20	12,68	12,23	12,25	13,07	13,83	14,06
Uruguay	15,22	15,63	15,84	17,45	18,13	18,18	19,29	18,92	19,13	18,54	18,76	18,83	18,65	18,85	18,27
Venezuela	13,72	12,33	11,28	11,58	13,03	15,51	16,54	16,43	16,42	13,62	11,10	12,41	13,41	13,47	17,33
LA average-18	12,94	13,10	13,21	13,33	13,91	14,64	15,36	15,63	15,45	14,70	14,79	15,21	15,56	15,81	16,22

1/ Given their relevance, tax revenues of the provinces are included (not of municipalities because there is no information available).

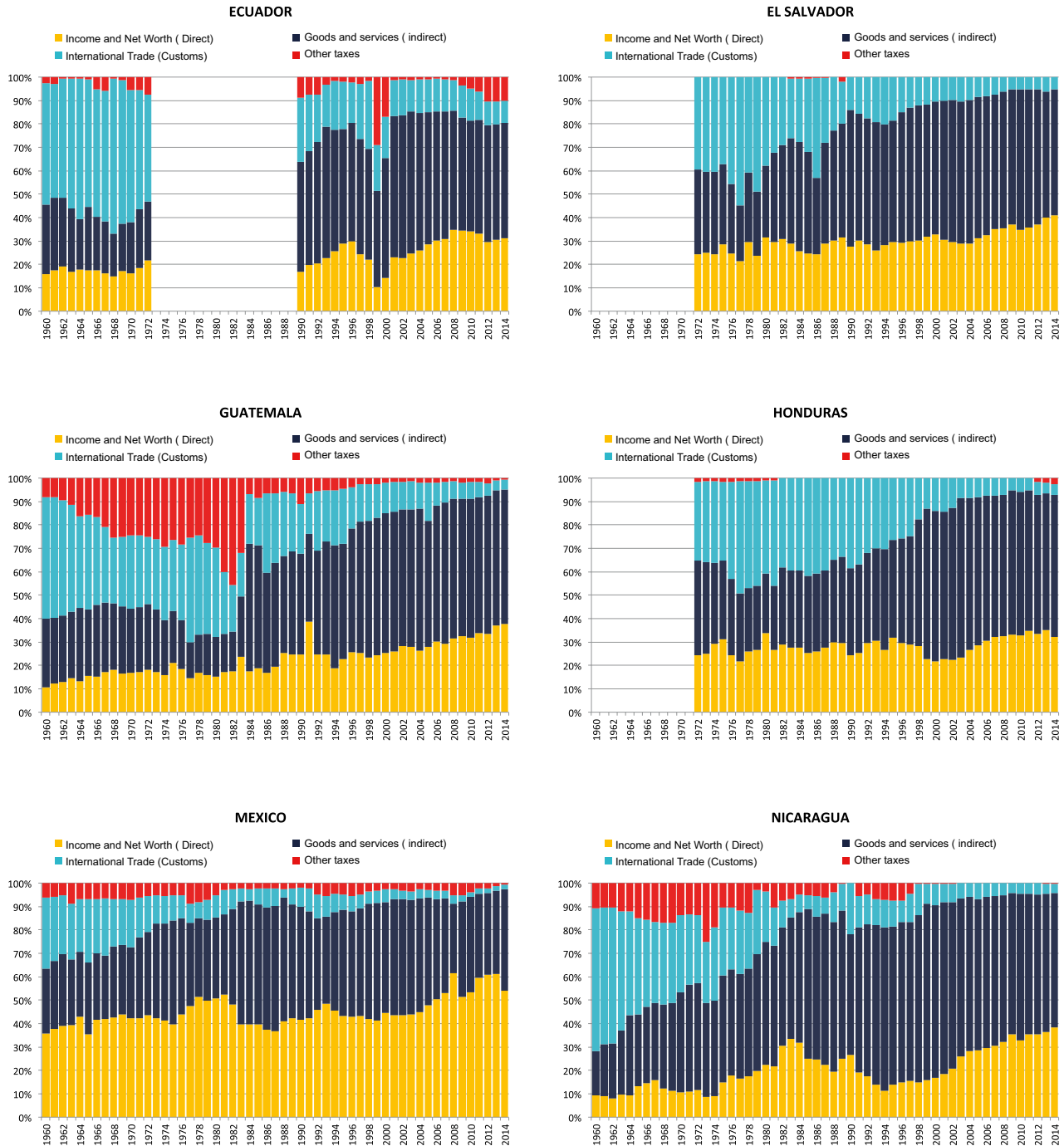
2/ Given their relevance, this also includes tax revenues of the states and municipalities.

Chart 5: Tax structure in Latin American countries
(In % of total net revenue, excluding social security contributions)



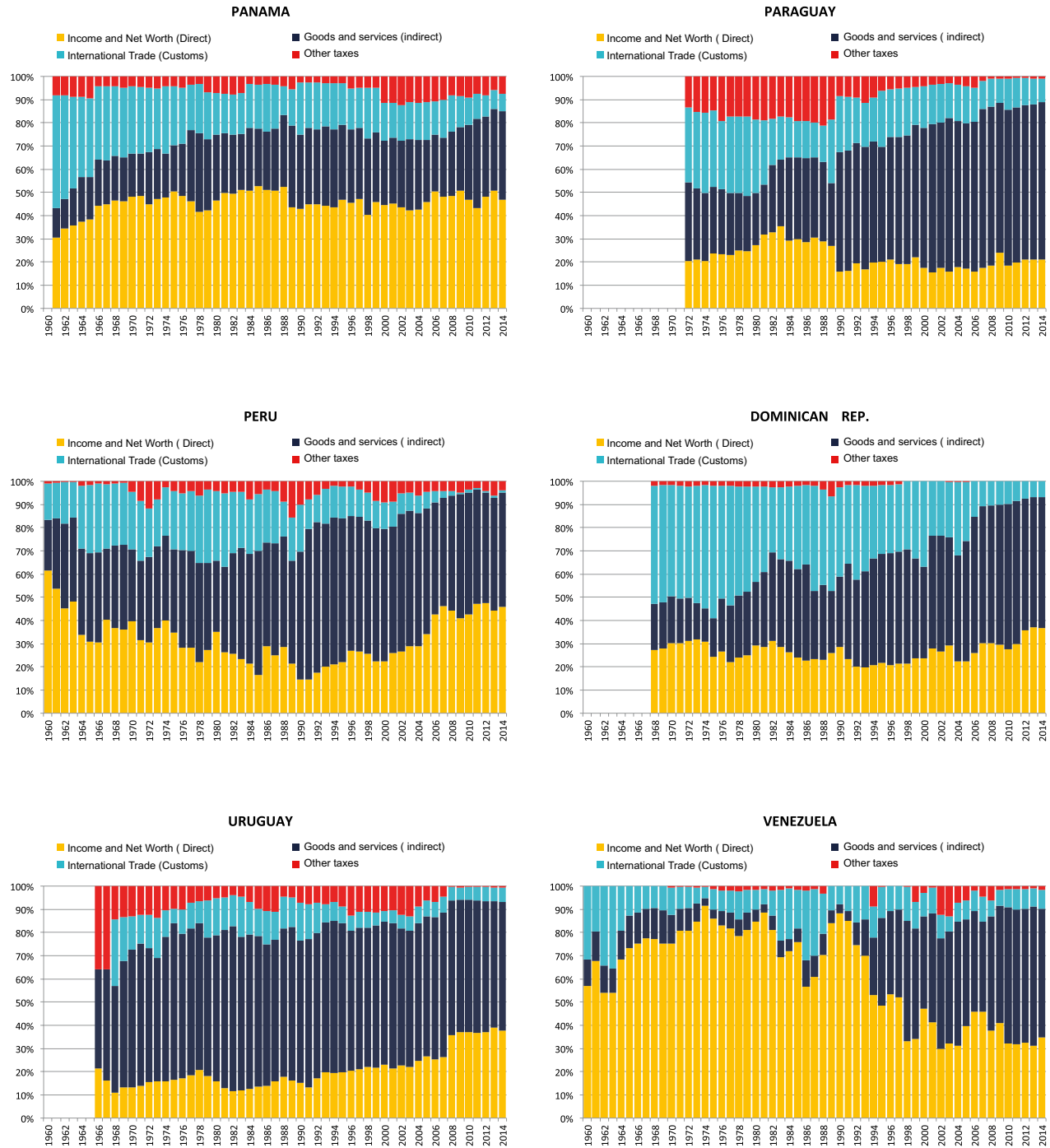
Note: In **Argentina**, the relative structure is for tax revenues received by the central government even if tax burden amounts presented include receipts by the provinces for which there was no information disaggregated by type of tax in the period under analysis. This criterion was also applied for the rest of the countries except for Brazil, where the tax structure refers to the aggregate amounts of the Central Government, the States and the Municipalities. In **Brazil**, direct taxes have included property taxes only since 1980 (for the 1970-79 period, they are accounted for under “Other Taxes”) due to unavailable prior disaggregated (IPTU and ITR) information. In **Colombia**, the Contribución Empresarial para la Equidad (Business Contribution to Equity) has been included under direct taxes since 2012.

Chart 5: Tax Structure in Latin American Countries
 (In % of total net revenue, excluding social security contributions) (Continued)

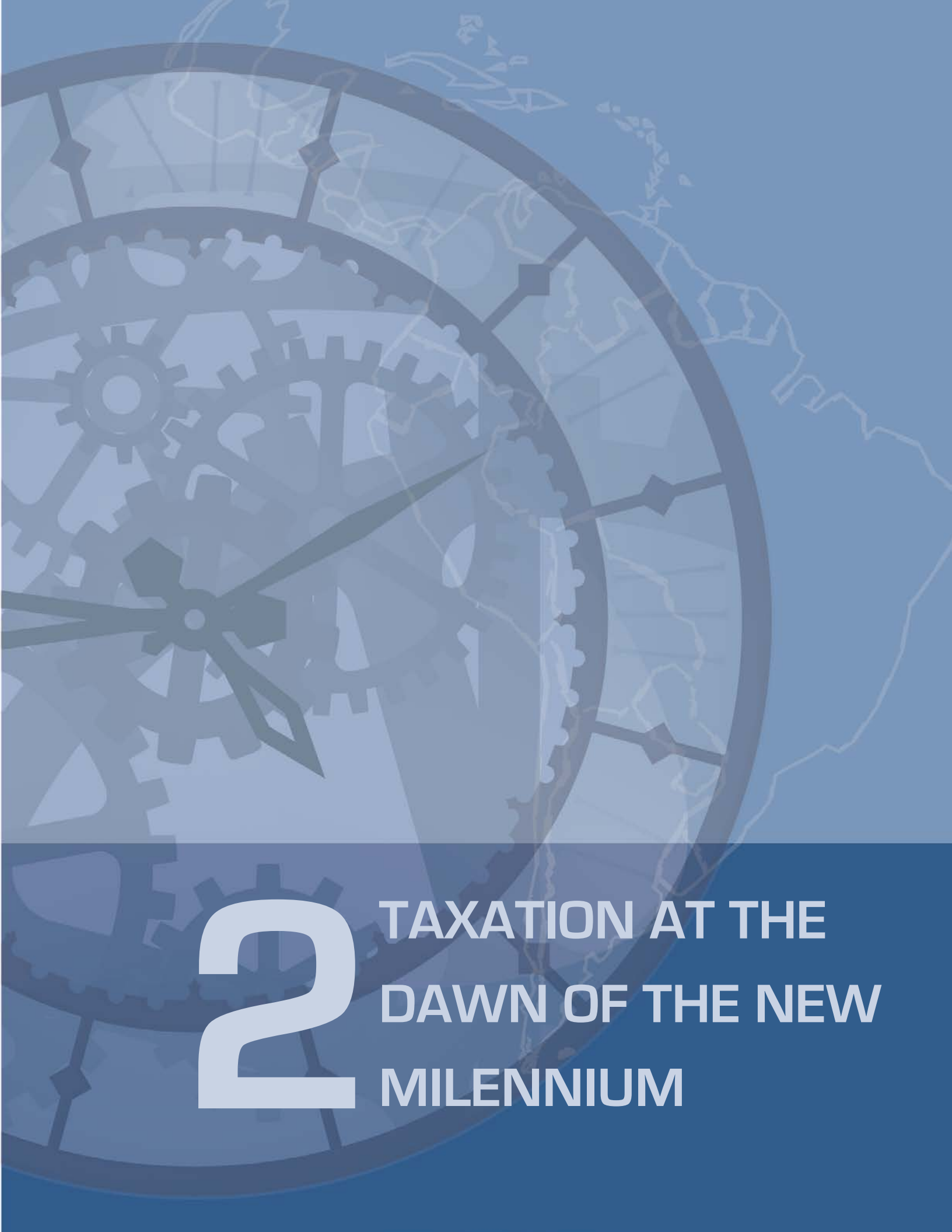


Note: There is no information presented for **Ecuador** between 1972 and 1989 because the IMF database includes revenues from oil companies as payment of corporate income tax, and this makes the tax structure biased and inconsistent with the compiled series. Also, indirect taxes on goods and services include Production and Sales, Transportation and Communication, and Stamp taxes from 1960 through 1972. In **Guatemala**, the weight of “Other Taxes” in the 70s and the 80s is explained by the stamp tax and stamped paper tax (sales and others). In **Nicaragua**, direct taxes include property taxes only as from 1980.

Chart 5: Tax Structure in Latin American Countries
 (In % of total net revenue, excluding social security contributions) (Continued)



Note: In Peru, the total amount of fiscal refunds was charged to IGV (similar to VAT) between 1970 and 1997 due to unavailable disaggregated information. As from 1998, refunds were appropriately charged to IT and VAT and as from 2010 refunds were charged to selective excise taxes and other duties such as customs. In Venezuela, the weight of direct taxes until the mid-1990s may be explained by revenues on account of IT paid by oil companies.



2

TAXATION AT THE DAWN OF THE NEW MILLENNIUM

2

TAXATION AT THE DAWN OF THE NEW MILLENNIUM

Juan C. Gómez Sabaini¹

Over the 1980s, Latin American economies suffered severe macroeconomic difficulties caused by adverse changes in external conditions that translated into excessive indebtedness and decrease in external revenues and activity levels, all combined with a series of sharp inflationary processes. Within this framework, the ideas of the Washington Consensus forced an amendment of the main purposes that guided tax policy in the subsequent years.

Emphasis was, essentially, on gaining efficiency and horizontal and attracting new resources. In this respect, governments of the region promoted a strong reduction of tax rates on international trade, VAT generalization, decrease in the level and number of IT rates both personal and corporate, significant cut down of taxes applied and continued efforts to streamline TAs and control evasion, though not always successfully.

At the beginning of the 1990s, Latin American countries managed to rebuild domestic macroeconomic conditions, principally through successful anti-inflationary programs. Structural reforms introduced in those years were, in addition, directed, in general, to implement market reforms and deepen financial and trade openness of economies. Even if this allowed for renewed positive growth rates in most of the countries, the diverse variants of monetary anchors resulted in a highly rigid context for economic policy. In fact, the second half of the 1990s saw a marked vulnerability of the external sector and volatility in activity levels evidenced by successive financial crises: first, the Mexican crisis (December 1994) and then several episodes that broke out over the second semester of 1997 in many Asian countries and which continued up until 2001 almost uninterruptedly (ECLAC, 2013).

In the area of taxes, still under the influence of neoliberal theories, as of mid-1990s a new stage of Latin American taxation commenced –which was subsequently reinforced as of 2002-2003– which showed an upward trend in the level of tax revenue as percentage of GDP in the region.

According to ECLAC data, average tax burden for the 18 countries of the region grew from 13.3% of GDP in 1990 to 15.0% in 1995, to 15.6% in 1998, to 16.1% in 2001 and to 16.9% in 2004. This accounts for a growth of approximately 27% over 15 years despite the fact that, as mentioned above, the countries had to face

¹ The author would like to thank the cooperation of Dalmiro Morán in the preparation of this document. However, the views expressed in this document are those of the author and do not necessarily reflect the views of CIAT.

a series of considerable internal and external crises that certainly affected their capacity to generate additional fiscal revenues.

This positive evolution includes cases where the increase was notable such as Argentina, where tax burden grew from 12.4% to 22.0% of GDP from 1990 through 2004, Bolivia, with a similar growth from 7.0% to 14.3% of GDP throughout the same period, Colombia and Paraguay where tax revenues increased from 9.0% to 17.5% and from 5.4% to 13.1%, respectively. Brazil, whose tax burden was 28.2% of GDP in 1990, also sustained significant growth to 32.1% of GDP in 2004 (OECD/ECLAC/CIAT/IDB, 2015).

Note that, despite the general trend in most countries of Latin America, some countries were unable to achieve a satisfactory performance. For instance, in Honduras or Panama, the level of tax resources as percentage of GDP registered almost no variation in the 1990-2004 period (in Honduras, there was an increase from 16.2% to 17.0% and in Panama, the percentage remained at 14.7%); meanwhile, in Venezuela, an exception in the region, tax burden decreased from 18.7% of GDP in 1990 to 13.3% in 2004. And Guatemala maintained its low level of levies all through the years at around 10% of GDP.

As regards the composition of tax revenue, throughout the 1995-2004 period certain general trends were emphasized and consolidated whose origins date back to the beginning of the 1990s and even the 1980s. In the face of the decline of selective taxes and taxes on international trade, the countries showed a clear decision to strengthen broad-based domestic levies such as VAT and IT which thus became the pillars of the tax structures in most countries of the region.

In the case of VAT, a widened taxable base and increased rates allowed for large revenues which, in many cases, reached levels similar to those of OECD developed countries. As for IT, its increased relative share resulted from higher corporate levies, contrary to personal taxes which continued to be, for several years, the principal weakness of the tax systems in Latin America at least in terms of distribution (GómezSabaini and Morán, 2014). In some countries, there was a third tax pillar: tax resources from social security contribution systems; however, the series of structural reforms implemented in several countries in the 1990s, as will be discussed below, strongly restricted its role as a source of financing for the States.

Despite these general trends, tax policy measures over the 1995-2004 period were governed and limited by two well differentiated macroeconomic contexts encountered over the 1995-2001 and 2002-2004 periods. Simplified regimes were first introduced over the 1995-2001 period for small taxpayers as a response to the difficulties derived from high informal employment. Also throughout this period, the first regulations in the field of international taxation were applied given the growth of operations by multinational companies in the countries of the region; and TFT as a rapid response to the financial needs of certain governments.

However, from 2002 onwards, a different international context –with an accelerated expansion of several emerging economies and a rapid rise in the price of commodities exported by various Latin American countries– favoured progress in the reformulation of fiscal schemes applied to exploitation of non-renewable natural resources, and this enabled to repair public accounts and to finance an increase in social public spending and in the level of activity in general.

Meanwhile, several structural reforms, such as the modification introduced to pension systems, were adopted all through the period and demand for a more global analysis from their commencement in the early 1990s. The changes in the paradigms of the TAs observed throughout those years further require a wider discussion. Below, there is a brief analysis of these characteristic elements of taxation

in Latin American countries over the 1995-2004 period, which, in addition, show the significant heterogeneity of the region.

a. TFT: Purposes, Outcomes and Challenges of an Heterodox Tax Policy

Over the past decades, Latin American tax policy has been characterized by attempts to make up for the deficiencies in the tax burden level by creating unconventional levies to obtain additional tax revenues to finance the increasing needs of public expenditure. TFTs are an example of this trend that focuses on collection and administration above any other purpose, disregarding the adverse impact of these instruments on the tax systems efficiency and equity, particularly in countries where the capacity of the TA is limited.

On the one side, as one of the advantages all TFTs allow for simpler administration compared to traditional taxation, thus giving place to fewer opportunities for evasion or avoidance. Administration of this kind of tax is simple because it may be introduced rapidly since it is based on a simple withholding operation by financial intermediaries and requires little preparatory work and no cooperation by the taxpayer. It has also been suggested that TFTs are usually able to indirectly capture income that eludes the traditional tax system. Additionally, in certain cases, these taxes have proven to be useful instruments to contribute large shares of revenues, at least in the short-term (Coelho, 2009).

Nonetheless, these unconventional types of tax are often subject to objections arising, for instance, out of their negative impact on resource allocation. On the production side, they promote vertical integration (intra-firm transactions to avoid paying the tax) and affect international competitiveness as they increase the cost of exports. On the consumption side, they increase the relative price of goods with multiple production phases or that require a faster turnover of financial resources. These taxes further discourage economy bancarization that ultimately translates into an increase of the informal sector and, consequently, less effective revenue from the rest of the taxes. Moreover, these taxes bear different distributive implications that should also be considered at the time of their actual application.

While it is true that the oldest of these taxes in Latin America dates back to 1976 (*Impuesto de Emergencia sobre los Débitos Bancarios* in Argentina), TFTs were largely spread as from the 1990s, especially in countries of developing areas. Throughout that decade and for variable periods, a considerable number of countries of the region applied taxes of this type: Argentina (1983-1992, 2001 onwards), Brazil (1993-94, 1997-2007), Colombia (1998 onwards), Ecuador (1999-2000), Peru (1989-1992, 2004 onwards), Venezuela (1994, 1999-2000, 2002-08) and, more recently, Bolivia (2004 onwards), the Dominican Republic (2004 onwards) and Honduras (2011 onwards).

Argentina stands among the countries that have maintained application of this kind of tax. There, the *Impuesto a los Débitos y Créditos en Cuenta Corriente* (with a 0.6% rate on each operation) has shown an acceptable yield contributing a share of tax revenues of approximately 2% of GDP in the past years and that, in 2012, accounted for more than 5% of the total tax burden of the country. In Colombia, the TFT (*Gravamen a los Movimientos Financieros*) is quite relevant for the current tax structure and, in 2012, contributed resources for 0.83% of GDP and 4.24% of total revenues. Nonetheless, a process for gradually reducing this tax rate has been recently considered for the purposes of completely abolishing the levy in the next few years.

At least up until they were abolished, TFTs were very productive in Brazil and Venezuela: in the first case, the Provisional Contribution on Financial Movements raised tax receipts equal to 1.4% of GDP or 5.8% of the total revenue throughout the last year of application (2007); in the second case, the TFT reported tax revenues for 0.9% of GDP and 7% of the tax burden in 2008. In all these cases, the high productivity of these taxes, with very low rates, is closely related to the degree of bancarization of the economy where the tax was applied.

All in all, the data show that the revenue generated, although limited and generally decreasing over time, has contributed to the recovery of tax resources in times of fiscal crisis and even exceeded the proceeds from other taxes. Besides, TFT opened the door for the potential use of the associated bank information in tax enforcement, in particular regarding VAT and IT (Pecho Trigueros, 2013).

b. Simplified Tax Regimes for Small Taxpayers: Purposes, Technical Alternatives and Identified Problems for Application

The design of special regimes to levy small taxpayers, whether individuals or businesses, based on excluding them from the general rules governing the main taxes, establishing presumptive methods for determining their contribution capacity and taxing these taxpayers at lower rates, has been one of the main roads followed by Latin American countries to “lighten” the work load of their tax administration systems and improve their oversight and auditing capacities and generate incentives for employment and economy formalization.

Implementation of these regimes in most countries of Latin America has been intended to make payment of taxes easier for taxpayers who, in general, mean: (i) low income level; (ii) large number of cases making official control more difficult, (iii) mostly informal, (iv) poor organizational structure and (v) high in and out mobility. Thus, the purpose is to simplify legal rules, proceedings and administrative costs relative or inherent to tax compliance, favouring entry of economic agents to the formal economy by improving the management of available resources.

In Latin America, simplified taxation regimes are widespread. In fact, except for El Salvador and Venezuela, all the countries of the region have introduced some sort of differential tax regime for small taxpayers. In certain cases, several regimes are even applied simultaneously such as in Argentina, Bolivia, Brazil, Chile, Mexico, Paraguay, Peru, Dominican Republic and Uruguay.

Simplified tax regimes have been introduced and developed quite recently. Even if there were two historical prior cases, Colombia (*Régimen Simplificado del Impuesto sobre las Ventas* of 1983) and Guatemala (*Régimen de Pequeño Contribuyente* of 1992), a first wave of simplified regimes was seen in the second half of the 1990s with Brazil (1996), Bolivia ((1996-97), Costa Rica (1996) and Argentina (1998). Between 2003 and 2004, Honduras, Mexico, Nicaragua and Peru joined the group of countries already applying these special schemes, and yet another considerable group (Chile and Uruguay, among others) did so between 2007 and 2009.

The simplified schemes of the region are fundamentally applied to individuals conducting economic activities, but in certain cases they are extensive to some specific type of businesses such as in Brazil, Costa Rica, Chile, Mexico, Panama and Peru. Most of these regimes provide for voluntary adhesion and self-categorization and are addressed mainly to the trade and service sectors.²

² In some cases, these regimes also apply to other sectors, such as manufacturing, agricultural and passenger transportation. For instance, Argentina applies a simplified regime exclusively for small agricultural producers and another regime for domestic household staff. In Bolivia, the Integrated Tax System is exclusively applied to urban, inter-provincial and inter-state passenger or cargo transportation.

Application of these regimes generally involves substituting for some tax applied under the tax system in force in each country, and in the region, it is generally VAT, IT or both simultaneously. In Chile, Colombia, Honduras, Panama and Paraguay the payment of only one of these tax duties is replaced, while in the rest of the countries these taxes have been jointly substituted for (Ecuador, Peru, Costa Rica) and in yet other cases, such as Bolivia, other additional taxes have been replaced as well. Then, there are simplified regimes with a structure that also includes social security contributions or tax resources, as in Argentina, Brazil and Uruguay, certainly an interesting case (Cetrángolo et al., 2014).

With regard to the tax revenues generated by these regimes, the country that has registered the highest revenue upon application of simplified schemes is Brazil with *SIMPLES Nacional*, close to 1% of GDP and close to 3.0% of the total revenue between 2010 and 2012. Argentina, by means of *Monotributo*, also exceeds the regional average of tax revenue (0.3% of GDP and 1.2% of the total revenue). In the remaining countries of the region, tax revenue from simplified taxation upon small taxpayers is visibly reduced and seems to have remained unaltered all through the past years (Pecho Trigueros, 2012).

Nonetheless, evolution of simplified regimes over time has carried a change in the understanding of the schemes and the purposes for which they are intended. It is well known that the potential revenue from this segment of taxpayers is considerably low, so countries should, at the time of designing these instruments, focus on the primary purpose of bringing employees and small businesses into the formal economy, so as to ensure they access social benefits which are essential for lower income sectors of the community, and in addition establish rules required to control taxation on suppliers.

As these regimes offer conditions favourable to attract lower income sectors, we see that they may as such become an incentive to remain indefinitely within the special regime, even if the taxpayer qualifies to pay taxes under the general taxation system. Thus, application of this special taxation treatment might ultimately be counterproductive with regard to tax revenues (if taxpayers can reduce their tax burden compared to the general regime), economic efficiency (if the regime motivates “fiscal dwarfism” in the businesses) and distributive equity (if the regime gives legal advantages to taxpayers who abuse of the benefits provided under the simplified scheme).

In such countries where they are applied, these instruments should be conceived as a “temporary bridge” between tax regimes specially designed for informal sectors and voluntary compliance with general taxation rules, limiting the requirements and benefits granted, attaining a steady reduction in the duration of the taxpayers’ participation in these systems and ultimately tending towards their exit from the program in the long term given that a broad general regime better respects the conditions of equity and tax neutrality.

c. Changes and Reforms in the Paradigms of Tax Administration

The structural changes in the economy that began after the Second World War, albeit with different intensity and scope over time in the countries of Latin America, have had substantive consequences for the current role of the TAs.

At first, the countries of the region depended largely on revenues derived from taxes on international trade (import tariffs and/or export taxes). On average in 1940-1949, these customs revenues accounted for 13% (6%) of total central government revenues in Argentina, 15% (1%) in Brazil, 26% (9%) in Chile, 23% (10%) in Colombia, 27% (5%) in Mexico, 29% (10%) in Peru, 29% (4%) in Uruguay and 24% (9%) in Venezuela (the average amounts for the 1990-1999 period are included between brackets).

Consequently, TAs were mainly responsible for the control of customs agencies and had smaller tax offices that administered SET and IT on businesses with revenues coming almost exclusively from commodity export firms. The strategies employed by the TAs were based on the control of each tax independently with evident disconnection among the several collection offices which used to compete to maximize the revenues under their scope.

As from the mid-1970s, a greater trade and (later on) financial openness and the major spread of domestic consumption led to deep changes in the countries' TAs and were responsible for generating a new paradigm in tax management. Tax administration shifted from a “tax by tax” control to controlling “subjects or taxpayers” that could simultaneously include importers, local producers and exporters of goods and services.

A determining factor in the principal changes observed was the application and spread of VAT in Latin America as the number of controlled taxpayers increased. These changes included creating a RUC to determine the potential universe of taxpayers, generating a tax current account covering all tax duties and the effective payments made by each taxpayer, and differentiating tax management upon the basis of economic and fiscal relevance of small and large taxpayers. In this respect, in 1983, the Regional Technical Cooperation Project on the Single Taxpayers' Registry and Current Account, RUC/CC –as per the Spanish acronym–, was undertaken for Central America and the Caribbean, financed by the IDB and administered by CIAT. The Centre then started acting as a specialized agency rendering technical assistance services for the TAs of Latin America and the Caribbean. There was also a change in the functional structure of the tax systems, which were basically divided into four systems: executive, regulatory, operations and statistical support. This structure has been followed in almost all the Latin American countries.

As from the mid-1980s, the strategies to control evasion in the countries of the region focused mainly in certain common areas. Countries incorporated more qualified human resources and began to use new information technologies. With the significant advances in automatic data processing, the global monitoring of taxpayers was integrated through two channels: regimes for withholding at source and for capturing information from external “sources”.

Also, the databases of the different collection agencies (customs, income, internal) were integrated, with the behaviour of the taxpayer (or the “taxed subject”) as a control parameter covering all actions, through the application of discriminant functions based on the fiscal conduct of each taxpayer. The advances in management strategy led to a process of integration into a single TA that covers customs duties, domestic taxes and in some cases –currently Argentina, Brazil and Peru– revenues to social security entities (Gómez Sabaini and Jiménez, 2011).

Table 1: Main reforms in TAs

Characteristics	Countries
Functional Organization	Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Peru, Dominican Republic, Uruguay.
Semi-Financial Autonomy	Argentina, Bolivia, Colombia, Ecuador, Guatemala, Mexico, Peru, Dominican Republic.
Large Taxpayer Unit	Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Peru, Dominican Republic, Uruguay.
Simplified	Argentina, Bolivia, Brasil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Perú, R. Dominicana, Uruguay.
Taxation for Small Taxpayers	Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Peru, Dominican Republic, Uruguay.
Integration with Customs	Argentina, Brazil, Colombia, Guatemala, Peru, Venezuela.

Source: Cornia et al. (2011).

In turn, collection agencies gained independence from political bodies and, in many cases, autonomy of these entities was promoted often with the allocation of an operating budget in proportion to the revenues collected. In sum, the administrative improvements (summarized in Table 1), together with the new information technologies, contributed to modernizing operations, reducing costs and increasing administrative efficiency.

From the mid-1990s, as a result of the effects of an international openness that led to the proliferation of multinational companies –both goods producers and financial companies– the countries of the region adopted a series of measures aimed at protecting their tax systems and prevent erosion of their tax bases and the transfer of benefits to fiscal havens.

Those measures included a gradual incorporation of specific rules applicable to transfer pricing among related companies. Mexico, Brazil and Chile were the first countries in the region to introduce this kind of provisions over the 1996-1997 period. Then, Argentina, Colombia and Peru adhered to this trend by the end of the 1990s and the beginning of the new century. Later on, from 2004 onwards, Ecuador, Uruguay, El Salvador and Panama followed this road although with varied degrees of effective implementation in practice. In general, except for Brazil, who adopted its own methodology, the Latin American countries followed OECD directives in the matter, and CIAT played an outstanding role in the spreading and exchange of experiences and knowledge by means of conferences and technical assistance programs for the purposes of favouring the proper implementation of these rules in the countries of the region.

With regard to international taxation, rules were incorporated to prevent thin capitalization of related entities intended to reduce the global level of taxation on the company. Several Latin American countries introduced this kind of measures based on limits of “debt-to-capital”, “debt-to-equity” or “debt-to-net worth” ratios. In addition, the countries of the region introduced regulations applicable to transactions with fiscal havens as these have similar consequences in terms of erosion of domestic tax bases. Indeed, while the definition of “fiscal haven”³ varies from one country to another, a considerable number of countries adopted specific rules in their tax laws. Among these, Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Honduras, Mexico, Peru, Dominican Republic, Uruguay and Venezuela are current examples.

d. Fiscal Revenues from Natural Resources: Increase of International Prices, Consequences and Responses given by the Countries

One of the elements in the diversity of financing sources available to the countries in Latin America is the share of fiscal revenues deriving from the exploitation of natural resources, which in some cases determines the resulting tax burden. In particular, this factor can have a strong influence on tax policy in these countries, especially around three central questions: the mechanism for State appropriation of the income generated by these economic activities, the effects of these public revenues on the domestic economy and the different options available to the State for using these resources to consolidate economic growth.

In countries with substantial non-renewable natural resource deposits (gas, oil, minerals), the most direct mechanism through which governments appropriate income from commodity exports and transform it into fiscal resources is participation in exploitation, through either public companies

³ While the definition is based in some cases on the amount of the CIT rates and the differences between the country of origin and the country of destination for example, Brazil and Mexico), in other cases there are lists defined by international organizations (such as the OECD “black list”) or there are lists specifically defined by means of general rules issued by the TA (Argentina and Ecuador).

or shareholding (Jiménez and Tromben, 2006). These companies are usually subject to a special tax regime, which can consist in leasing or rental fees, additional taxes for the public companies (as in Chile) or special taxes on oil production (as in Mexico and Venezuela).

Other mechanisms of State appropriation include the use of royalties, which are usually production based and which ensure a minimum payment for the resources to both national and subnational governments (as in Bolivia). Most countries apply the traditional income tax with differential rates, as well as other special taxes on companies dedicated to the exploitation of non-renewable resources.

However, given the size and persistence of the price rising cycle commenced in 2003, export or producer countries of the region found sufficient grounds to make significant reforms to the fiscal regimes applied to hydrocarbon and mineral production. The most relevant legal reforms towards ensuring public control of non-renewable natural resources focused on the hydrocarbons sector with the nationalization and restatization of companies and fields (Argentina, Bolivia, Ecuador, and Venezuela). Moreover, some governments reinforced the royalty systems, such as Bolivia in 2005, and implemented novel specific taxes based on yield, such as Chile with the *Impuesto Específico a la Actividad Minera* in 2005 (ECLAC, 2015).

Due to these changes and a favourable international context, there was an extraordinary positive evolution in the amount of accumulated fiscal revenues, in the States share in economic income of sectors exporting non-renewable resources and the relative share of these resources within public finance as from 2003, with a maximum peak as at 2008 (prior to the financial crisis) clearly in contrast with the previous decade (Gómez Sabaini et al., 2015).

In the hydrocarbons sector, many countries have reflected this phenomenon: Bolivia, where this source of resources grew on average from 2.7% of GDP and 11.0% of total fiscal revenues in 2000-2003 to 9.1% and 28.2% in 2005-2008. Ecuador also accumulated a considerable rise in those periods, from 5.7% to 8.7% of GDP and from 29.3% to 35.3% of total fiscal revenues, with a sustained trend registered throughout the subsequent years and despite the adverse impact of the 2008 international crisis reaching average amounts of 13.4% of GDP and 40.3% of total revenues in the 2010-2013 period.

As regards minerals, Chile is an interesting case, where fiscal revenues associated with this extractive industry accounted for on average 0.8% of GDP and 4.0% of total revenues throughout the period prior to the price boom (2000-2003) and then reached amounts equal to 6.9% and 27.7%, respectively, over the 2005-2008 period. Well behind, Peru also experienced a significant increase in absolute and relative amounts of these fiscal revenues, from 0.2% to 2.1% of GDP and 1.0% to 10.6% of total fiscal revenues considering average amounts for the same periods.

The boom in international demand for the region's commodity exports and the sustained increase of their prices have been central to the improvement of the macroeconomic performance and fiscal position of commodity-exporting countries of the region from 2002 onwards. Nonetheless, it is also true that this phenomenon led to a greater economic dependence, in several cases, on fiscal revenues from extractive industries with severe consequences for State financing and risks to its sustainability.

On the one side, two important issues may be raised: **(1)** If the resources are non-renewable, what happens when the resources run out? **(2)** How should the government deal with the volatility of public revenues originating in the price cycles of exported commodities? The first question entails the problem of intergenerational equity, since the shortfall resulting from the reduction in non-tax revenues will affect future generations through lower levels of spending or higher taxes. With regard

to the second question, price fluctuations have a significant impact on revenues and the solidity of the public finances, which makes it even more difficult to determine the appropriate tax structure for the country.⁴

On the other side, allocation and distribution of fiscal revenues among all the jurisdictions of each country is as important as obtaining such revenues from extractive industries. Except for Argentina, in the countries of Latin America there is a high degree of fiscal centralization in this matter (even in such a federal country as Brazil), supplemented by different revenue-sharing systems and transfers among the levels of government. This allocation of resources is, at least in the region, almost exclusive for producing areas or towns to the detriment of non-producing regions, with just a few offset mechanisms to allocate some resources to the latter. Besides, royalties prevail over taxes as the base for regional distribution of extractive income to subnational governments, with considerable exceptions such as Bolivia and Peru (ECLAC, 2014).

e. Financing of Social Security: “Parametric” and Structural Reforms and their Fiscal Consequences in the Countries of the Region

With respect to State financing, the role of social security contributions constitutes a key factor that differentiates Latin American countries. As a matter of fact, Latin America includes countries with very developed pension systems that move a vast amount of monetary resources collected from formal workers, as well as countries with rudimentary pension systems that, for different reasons, have not been able to achieve much concrete progress in this area.

Also, the countries vary with regard to the nature of the institutions that provide the services, which is an important characteristic for classifying the different systems (Cetrángolo, 2009). In general, public systems are characterized by undefined contributions (which tend to increase in the long term due to the ageing of the population and the maturation of the system), a pay-as-you-go or collective partial capitalization financing scheme and public administration (by an autonomous entity or directly by the State). Private systems have defined contributions (fixed in the long term, although the ageing of the population will eventually force either an increase in contributions or a reduction in pension amounts), a full individual capitalization scheme and private administration, although administration can be public, private or mixed.

In particular, the region has undergone tremendous changes in State participation and financing in recent years, and many of these reform processes are still in the transition phase (Table 2). Thus, some countries have implemented “structural” reforms in which the public system has been fully or partially substituted by a private system; others have opted for “parametric” reforms aimed at financially strengthening a long-term public system, whether by raising the retirement age, increasing contributions, tightening the calculation formula or taking other measures (Mesa-Lago, 2004).

Unfortunately, the status of any given system is not always easy to classify. In particular, the combination of reform processes that attempt to address the crisis of the old social security systems and those that aim for higher levels of coverage—whether or not concurrent—have increasingly led to the development of hybrid systems.

⁴ The issue of volatility of these resources and their macrofiscal effects is also faced by agricultural exporter countries (under normal conditions, agricultural products are not subject to a natural exhaust process as hydrocarbons and minerals), such as Argentina, Brazil and Paraguay with soybean trade.

Table 2: Reforms to Social Security Systems in Latin America

Structural reforms (Individual capitalization)	Substitute model (private system replaces public system)	Parallel model (competition between public and private systems)	Mixed model (public and private systems are complementary)	Notional accounts
	Chile (1981); Bolivia (1997); Mexico (1997); El Salvador (1998); Dominican Republic (2003-06)	Peru (1993); Colombia (1994)	Argentina (1994-2008); Uruguay (1996); Costa Rica (2001); Ecuador (2004)	Brazil (RGPS Privado, 1999)
Parametric reforms or without reforms	Brazil; Cuba; Guatemala; Haiti; Honduras; Nicaragua; Panama, Paraguay, Venezuela.			

Source: Mesa-Lago (2004) and Cetrángolo (2009).

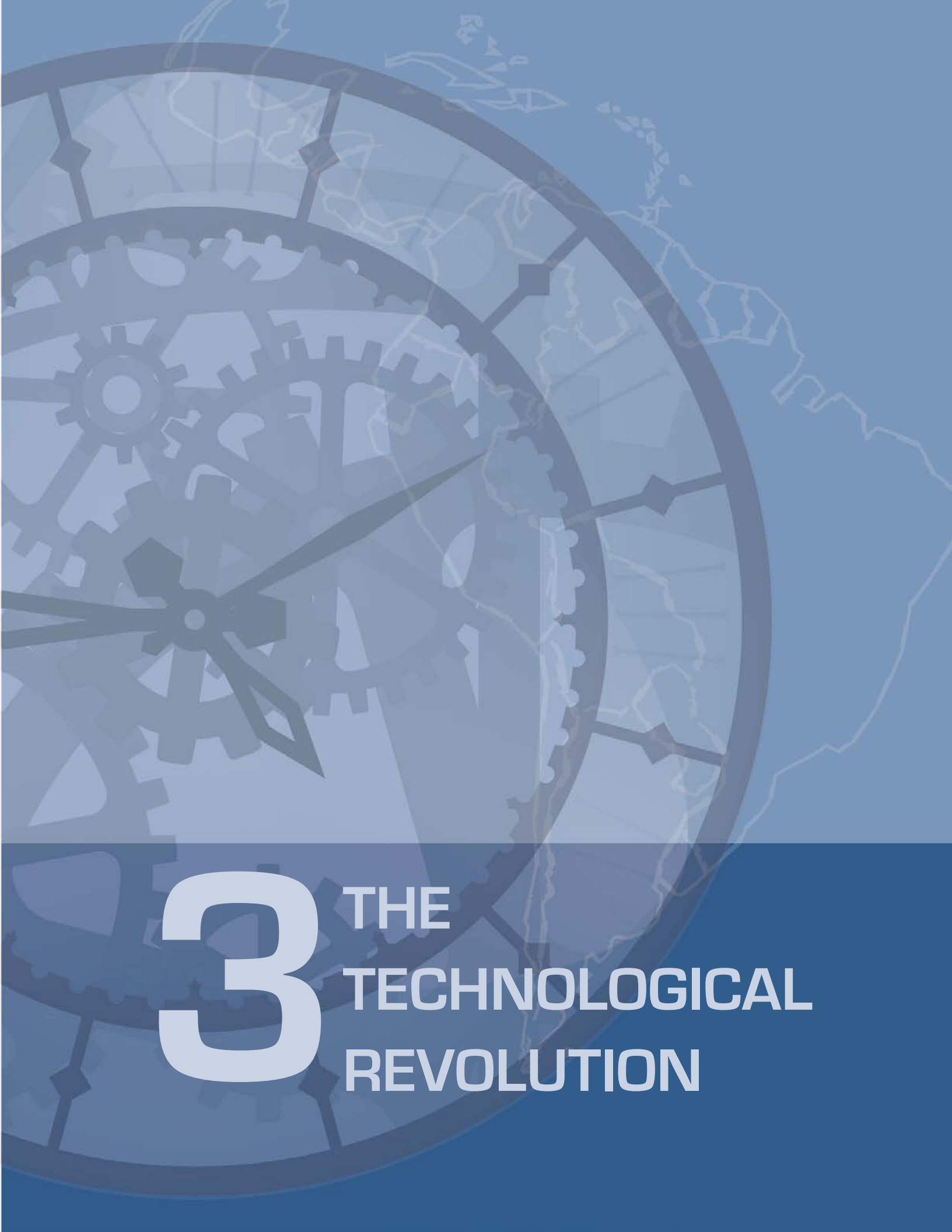
An ECLAC report (2006) presented a classification of the different social security systems mainly upon the basis of their financing scheme, taking into account the fact that, as a result of total or partial privatization of the pension system, and in some cases health care, some countries of the region recorded a drop in the relative share of social security contributions as a source of revenues in the 1990s.

In this respect, if contributions are mandatory, the system is managed by public institutions and the benefits play a redistributive role, then the contributions should be included as part of the tax pressure and the corresponding expenditures should be considered public. Examples include the cases of Argentina, Brazil, Costa Rica, Panama and Paraguay. To the contrary, if contributions are managed by private institutions, whether mandatory or voluntary and whether or not they finance redistributive benefits, they should not be part of the public expenditure and the resources should not be considered elements of tax pressure; Chile is a well-known example.

Despite these general guiding considerations, each country has its own method of organizing its public accounts and presents information pursuant to its own requirements. However, social security contributions are currently of utmost importance in the tax burden composition in some countries including, among others, Panama, Costa Rica, Ecuador, Paraguay, Nicaragua, Uruguay, Brazil and Argentina, with a relative share that exceeded 20% over 2012. In Argentina, the introduction of the private individual capitalization system reduced the tax revenues of the Argentine general government in the late 1990s and much of the last decade. Revenues then recovered starting in late 2008 when the two parallel social security systems were unified in a single public pay-as-you-go system.

In contrast, social security contributions currently represent less than 15% of the tax revenue structure in several countries in the region. However, the causes that explain this poor result in revenues are diverse and vary by country. Despite the different degrees of development of each social security system, in some cases these amounts are the consequence of the structural reform processes applied to the pension systems, in particular, in Chile, Colombia and Mexico.

In countries such as Argentina, Brazil or Uruguay, the increase in revenues obtained owes to a rise in the level of coverage of the current systems by means of successful employment formalization programs and extension of social benefits. Nonetheless, in most of the countries in the region, and regardless of the type of regime adopted, there are deficiencies in population coverage, with high levels of informality that limit the reach and financing of the social protection systems in place.



3 THE
TECHNOLOGICAL
REVOLUTION

3

THE TECHNOLOGICAL REVOLUTION

Raúl Zambrano

a. Information and Communication Technologies and Tax Administration in the 1980s

The 1980s evidenced a growth in the close relationship between TAs and ICTs as the latter became essential tools to improve processes, both for control purposes and for facilitating compliance.

At the beginning of the decade, most information systems were operated in large computer environments, called computer mainframes, including, among others, those supported by operating systems such as MVS, DOS or VMS. Information was stored mainly in file systems, for example VSAM, that provided access to the files through sequential read for bulk data processing by means of master/detail file schemes which were essentially designed for batch processing and which supported a variety of tasks such as the processing of tax returns.

Terminals became popular to facilitate on-line, interactive transactions with random access to the file storage system or the database with multiuser access. The use of terminals –such as the 3270 with its full-screen transmission mode or the vt220 terminal, which sends one character at a time– prevailed at different working points of the TAs, including teller windows for on-line operation service for taxpayers. These terminals were connected to the mainframes over coaxial cable to the control unit in the case of the former and over serial cables in the case of the latter.

Large volumes of information, for example, in the case of tax returns, were captured by data entry dedicated processes for batch processing. The TAs required whole units for the analysis and physical coding of documents so that, later on, data could be captured by means of double input digitization systems, in general, with specific equipment which often operated disconnected from the central systems. Batches of documents were delivered to transcribers that would capture data field by field, document by document, and then deliver the batch to another transcriber or verifier who would make a second capture of all the fields. The capture system, generally operating disconnected from the central systems, requested a third transcription by the verifier in the event of discrepancies between the first and the second captures.

One of the consequences of using this mechanism was the need to structure the processes within the TAs also in a sequential scheme and by batches: first, returns were received,

then the relevant file was traced followed by field coding (not always available), subsequently, there was a transcription process, and finally the data were loaded to the central system for ultimate processing of the returns. It was only then that non-filers were identified, and the processes of verification, application of payments and identification of debtor-taxpayers were completed, including calculation of amounts due pursuant to return-based assessments or amounts assessed in the event of errors in the returns.

During the 1980s, the usage of fourth generation languages, such as Natural, CSP or Mantis, consolidated and particularly the use of SQL substituting for third generation general-purpose languages, such as COBOL or PL/I. These fourth generation languages accelerated functionality coding and ultimately led to the introduction of significant changes in the TAs' processes. Using management systems such as ADABAS or DB2, data models which use table-based format – where access to data for the different processes is based on demand of one or more records and not on a sequential and ordered read of file and file details for processing and creation of another file with results– enabled the TAs to structure their processes in additional modes other than the batch-based structures.

The TAs went from work initiated at night by operators to interactive screens with information and the possibility of executing interactive actions.

In the telecommunications field, wide-area networks were consolidated with point-to-point links that provided the means to maintain centralized systems increasingly integrated. Connection required 9600 modems on dedicated links.

Taxpayers' registration, return processing, and management of payment, current accounts or collection developed into corporate systems within the organizations.

This generalization of centralized transactional systems was advantageous to standardize procedures through on-line transactional systems, reducing regional asymmetries among

the different taxpayer services. These procedures included, among others, taxpayers' registration with data entered or adjusted directly at the teller window by TAs' officials through on-line service to taxpayers.

Management of direct revenue by the TAs with collection offices was transferred to the banking network upon agreements entered into with banks, thus increasing significantly the number of service points previously limited to TAs' collection agencies.

Collection agreements with banks included, in some cases, capturing information contained in the returns and submitting the processed transcription on magnetic media at first, and then through dedicated data links to the TAs. In some countries, for example in Peru, the SUNAT developed and distributed a data-capture software for banks to use. The system enabled and required a double capture of information at the banks' agencies, then the subsequent consolidation of data filed by each taxpayer at the agency, with the bank and ultimately with the SUNAT once the returns were put together. This mechanism was intended to improve the quality of the data submitted by taxpayers. An interesting side of these agreements is that banks were allowed to withhold the funds collected for several days in consideration for their services, rather than receiving direct disbursements by the TAs.

Many TAs decided to use smaller multiuser systems, typically based on operating systems such as UNIX (AIX, HP/UX, OSF1) as a cost-effective alternative demanding fewer infrastructures compared to mainframes, with local area equipment.

These solutions supported smaller systems operating with departmental or localized functions. Some countries developed solutions for specific areas, such as enforcement, that worked with a subset of data from the central system. One of the standard practices was to apply replicas of one single solution at the different administration offices with integral and operating copies of the system to serve different categories of taxpayers.

The systems used to serve larger taxpayers were an emblematic example of the foregoing and underpinned the strategy for large taxpayers. *Sistema 2000* and *Sistema 2000 Regional* in Argentina or the large taxpayers system in Venezuela, called *SIVIT*, are good examples. Under these systems, all transactions, including changes to taxpayer details, administration of tax duties, receipt and computation of payments, receipt and capture of tax returns, tax assessments, control processes for non-filers and tax collection were managed on line and upon a transactional basis.

This strategy was developed all through the period in an attempt to concentrate all the resources necessary to administer liable taxpayers mainly in the TAs. Such concentration included the facilities, the required human resources to support all the operations of the business area, the technological platform and even an internal bank agency to manage tax revenues.

The service provided to large taxpayers and the control processes applied to them were far more efficient than the services for small taxpayers. The response time by the TAs in the event of non-compliance, especially in cases of non-filing of tax returns or total or partial non-payment of declared values, was fast mostly thanks to the automation of the process to detect non-compliance within a smaller universe. The formal compliance level of this group of taxpayers improved.

Coexistence of the two strategies, however, was not easy and brought new difficulties. Centralized systems serving all of the processes for taxpayers not assigned to specific units as well as the systems serving specific groups of taxpayers needed to adequately replicate the information, both for generating centralized statistics and for synchronizing updated data of one environment with all the others. This synchronization was quite complex in certain cases, in particular where a taxpayer of a special category had to be removed from the class, for whatever reasons, or whenever a merger or acquisition process incorporated into one single category taxpayers traditionally managed through separate information systems.

Popularization of personal computers and office tools, such as word processors and spreadsheets, was a turning point in TAs' technology over the 1980s. Their incorporation changed the work environment, where typewriters and table calculators were gradually replaced by personal computers. These personal computers were connected to local networks to share resources, such as printers, and to facilitate access to central systems through terminal emulators including VT or 3270. The TAs, as any large organization working with information, witnessed a struggle of standards for implementation of the local network until the Ethernet twisted-pair cable prevailed, which, with improvements, is still in use.

The work of employees who took notes and wrote official communications for the members of the administrative units was progressively substituted for. Technicians using the new equipment began to write their own documents and generate their own calculations. The number of computers grew from just a few per administrative unit to one per employee for practical purposes. The use of technology significantly increased at the work environment supported by large investments in IT.

Personal computers, able to support calculation in small systems or use spreadsheets or statistical software, led to the development of analytical capacities by individuals or small working groups, both in the area of economic studies and in the first specific solutions for enforcement as an aid for auditors. With data downloaded from the central equipment, for instance, comparative analysis of taxpayers were generated against other taxpayers of similar size, activity and location. Chilean ARCO is an example of this type of solution; at the time, this system already included: (a) behaviour indicators expressed in number of occurrences: drawings, rectifying returns, freezing orders, releases; (b) compliance indicators: with records indicating whether or not the taxpayer filed its VAT or IT return for each tax period; (c) indicators of flows of operations: showing investment, export and sales volumes; (d) VAT indicators: showing debit/credit ratios, level of credits, level of debits, trade differential; and other similar indicators.

b. Information and Communication Technologies and Tax Administration in the 1990s

The 1990s evidenced an increased dependence of the TAs on ICTs. Over the decade, real disruptive technologies were developed within the TAs' environment.

A material change in terms of architecture and platform provided the means to physically reduce the size of the equipment while maintaining the capacity to support the processing needs of the TAs. Many TAs abandoned the mainframes to deploy their central systems on smaller equipment with increased capacity, such as System/38 or AS400 by IBM, or more generally equipment using operating systems such as UNIX (AIX by IBM, HP/UX by HP, OSF1 by Digital or SUN/OS or Solaris by SUN Microsystems).

In this work environment, client-server applications were developed on a distributed basis with central equipment acting as a server providing resources in response to the requests by smaller equipment, in general, personal computers.

The performance of the relational database management systems was a key element of this model, in particular, Oracle, Sybase SQL Server, MSSQL Server or Informix, which worked as servers for the data requirements made by applications run by customers.

The development of the applications for customer equipment was supported by integrated tools in high-productivity and specific development settings, which were object-oriented, on graphical environments and event-driven. The visual environment of the applications went from a simple setting of screens with 80x25 columns to a graphical setting on Windows managed through the keyboard and the mouse. Tools used by the TAs varied, including among the most common, VisualBasic and PowerBuilder. Applications developed in El Salvador or Venezuela, or the Tax Solutions system developed by CIAT and implemented in the Dominican Republic, Haiti, Cuba and the Brazilian states of Maranhão, Pará and Santa Catarina, are examples of such technological progress.

Communications also changed significantly. In local area connections, allowing for connection of personal computers to the network, the Ethernet technology prevailed. With regard to remote unit connection, there were several examples highly dependable on the availability of a telecommunication service in the country; these connections used diverse standards such as X.25, Frame Relay or ATM.

Tax returns had historically been prepared by taxpayers on paper forms that were then filed to be captured and loaded to the information systems. Below are some of the problems inherent to the manual preparation of these return forms:

- Problems with taxpayer identification as errors were made when filling out the taxpayer identification number or the relevant period.
- Moving field and arithmetic errors.
- Inconsistencies between returns.
- Use of forms for periods other than the declared period.

In addition to the foregoing, there were errors arising from the data capture process, both by the TAs and by service providers, generally the banks.

One of the first measures taken consisted in generating self-adhesive labels containing the taxpayer's number, name and registered name, and the relevant tax and period, to be added to the forms submitted to taxpayers for use on their tax returns. The purpose was to mitigate the identification errors found in the returns which generated intractable problems for the TAs.

Some TAs, though with limited success, opted for OCR technology for direct machine-scanning of the paper-filed tax returns.

In the 1990s, taking advantage of the widespread use of personal computers in the community, the TAs developed and distributed software to assist taxpayers to fill out their returns. It was software that enabled easy preparation of the returns, print out of the document or creation of a file to be sent to the TA.

Work methods were diverse. In Spain, the means used was paper itself: the software printed the returns on paper with a two-dimensional bar code including all the data of the return which was then scanned by an appropriate data capture device.

Other countries developed software capable of generating files to be recorded on flexible discs, at the beginning, and then on compact discs. These files were submitted to the TAs, together with a paper-printed return, such as in Panama, or with no paper-printed form, such as in Argentina, or through the banking network, using the relevant software also generated by the TA for each bank agency to scan and process the files submitted by taxpayers on magnetic media, such as in Honduras or El Salvador.

Other TAs, particularly Anglo-Saxon administrations including the American IRS, issued standards to enable third party products to assist taxpayers with their returns and to generate the files to be submitted to the Tax Administration.

In Brazil, in 1997, RFB offered a product named *Recitanet*, downloadable form Internet which provided the means to prepare the PIT returns and submit them to the TA via Internet. It was no longer necessary for taxpayers to go to a TA office or authorized bank agency to file paper-printed tax returns or deliver a file on some sort of magnetic support.

Incorporation of software-assisted returns, with files submitted on physical media and especially with fully electronic files submitted via Internet, was the key technological element of the decade and brought a series of opportunities and capabilities for the TAs that arose from an instant improvement in the quality of the information contained in the returns and from a more efficient processing.

It was throughout the 1990s that the TAs widely implemented workflow management software, either built by the TAs themselves or through acquisition of specific tools, that set the structures to perform and control sequential tasks in administrative proceedings involving more than one player in one or more administrative units.

With these tools elements of management were systematized: allocation of cases, execution of specific tasks, action approval, drafting and revision of documents, task supervision and system-based control of work and of time used to accomplish duties. The TAs made good use of the potential derived from automatic criteria for management control and the possibility of standardizing criteria and terms.

Integration of transaction-oriented systems, mass control processes and workflow management was a major step in terms of task automation for the TAs. In practice, several processes were already executed, on a permanent basis, with almost no human intervention. These processes included banks receiving information on transactions conducted on the bank network, the receipt of returns, and the generation of massive communications addressed to taxpayers via traditional mail or, in specific cases, via electronic mail.

As businesses became computerized, and telecommunication capacities of countries improved and information systems were modernized, it was possible for the TAs to request taxpayers information on their transactions conducted with third parties. Examples of the multiple types of information requested from and reported by taxpayers, in the form of an annex to the tax return as in Ecuador or as specific informative returns as in Colombia, include data on the payment of employees' salaries or remuneration, payments for purchases of goods or services provided by third parties, interest on investments, donations received by charities, or currency purchase and sale.

This organized and summarized information provided by taxpayers was used to cross data and identify evident differences in the values declared by taxpayers or indicators of suspicious operations that would call for an enforcement or control action by the TA.

The TAs streamlined their enforcement processes thanks to their improved systems and tools, the availability of timely and quality information and the considerable amount of available data about transactions carried out among taxpayers, and the TAs were further able to develop better mechanisms to select cases and assess non-compliance risks. These capabilities were achieved together with monitoring and enforcement processes and subsequent stages in recursive processes, and also the availability of specific tools for field audit, such as ACL.

Implementation of desk audits to control more specific situations, based on monitoring and enforcement processes of a massive nature compared to traditional audits, was a major development in this area.

The TAs of countries that apply VAT have always faced difficulties in the issue of sales invoices or receipts in operations with end customers, particularly, in the case of cash payment transactions.

Several TAs adopted, on a mandatory basis, cash registers and other fiscal equipment, especially printers, as hardware-supported solutions with security devices to record the transactions made and disabling any chance for deletion or alteration. Authorized specialized officials of the TA were appointed to extract records and details of the operations transacted by taxpayers.

The TAs, on their own or in cooperation with other government entities, developed assessment and authorization processes applied to fiscal equipment to be used by taxpayers.

The advantages of fiscal equipment with security memory turned out to be useful when these tools were introduced as taxpayers perceived a subjective risk derived from the enhanced ability of the TAs to audit operations. However, the TAs off-line operating mode coupled with insufficient TAs' human resources to visit all the facilities to extract data regarding such operations on a regular basis impaired the mechanisms' efficiency as an instrument to discourage wrongful actions by certain taxpayers.

The technological tools used by several TAs in the 1990s included, among others, data storage management tools. On line transactional systems management cannot compete for the same computer resources with other processes of analytical nature which work with larger volumes of data for different periods. In this respect, tools were acquired and developed to extract, transform and load data from the transactional systems of one or more sources, either current or historical, to long-term repositories facilitating generation of reports, managerial information and data analysis.

This technology brought immediate advantages including absence of impacts on the response time by the transactional systems and the ability to concentrate information of the different systems in the hands of the TAs. Thus, the TAs were able to define the problems derived from substituting new

technologies for legacy information systems still in operation as well as departmental or regional systems.

Nonetheless, in several TAs, the investments made in these tools did not suffice to achieve the overall purposes originally set. This owed to the difficulties faced to compare non-homogeneous data, faulty historical data, complications to create appropriate dimensions and domains, and discrimination of information for end user with no assistance by specialized staff.

Corporate electronic mail is an element of technology that has indeed changed the way all officials at the TAs work. It became the main via of internal communication, gradually replacing the use of internal memoranda, and progressively turned into a corporate file-storage and backup mechanism for instructions given, documents delivered and compliance records.

Electronic mail also simplified external communication with other entities that interact with the TAs and even with taxpayers. Traditional communication by means of official documents or printed-paper memoranda were gradually reserved for complex issues in light of the advantages of electronic mail, both in terms of delivery costs and time.

Usage of electronic mail even changed work daily routines making tax administrators invest considerable time to read, organize and respond to electronic mails.

c. Information and Communication Technologies and Tax Administration in the 21st Century

The beginning of the new century witnessed a boom in the use of ICTs by the members of society with mass Internet access and unprecedented development of mobile connectivity and applications. The TAs were not alien to this reality and faced challenges, responded to an ever-increasing demand for agile service provision and made good use of the opportunities to improve control and enforcement.

With the advent of Internet and as Internet platforms became popular, client-server solutions were, in general, replaced by n-tier platforms with graphical interface supported by Internet browsers.

Current data centres have a large set of redundant servers, with different purposes, in general less costly than older general-purpose equipment, to provide specific and redundant services.

This type of structure was supported by one of two possible strategies: on the one hand, Windows universe supported by Windows Server operating system, SQL Server database management system and .net development framework, and their supported programming languages, especially C#; on the other hand, the UNIX universe (AIX, Solaris or HP/UX) - LINUX with relational database management systems, generally Oracle, and development settings supported by JAVA EE platform for deployment of services on application servers.

Presentation tier developments were directed to general-purpose web browsers, with greater independence from the hardware setting in which they operate. There was extensive use of the benefits of HTML, CSS and JavaScript standards as a language interpreted in the browser running environment.

This technology meant a return to a centralized model of software execution, in contrast to the primary model of the previous decade which had been in general distributed for execution by clients.

This centralized setting allowed for deploying applications on a controlled basis, exclusively within the data centres from which pages are served to requesting Internet browsers with visual elements and local execution scripts. This has mitigated two big problems of the prior model: the distribution of software updates and the restrictions for upgrades over time arising from specific requirements for software execution.

Also, there was another very important change in this decade: the possibility of using public Internet as a means of communication with several points of the TAs' wide area networks using private virtual networks, thus reducing complexities and costs of connection for small offices and even personal equipment.

Virtualization technology, together with hypervisor equipment, brought the capability of creating, installing and running virtual servers executing independently from physical equipment. In addition to the advantages from the technological perspective, including security, optimization of resources, administration of equipment and backups, the TAs obtained IT resources updates less dependent upon complex regulations to acquire equipment.

By the end of the decade, the use of a new model of applications architecture consolidated. In this model, technological resources, including software, hardware and platform, are provided as on demand services over Internet allowing for task execution and data storage at third party data centres. Just a few TAs are using this new platform extensively. The Mexican SAT is one of them.

Internet omnipresence brought one of the most disruptive changes of the decade. The TAs developed services for taxpayers to use from their own computers. These services, already used over the previous decade mainly as a means to disseminate information, have now been extended to the several areas of the Tax Administration's jurisdiction.

Processes such as taxpayers' registration and data adjustment, return filing, current account consultation, request management, filing of

administrative remedies, issuing certificates, requests for refunds or reimbursements, incorporation to special regimes or temporary benefits under tax amnesty were gradually moved to Internet, enabling taxpayers to directly execute, or at least initiate, each proceeding.

This turn in over-the-counter (face to face) service for taxpayers to access auto-service has been quite successful in the TAs, not just because of improved efficiency derived from the considerable increase in the number of service points, but also, and may be principally, because taxpayers have accustomed themselves to this type of actions as digitalized citizens capable of managing their businesses from diverse sites.

For the TAs, this self-management capacity and the provision of electronic services bring along endless opportunities arising from a much better service supply, error minimization, reduced subjective criteria in taxpayer service and less direct contact with taxpaying citizens on daily transactions.

However, the foregoing also carries enormous challenges that make the TAs rebuild their processes. These services demand, due to their own nature, a different type of assistance; Call Centres have been established almost as a mandate. In addition, these services operate 24x7. Indeed, it is well known that tax return filing, for instance, tends to be concentrated on the last day before expiration, and in some cases, even over the very last hour. Apart from the need to serve taxpayers at any time of the day, the TAs have increased by thousands the number of potential on-line users using the administrations' information systems. A system that ten years ago had one potential user on each server of the TA now has a potential user in each taxpayer.

But this expansion has also brought challenges in terms of security, both to maintain the systems in operation with very high availability levels despite legitimate or deliberate overloading that put system stability at risk, and also to protect the systems against IT attacks from within or outside the administrations intended to obtain, or what is worse alter, non-authorized information. The information obtained about transactions

conducted by taxpayers with third parties has reached levels never seen before, both in terms of data and informant volumes, with information pieces that are more and more complex. Usage of standard formats such as XML and XSD-type schemes has enabled taxpayers to validate at the time of preparation many of the information files prior to submission. The increase in information reports has forced the TAs to face new challenges regarding compliance with respect to the frequency of filing and the quality of data.

With the information available and the possibility of providing on-line services to taxpayers via Internet with satisfactory execution levels, some TAs now offer pre-filled returns, especially for IT, which are provided to taxpayers with information supplied by third parties. Items such as income from employment, interest earned on savings and fixed-term deposits, stock exchange operations, dividends paid by corporate businesses, as well as expenses incurred in health care, interest paid on mortgages or loans for family burden are pre-filled.

So taxpayers may verify, supplement or correct this information or accept it if it is true and complete and ultimately file the return. Responsibility for the return still lies on the taxpayer; however, there has been a positive attitude toward the system. Voluntary compliance is increased, and the need for mass enforcement actions is reduced upon the basis of cross information, because verification occurs at the beginning of the process and therefore a higher subjective risk is perceived.

Throughout this decade, and particularly in Latin America, one of the most interesting developments occurred with the implementation of electronic invoices and other similar documents. Electronic invoices are fiscal documents that completely replace paper invoices and that are digitally signed, in general, under a PKI infrastructure. Unlike application in other regions of the world, in Latin America the decisive factor for implementation has been the participation of the TAs both in the project management as well as in the definition of the related national standard and the mandatory use.

Taxpayers who adopted electronic invoicing issue their invoices to purchasers of goods or services in electronic format or alternatively have them delivered to the company's representative. The invoices are submitted to the TAs after the transaction, as in the case of Chile, or even before the transaction is made for prior authorization, as in the case of Brazil. Invoices may be directly submitted to the administration, such as in the cases of Ecuador or Peru, or via authorized third parties, such as in the case of Mexico.

In general, electronic invoicing was introduced on a voluntary basis and has been gradually extended as mandatory to several categories of taxpayers. At present, the number of electronic documents in the hands of the TAs exceeds 30 billion from more than 5 million issuers. Argentina, Brazil, Chile, Ecuador and Mexico are among the countries where electronic invoicing has consolidated the most, closely followed by Peru and Uruguay.

The volumes of data associated with electronic invoicing in countries with consolidated implementation were higher compared to any other prior set of information. However, the demands for technology to handle such volumes are huge, but also huge are the possibilities of analysis of information which go beyond cross information to compare with sales and purchases reported by taxpayers in their returns or even with the data on pre-filled returns. The analysis of these data, together with other information already held by the TAs or that may be obtained by other means, including financial and customs operations or social media presence and action, enable the TAs to infer signs of non-compliance with tax duties by taxpayers and even predict taxpayers behaviour.

To develop these capabilities it is necessary to incorporate knowledge and skills to the TAs. These skills and knowledge include: analysis of large volumes of data –big data–, data science tools, social media network analysis, artificial intelligence, in particular, machine learning and neural networks. Also, new databases schemes must be incorporated. Relational databases do not have the velocity required to

support these volumes of data and the type of today's processing. So we can predict that database management systems based on distributed storage, such as Hadoop, or column-oriented databases will be incorporated.

Interoperability with other systems has made it possible to validate information at a fast pace, increase the level of automation, and even, in certain cases, integrate these interactions within specific workflows.

Possibly, taxpayers' registration is the most evident and primary area where such interoperability comes to light: at the very same time the taxpayer is entered into the system, queries are generated and information is extracted on line from the electoral system or the civil registry of the relevant country, or from public registries which keep records of company incorporation, changes in shareholding or appointment of legal representatives. There remains no place for errors from failure in identification of individuals or duplicity issues and, in any case, checks may be activated. Also, the TAs may make inquiries on the taxpayers condition under the public procurement system.

One of the initiatives under the BEPS project is the demand for automatic and spontaneous exchange of information, delivering and receiving data to and from other TAs where cooperation agreements are in place, and also reports received country by country, which initiative will certainly increase the demands for data reception capacity and interoperability with external systems.

Over this decade, the most significant change brought by ICTs in the work environment has come with mobility. TAs' officials can be connected to the office through their mobile devices, even if they are out of the office or town or country, via electronic mail, instant messaging or remote access to office-based computers. So the office environment and the working hours have been extended.

TAs' officials no longer need to be physically at the office to carry out tasks, receive or give instructions or follow processes and results in the areas and duties for which they are responsible. In practical terms, we may assert that for many work administrators the working hours have actually been raised.



4

TAX-LEGAL RELATION AND ADMINISTRATIVE FISCAL COURTS

4

TAX-LEGAL RELATION AND ADMINISTRATIVE FISCAL COURTS

Juan F. Redondo and Javier Paramio

In his opening address at the CIAT First General Assembly held in Panama from May 1-10, 1967, Sheldon S. Cohen, Commissioner of the US Internal Revenue Service said: *“As tax administrators, I believe it is our duty to prevent any form of arbitrariness or disrespect against taxpayers. Respect brings along respect. Our positions and those of our employees serving taxpayers do not make us superior or privileged. On the contrary, we are public servants. Therefore, we must administer tax laws in a vigorous manner, yet with respect for the rights of taxpayers to receive fair and equitable treatment pursuant to the law at all times.”*

Perhaps this is the cornerstone of CIAT’s efforts throughout its history to establish a balanced relationship between the powers of the TA and the rights of taxpayers. These efforts are evidenced by the wide range of issues discussed at the different General Assemblies held by CIAT over its 50 years of existence and, of course, in the several versions of the CIAT Tax Code Model –whose first edition was published in 1997– which have contributed to improve the technical and legal regulations promoted by CIAT in this area.

a. The Treasury-Taxpayer Relationship at the CIAT General Assemblies

The first CIAT General Assemblies, even though they focused on organizational challenges faced by the TAs, also approached, quite extensively, the issue of how to achieve a good treasury-taxpayer relationship. This can be seen, for instance, in the General Assemblies held in Buenos Aires in 1968, in the City of Mexico in 1969, and mainly, in the Montevideo Assembly held in 1970. In Montevideo, the treasury-taxpayer relationship was analysed with a view to adopt measures and mechanisms to promote voluntary compliance with tax obligations. This Assembly considered and discussed diverse experiences in the implementation of assistance services for the taxpayer.

As Dr. Manuel Rapaport, IDB consultant, asserted at the Montevideo General Assembly: *“The structure of broad-based modern taxes introduced over the past decades and applied in Latin America is such that taxpayers’ participation is of utmost relevance for the determination of the tax and the tax payment. So voluntary compliance by taxpayers is the best aid to administer a modern tax system.”*

Issues derived from education in tax matters and generation of a fiscal consciousness, understood in a very broad sense and in close relation with the measures aimed at favouring voluntary compliance, had a predominant role in those years. One such example is the comment by George F. Davidson, President of the Canadian Broadcasting Corporation, in Montevideo, who reiterated that tax administrations and lawmakers have the duty to: *“make their laws as simple and understandable as possible ..., make their laws understood by means of diverse forms of advertising, and, ultimately, provide all sorts of help and assistance throughout the implementation process.”*

According to the conclusions of several presentations on VAT enforcement given at this Assembly, one of the factors for success in enforcement is: *“the power and authority of the TA to, under a fair balance, collect revenues within prescribed terms and obtain full information about taxpayers’ behaviour and actions without detriment to taxpayers’ individual rights and defenses.”*

The General Assembly held in Rio de Janeiro in 1971 introduced a significant element for discussion of the treasury-taxpayer relationship: control of fiscal fraud, application of sanctions and pursue of fiscal offenses. According to Randolph W. Thrower, Commissioner of the US Internal Revenue Service: *“We acknowledge that an efficient program against fraud, duly balanced with support programs such as enforcement or revenue programs, may be used as a highly effective means to promote compliance with tax laws. Also we acknowledge that such programs may lead to abuses if used to pressure certain categories of taxpayers, whether on a whim or on purpose. We are constantly alert to prevent any deviations from the goal of the program.”*

The issues discussed at the General Assembly held in Guatemala in 1973 are clear evidence of a generalized concern at the time among member TAs of CIAT. The leitmotiv was “the treasury-taxpayer integration” and the presentations made discussed the different experiences in the relationship with taxpayers both in terms of assistance services and in terms of advertising campaigns to incentivize payment of taxes.

Moreover, this Assembly proclaimed the respect for the rights of taxpayers as far as sanctions are concerned. This was discussed by Dr. Narciso Amorós Rica talking about the role of sanctions in the treasury-taxpayer relationship: *“Improvements in the relationships between the taxpayer and the treasury are highly dependable upon the role of the latter in the tax relation. The TA must act according to the law at all instances, far from considering that laws only apply to the taxpaying citizens. The continual non-compliance associated with a correlative increase of sanctions and a permanent state of uncertainty should not end up undermining the mutual trust. The TA should not be domineering and overbearing to reduce the taxpayer to an insignificant position.”*

At the General Assembly of Port of Spain, 1978, there was a large dogmatic discussion on the principle of legality applied to the fiscal field. The principle was initially conceived as a protection mechanism for the taxpayer against the TA, which gradually evolved to become the corollary of the principle of hierarchy of laws –of utmost relevance in fiscal matters– and, above all, because this principle subjects the taxpayer relationship with the treasury to the rule of law.

At the General Assembly held in Washington D.C. in 1980, Spanish Professor Gabriel Casado Ollero explained: *“Also the current condition of the legal-tax relation, strictly speaking, shows an appreciable transformation of the taxpayer role in its relationship with the Public Treasury. Indeed, one can easily see how the TAs supremacy and the subjection condition of the taxpayer has progressively turned into a parity relationship in which both parties are subject to the rule of law and the respective interests of the parties tend to be equally guarded by tax law. In other words, this means that the prior status of the subjugated taxpayer has been transformed into a taxpaying-citizen status; the tax authority still holds the powers vested upon it by the legal rules to levy the taxpayer but now on equal terms as to the forms and the procedures used by the said authority.”*

Later on, in 1984, the Cartagena de Indias General Assembly was held. There numerous delegations presented specific and practical measures in this field driven by the need for a

legal system supported by voluntary compliance, acting as a deterrent against any breach and based on the principle of simplification of formal and material obligations.

The main point discussed at the Buenos Aires General Assembly in 1986 was precisely tax simplification, understood as a mandatory principle that must govern the process of making, drafting and approving substantive tax laws. The information of revenue- and audit-related administrative procedures and the provision of assistance and information to taxpayers should also follow this principle.

At the Washington D.C. General Assembly in 1991, where the theme was “Strategies of the Tax Administration for the 1990s”, Edison Gnazzo, Executive Secretary of CIAT, made a summary on this matter and concluded as follows: “*Members of CIAT have paid special attention to the treasury-taxpayer relationship, especially with regard to assistance, information and education.*” It has also been acknowledged that “*the closest the relationship between both parties, the better, as it is a fundamental element to ensure full compliance by taxpayers with their obligations.*” This statement remains fully applicable and has been streamlined by the possibilities offered by the new technologies which, in addition to facilitating the treasury-taxpayer relationship, are useful for the TA to be more efficient and operative.

To conclude and as Claudino Pita, Executive Secretary of CIAT put it: “*If we were to remark a notorious change in tax issues over the past decade, we should certainly mention the new conception of the Tax Administration and its purposes, especially in Latin American countries. Having overcome the fiscal vision that defined the TA as merely a collection entity which applied tax laws on a mechanical and impersonal basis, a novel approach arose which incorporates service as an essential element of the TA work. This means that, rather than being a body exercising a penalty duty, the Tax Administration should promote compliance, in particular, through an improved self-image offered to taxpayers only possible if the latter’s rights are respected and the means for them to comply with their obligations are provided.*”

As seen in the above summarized overview of its history, CIAT has played a key role in this process of transformation and change, also observed throughout the several editions of the CIAT Tax Code Model since 1997.

b. The Treasury-Taxpayer Relationship in the CIAT Tax Code Model

The first edition of the CIAT Tax Code Model (CIATTCM) published in 1997 was intended as an attempt to respond to the rooted changes in the Tax Administrations referred to above: incorporation of service and assistance to the taxpayer as defining elements, focus on promoting voluntary compliance with tax obligations, the impact of the new technologies, etc. However, this model was subject to criticism by professional and academic sectors who saw the model’s provisions as contrary to the principles of legality, equal condition of the parties involved in the tax-legal relation, legal certainty, due process in the TAs proceedings and effective jurisdictional

protection and, especially regarding penalization, presumption of innocence, guiltiness and the right to appeal.

The 2006 revision introduced improvements to the structure and systematization of the text, new regulations were adopted in the system to review decisions and other provisions were incorporated in the field of international taxation and the new technologies in the TA. Nonetheless, no progress was made in the sections on tax violations and sanctions where the drafting of the previous model was maintained even if it had been subject to extensive criticism.

The course of time and mainly the need to provide more ambitious responses to the current challenges in tax law application called for a new revision of the CIATTCM which was published in 2015 and which developed significant innovations in all the sections. With regard to the treasury-taxpayer relationship, the new model includes radical measures aimed at overcoming past imbalances through the consolidation of a more advanced technical regulation. As Professor Taveira Torres said “...*a chegada do novo Modelo de Código Tributário do CIAT, como oportunidade para reascender diálogos acadêmicos sobre eventuais mutações do Código Tributário vigente, desde que sob a inspiração dos direitos fundamentais, além de outros aspectos pertinentes ao aperfeiçoamento da legislação tributária. E será particularmente relevante ao atual quadro das demandas*

de reformas, para melhorar a qualidade de arrecadação e as atividades do Fisco, propiciar maior segurança jurídica aos contribuintes e estimular as atividades econômicas do País, com transparência, compliance e justiça fiscal.”

So, upon the basis of the definition of the legal-tax relation (article 19 of the CIATTCM) as a plurality of connections –obligations, duties, rights and powers– between the State and the taxpaying citizens, we will analyse below the rights explicitly included in the 2015 CIATTCM and the rights derived from the Tax Administration’s obligations and, then, we will discuss the duties of taxpayers.

Article 75 of the 2015 CIATTCM explicitly establishes the following rights and guarantees of taxpayers:

- The right of the taxpayer to receive impartial and ethical treatment by the TAs staff and the right to confidentiality of tax data, reports or background so that any information contained therein shall not be assigned to third parties other than in the specific exceptional circumstances set forth in article 117 of the CIATTCM. This article provides for a correlative duty of confidentiality to be complied with by the TAs officials, a violation of which might give rise to disciplinary action or confirmation of offense. Exceptions to this secret nature of the information derive from the safeguard of certain legally protected interests (pursue of offenses, minor protection, prevention against money laundering or cooperation with other Tax Administrations).
- The right to be informed and assisted by the TA, to make inquiries and not submit documents already filed. Specifically, article 99 prescribes that the TA shall provide assistance to taxpayers by means of IT programs and pre-filled return forms, shall publish updated information via web sites about interpretation criteria, and shall hold informative meetings especially throughout the periods for filing of returns. Likewise, article 100 of the CIATTCM provides a complete regulation of the tax inquiries that may be made even if the term for filing has expired. This article further stresses the mandatory nature of the decision for the TA to the extent the criterion favours the interests of the petitioner and prescribes that any subsequent change of criteria will only be effective upon pending obligations. Besides, this mandatory nature is extensive to other taxpaying citizens who are in an identical situation.
- The right to a refund of undue payments upon application of time limitations both in connection with assessments or sanctions, and to the non-application of interest, charges or penalties in the event of changes or amendments to the interpretation criteria not expressly published. With regard to the limitation periods, the CIATTCM introduces a new regulation whereby the limitation may be enforced sua sponte or at the request of the interested taxpayer, taking effects back to the time of compliance with the time limit. This article also includes a detailed regulation of this type of discharge of tax obligations and sets very restricted cases where the time limit may be extended and a closed list of cases where the limitation period may be interrupted. As for the scope, the CIATTCM provides that the limitation period for the TA to determine a tax is not an impediment for obtaining and using information on the acts or events occurring during such period for determination under other non-expired terms. In addition, the Code provides that payment of a time-barred obligation shall not mean a waiver to the applicable time limit which gives right to a refund of the amount paid.

- The right to learn about the status of the proceedings to which the taxpayer is a party and to have access to the administrative proceedings, and further to identify the personnel responsible for said proceedings. Article 78 of the CIATTCM establishes that knowledge by the interested parties of the status of the proceedings guarantees the defense of taxpayers' rights and prevents arbitrariness. Logically, this right is limited in the event that proceedings have not concluded. In connection with this, the right to be informed of the commencement and of the scope of audit proceedings is recognized and requires that the relevant document whereby the proceedings are initiated be notified, which document shall be supported by an order of the competent authority.
- Lastly, the CIATTCM introduces the right to correct returns, challenge any adverse decisions and obtain a ruling, the right to due process and to file appeals and evidence. To protect these rights, the CIATTCM, following the general trend of the different Latin American countries, suggests the creation of the Taxpayer Ombudsman Office conceived as an entity independent from the TAs whose main role is to see for the effective exercise of the taxpayers' rights.

The CIATTCM includes this open list of rights and guarantees of the taxpayer according to the “didactic” function of the model but in the knowledge that in the event they were not included, effectiveness would not be impaired. Now, in addition to these rights, it is worth highlighting in this analysis the rights resulting from the obligations of the Tax Administration, including, among others, the following:

- As for interpretation of tax laws, article 18 of the CIATTCM prescribes that general interpretation criteria shall be informed and mandatorily observed by the TA, not the taxpayer, though. Any amendment to such criteria shall be specifically informed and shall not affect any condition occurring while the prior criteria were in effect.
- With regard to tax liability, the CIATTCM provides in article 40 that liability arises only with respect to the principal obligation and not the sanctions –except for perpetrators of or accessories in a violation. Also, the article provides that liability shall be awarded by an administrative decision, provided there is a prior conference with the interested party where the determinant circumstances and the extent of liability are expressly stated. At this point, the CIATTCM introduces a novel rule: the liable taxpayer shall be entitled to challenge the liability awarded and the debt claimed excepting where such debt is final and conclusive. Furthermore, the CIATTCM provides that joint and several liability shall not be presumed, rather it shall be established by law.
- Then, article 46 provides that taxpayers shall be entitled to appoint an attorney to represent them, and taxpayers shall be entitled to appoint any individual of their choice.
- As for domicile issues, objective criteria prevail in the CIATTCM (residence, place of business, etc.) and it is contemplated that, pursuant to said criteria, the taxpayer may elect domicile.
- Under the chapter on determination of tax liability, the CIATTCM provides that returns filed by taxpayers shall be presumed to be certain, notwithstanding the right of the TA to verify whether the returns are true and accurate (article 53), and limits to specific cases the power of the TA to determine a tax duty on its own motion (article 55).
- The CIATTCM establishes the order for charging payments which shall also be applied by the TA in the case of voluntary payments with no indication of debt. Within this framework, the CIATTCM also provides that the taxpayer shall be entitled to request to defer or break the payment of tax debts if due to a temporary financial or economic condition the taxpayer is unable to make the payments within the terms set, and article 64 of the CIATTCM provides for debt offset with tax credits either automatically –in such cases as are specifically established by law– or at the request of the taxpayer citizen.

- As for procedural matters, in addition to article 78 on access to the proceedings mentioned above, the CIATTCM sets forth the right of the interested party to be served with notice of resolutions and decisions that affect the taxpayer's rights and interests and provides, to this end, a very complete and updated set of regulations regarding notices and means of communication, places or addresses where notices should be given, and persons authorized to receive and ways to deliver such notices.
- In the field of evidence, article 88 of the CIATTCM provides that the duty to bring evidence shall be deemed complied with if the elements of evidence in the hands of the TA are specifically identified. The article further provides that all means of evidence admitted by law shall be allowed. One of the striking features of the rule under the CIATTCM is that the elements of a tax obligation proved or investigated in the course of a proceeding which has concluded with a prior assessment shall not be subject to a subsequent audit process.
- Also in connection with procedural issues, article 95 of the CIATTCM sets forth the duty of the TA to issue a resolution and provides that if upon expiration of the term prescribed the TA has not resolved the issue, the interested taxpayer may deem the petition denied and initiate appellate proceedings. The Code further entitles the taxpayer to file with the TA complaints for omission or delay and to pursue any available remedies.
- As for management issues, the CIATTCM contemplates the right of taxpayers to claim a refund of improper payments (article 119) or any amounts duly paid in excess upon application of the rules governing the different taxes with interest accruing in arrears. Likewise, the CIATTCM stipulates the right to correct the returns (article 124) and provides, for the different proceedings, a term to file the relevant arguments (articles 125 and 130).

One of the most striking aspects of the 2015 CIATTCM is the fact that it includes the so-called "conclusive agreements" as an alternative way of resolving conflicts between the tax authorities and the taxpayers. These mechanisms seek to establish a more balanced relationship between the tax authorities and the taxpayer, improving legal certainty and reducing tax disputes. The fiscal audit procedure proposed in the CIATTCM (article 130) contemplates rules including mandatory notice of the elements and scope of the fiscal audit, the need to obtain judicial authorization in the event of audit proceedings to be carried out at the taxpayer's domicile, a maximum term for completion of the proceedings, a mandatory term set for a conference with the interested party, etc. With regard to executive collection procedures, a new regulation is introduced which provides that transfer of property shall be brought to a standstill until the assessment is final.

Section IV of the CIATTCM is quite a novelty in the field of Violations and Sanctions and it introduces many improvements when compared with previous editions of the model. This new

section reinforces the subjective nature of tax violations and emphasizes the principles of legality, typification, subjective liability, proportionality and non-concurrence. Then, the paragraph on sanctions provides a very detailed regulation to adjust penalties so that the amount of the sanction is proportional to the concurrent circumstances of the violation.

In **Section V**, on procedures for review of decisions, together with other special revision procedures, the CIATTCM entitles the taxpayer to resort to administrative proceedings prior to a challenge of actions via a jurisdictional suit. Also, as a stage prior to a jurisdictional action, the model contemplates the possibility for TAs to review decisions by means of appeals for reconsideration. This section further proposes the creation of Administrative Fiscal Courts specialized in taxes.

The same as the regulation suggested for the rights and guarantees of taxpayers, the duties of the taxpaying citizens are specifically prescribed by the CIATTCM while others derive from the powers of the Tax Administrations.

In addition to this description of substantive and formal tax obligations, the CIATTCM contains a categorization of the different types of taxpayers. Among these, it is worth mentioning the withholding agents and the collection agents which, such as in several Latin American countries, are used as they have proved to be effective in tax collection.

And jointly with the foregoing, the proposed provisions set forth an exhaustive regulation of joint and several liability and secondary liability of the parties. Among other obligations, the CIATTCM provides for the duty to appoint a representative domiciled in the country in the case of taxpayers not residing in the country (article 48), the rules applicable to the tax domicile, and, especially, the duty to inform any changes to the tax domicile as and when determined by the Tax Administration.

Moreover, the determination of the tax duty will be in accordance with the taxpayer's return (article 53), whilst article 58 sets forth the principal obligation to pay within the terms prescribed by the relevant model.

Article 113 of the CIATTCM sets forth a list of the specific obligations of the taxpayers that are subject to subsequent development in the model. In this respect, the Code provides for the duty of registration with the TAs registry and the

duty to file returns, communications and self-assessments. Additionally, the duties to set up and keep accounting books and tax records, check the electronic mailbox assigned by the TA, keep supportive documentation for any disposition or transfer of property and services provided, provide any such information as may be required in general or with regard to specific requirements for information and to receive and cooperate with the Tax Administration.

The model specifically regulates information duties by third parties as these are essential for application of current tax systems, including individual requirements for banking information. Added to this, the model is quite specific as to fiscal audit and collection duties and especial duties to be complied with by government officers.

So we arrive at the conclusion that the 2015 version of the CIATTCM clearly and accurately defines the powers and duties of the Tax Administration and the rights and guarantees of the taxpaying citizens and in doing so the model fairly responds to the need for an improved and consolidated relationship between the TA and the taxpayer, in line with the trend followed by CIAT along its 50 years. This Centre has bet, from the very beginning, to build a balanced relationship that would keep in step with the evolution of the Tax Administrations.

c. Administrative Fiscal Courts

If we compare the administrative panels in charge of resolving the controversies arising between the TAs and the citizens, we will see there are several different cases both in terms of the actual existence of these panels and of their structure and basic features.

Indeed, on the one hand, only certain countries have administrative panels to hear tax complaints at an instance separate from and prior to Courts of Justice, and which are distinguished from the entities responsible for enforcement of taxes in the several stages.

On the other hand, there are often appreciable differences among such panels in diverse areas. One instance could be the scope of their competence because, even if these panels hear, basically, tax-related matters, they may also review other issues such as recognition of retirement or pension rights of government officers, administrative contracts or liabilities of the Tax Administration.

The considerations below are for Administrative Fiscal Courts hearing tax controversies and that, even if structured pursuant to diverse institutional models, are framed within the sphere of the Executive Branch of Government. The existence of these Administrative Fiscal Courts is supported by two basic principles of law.

First, the principle of legality in its widest meaning: as a safeguard of the privileged role of the constitutional rules under any legal system; as a duty of the Tax Administrations to act in all matters in accordance with the law; and as an expression of observance of the statutory reserve, which becomes of utmost relevance in tax matters.

Second, the guarantee of an effective control system by the Executive: the political control, alien to the issues at stake; the judicial control, by Courts of Justice; and, the administrative control, exercised via several administrative remedies. In other words, a “jurisdictional function” of the TA when it faces the possibility of overruling its own decisions if these are contrary to law.

These bodies empowered to review the legality of administrative decisions have traditionally been subject to vigorous debate as to whether they are or not instruments of an unjustified privilege of the TA. To carry out a rational analysis of this issue, we must first respond two questions for each organization: first, what is the purpose of these administrative fiscal courts under the system for review of administrative decisions in tax matters?; and second: do these bodies adequately serve such purpose in any specific system?

Naturally, the first question may be approached differently from the two viewpoints of the parties involved in the proceeding: from the perspective of the TA who issues the decisions, and from the side of the citizen as addressee of said decisions. Despite this double perspective, however, both parties need to agree in that the courts should be capable of effectively deciding whether such acts are lawful.

As for the second question, the response will arise upon consideration of all the possible alternatives. In principle, the opportunity for the TA to rectify its errors and review its proceedings may be deemed fully justified, for the benefits of the impaired citizens, upon the exercise of a legitimate self-control power. If so, the advantages of a review system implemented through panels whose members are adequately specialized in tax matters and which operate separately and independently from the bodies that conduct the proceedings subject to review, seem to be quite clear, as more objective decisions may be obtained.

In any case, the debate is futile if it only takes into account theoretical positions separate from a specific reality that may be assessed. A critical view on the existence of these administrative panels might well rest upon such cases where their composition and mode of operation infringe, in practice, the fundamental right of citizens to obtain effective judicial protection recognized in any legal system.

To conclude that Administrative Fiscal Courts should certainly exist in any given system, these courts should comply with the features described below.

Notwithstanding the fact that these entities may have differences, sometimes in relevant aspects, the comparative analysis of the administrative courts actually existing in several countries suggests that they should meet the following features so as to be capable of appropriately serving the purposes for which they are created¹:

¹ Pursuant to the Court of Justice of the European Community, located in Luxembourg, an entity with these characteristics, even if framed within the sphere of the Executive Branch, should be deemed as a “jurisdictional body” for the purposes of article 234 of the Treaty of Rome (establishing the European Community). This was raised as the basis for the Spanish Central Economic-Administrative Court to bring pre-judicial matters to such Court of Justice, a criterium ratified by the above-mentioned Court of Luxembourg.

- Be of legal origin, created by legal statute. This is a necessary though not unique requirement to ensure effective operative independence in issuing decisions;
- Be permanent bodies;
- Be a mandatory “jurisdiction”; that is, remedies at this instance must be exhausted prior to bringing the case to the Courts of Justice;
- Make decisions upon the basis of the law, unlike other entities whose resolutions are supported by equity criteria; and,
- Resolve in contradictory matters, so there must be two parties to the proceeding (in general, the TA and the taxpayer, but there may also be conflicts between private parties). The court should take no position in the litigation, rather it must resolve the matter based upon the allegations and assertions of the parties. This principle is complied with even if the court may and will resolve all the matters arising in the case, even if not raised by the interested parties. It is essential, however, that both parties be given the same rights to be heard and to produce evidence; that is, the conditions of the parties to defend their allegations be equal.

CIAT has played a relevant role in the creation of the AIT, which was agreed during the CIAT Technical Seminar held in Guanajuato (Mexico) on May 4-7, 1992. Throughout this Seminar on Fundamental Aspects of Present Problems on Fiscal Legislation, several topics were considered, including, among others, “Tax Courts: location, autonomy, competence and composition.”

Also during the seminar, the grounds for the implementation of bodies within the sphere of the Executive with the duty to review the decisions of the Tax Administrations were discussed. As usual, there were arguments in favour and against. In the general report of the Seminar, entrusted to me, I summarized the discussion as follows:

“Regarding this issue ... there have been arguments in both directions.... The reply to the question of the reasons that justify the existence of these administrative courts rather than promoting the courts of justice has been that if the courts currently in existence evidenced satisfactory performance, this sole circumstance should suffice to justify their use and support their future work. In any case, the general opinion is that two requirements must be met: (1) the administrative courts’ independent criteria should be guaranteed for the resolution of the conflicts brought to them; and (2) taxpayers should have the possibility to ultimately bring the case to the Courts of Justice.”

In a session parallel with the Seminar, the presiding officers of the participating administrative courts (Argentina, Bolivia, Costa Rica, Ecuador, Spain, Mexico, Peru and Uruguay) decided to study an appropriate way to institutionalize cooperation among the existing courts in Latin American countries and Spain. To such end, permanent cooperation systems were established allowing for the exchange of knowledge and experiences to facilitate the proper operation of these bodies for the benefits of the Tax Administrations and the taxpayers.

Contact among the presiding officers of said courts was maintained ever since the execution of that agreement so as to define the appropriate framework to implement a cooperation channel to attain the goal set. Again, it is worth noting that CIAT Executive Secretariat played a decisive role in this process sharing its vast experience in international cooperation regarding tax matters.

The process concluded with the agreement to create the AIT, executed in San Juan del Río, Querétaro, Mexico, on August 21, 1996, by the presiding officers of the courts that participated in the 1st International Congress on Administrative Justice, on August 19-23, 1996. The members of

the Association were the Administrative Courts of Argentina, Colombia, Costa Rica, Ecuador, El Salvador, Spain, Mexico, Peru and Uruguay. Since then, other courts have been added and today the AIT is composed of the courts of fifteen countries: Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Spain, Mexico, Panama, Paraguay, Peru, Portugal, Dominican Republic and Uruguay.

The by-laws of the AIT clearly express the purpose for which the Association was organized: “Foster the development of fiscal and administrative justice through an exchange of ideas and experiences regarding the issues brought to the consideration of the several jurisdictional bodies that make up the Association, or that are in connection with the structure, organization, administration and procedure of its members.”



5

**TAX COMPLIANCE
OVERSIGHT**

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TAX COMPLIANCE OVERSIGHT

José García Ríos, Paulo dos Santos and Stefano Gesuelli

To accomplish the goal of maintaining an acceptable level of voluntary tax compliance, the TA must make use of its powers of dissuasion. First, it must identify the causes of breaches by using the tools offered by sociology. It must apply these tools to fiscal and tax socioeconomic policymaking with a view to striving for better scenarios, and offer a better service to the community. Finally it must manage appropriate risk conditions.

Sevilla (2004) reports that countries with fiscal gaps in excess of 40% are faced with enormous difficulties to bridge the evasion gap. These countries are generally characterized by a very weak TA, often unable to enforce rules in general due to lack of coercive capacity.

Withholdings and massive control actions are some of the tools TAs have used to secure their revenues. The former were used seeking to expand their reach and the latter through high-impact actions aimed at raising risk awareness throughout society.

Both these aspects will be addressed below, but not without first reflecting upon Orwell's dystopia (1949) which presented a future for the early 20th century where society could not escape the control exercised through information systems manipulated for the purposes of mass repression.

It is just not possible to discuss ways of addressing tax compliance without analysing the tools required for that purpose. There will always be a need for information technology, whether as feedback for socioeconomic and tax policymaking, to offer the community the services they need or, ultimately, to exert the TAs dissuasion power.

Ever since it was established, and especially since the last decade of the 20th century, hand in hand with technological developments, CIAT has maintained a red flag over informality and focused on project development, personnel training, research paper competitions and, most notably, the exchange of experiences with those countries that have contributed the most to technological breakthroughs.

These breakthroughs were part of its history and were anticipated in amazing predictions, such as those by Pedro Pavesi at the 1981 General Meeting in Mexico D.F. in his presentation "*Perspectivas de las funciones críticas de la AT*" which forecasted advances in data processing by using: i) a technique for databases and ever-cheaper storage mechanisms, with growing capacity; ii) the development

of interconnection between intelligent units creating transportation and processing networks; and iii) the development of the small domestic computer.

He predicted that –in the future– tax life would be stored and monitored by information systems, that taxpayers would create the information through direct and automatic reading mechanisms and that there would be an exchange of information support between taxpayers and TAs, and that it would be possible to transmit information across computers using telecommunication and that taxpayers' communication in TAs' central computer would operate out of what he called a domestic computer.

After just one decade, these predictions materialized, as clearly reflected in the reports that I have had to prepare. These advances have allowed TAs to develop the dissuasion powers they have now, which will undoubtedly be the basis for an even more promising future.

a. Mass Adoption of Withholding Regimes for Most Common Taxes

Withholdings may be deemed to include mechanisms which secure the collection of taxes from a large mass of taxable subjects by delegating the collection duty onto a third party. In his work, Samanamud (2013) defines them as advanced payment mechanisms.

Higgs (2007) argues that the precedents of withholdings date back to the time of the American Civil War (1861-1865) when the Treasury withheld taxes from federal employees under a law subsequently repealed in 1872. He explained that “wars have demanded revenues that have been used as arguments to create and establish new forms of taxation, States create new taxes, increase tax rates and resort to all sorts of measures to raise those revenues: withholdings are one of those measures.”

In 1913, following approval of the IT laws, taxes were withheld at the source. This system gave rise to so many complaints on the part of employers that Congress withdrew the authorization in 1917.

After the approval of the Social Security Act in 1935, salary taxes authorized thereunder began to be collected at the time of payment.

As from 1940, as the Government began to mobilize to wage the Second World War, the demand for revenues spiralled and after over one year of discussion by bureaucrats and Congress on how to meet such demands, the Current Tax Payment Act was enacted on June 9, 1943.

The withholding system has remained uninterruptedly in place in the US since 1943 and has made a huge contribution to supporting the post-war State. According to Higgs, the Treasury has publicly acknowledged, in a technical report on the history of the US Tax system posted on his website, that wartime withholding not only “greatly eased the collection of the tax,” but “also greatly reduced the taxpayer’s awareness of the amount of tax being collected.”

He also refers that Milton Friedman, who admitted being “one of the architects” of the Treasury’s proposal for a withholding system, noted in his memoirs that withholding was an essential element of the government’s wartime revenue grab. According to Higgs, Friedman concluded, “we concentrated single-mindedly on promoting the war effort. We gave next to no consideration to any longer-run consequences. It never occurred to me at the time that I was helping to develop machinery that would make possible a government that I would come to criticize severely as too large, too intrusive, too destructive of freedom. Yet, that was precisely what I was doing.”

In Latin America, tax withholdings have been applied since last century, especially for Income Tax, but their massive use and application, especially with other taxes, is a tendency that began some 20 years ago.

Over the 80s, CIAT discussed the issue of withholdings at its General Meetings and Technical Conferences, and countries presented the benefits and weaknesses of such regimes.

At the 1985 Technical Conference in Buenos Aires, José Alves da Fonseca from Brazil argued that evasion rates were significantly lower for taxes featuring withholdings or advance taxes. For instance, income not subject to withholding is much more susceptible to being omitted from tax returns.

In his 1987 presentation at the Technical Conference of Madrid on the impact of the reforms on Colombia's TA, Héctor Jaime Duque Arbeláez underscored the advantages of withholdings for tax collection, and highlighted the increase of withholdings as a benefit both to control evasion and to bolster tax revenues.

At the 1989 General Meeting in Montevideo, Jorge Cosulich and Jorge Corradine presented the results of a survey which showed that six countries already had withholding systems.

Back in 1991, while describing TAs' strategies for the 90s, Edison Gnazzo highlighted at the General Meeting in Washington D.C. that, together with new legal systems in the 80s, Colombia, Guatemala, Honduras, and Panama had extended their withholdings and advance tax regimes.

William Chong Wong, from Honduras, pointed out at the same meeting that withholdings were just a form of simplification that cut down costs for contributors and for the administration.

Angel Yoingco, from the Philippines, and Ching Chang Yen, from the People's Republic of China, in their presentations at the 1991 Taipei Technical Conference, reported on the extension of tax withholdings in Argentina and Paraguay, the incorporation of real estate transfers to Colombia's regime and the payment of taxes on

debts in El Salvador. They further explained that in the People's Republic of China they were used to facilitate tax collection.

Silvio Ivan Bendaña Mora, from the General Directorate of Revenues of Nicaragua (DGI), at the 1993 General Meeting in Santiago, pointed out a substantial increase in tax revenues caused by a fiscal policy reform consisting mainly of a generalization of tax withholdings to the agricultural and farming sectors.

However, at a presentation at the same meeting, Mario Aranguren argued that Colombia's 1986 reform had attached significant interest to administrative practices and to the institutional structure, which had become obstacles to an efficient system; that the TA made a decision to present reforms to facilitate taxpayers' compliance that were approved by Congress, they reduced the Income Tax on Legal Persons (ITLP) rate and adopted the regime of withholdings at the source. He concluded that, most likely, the effort to articulate substantive and administrative matters had led not to streamlining the TA but to a redesign of the system taking its shortcomings into consideration.

At the 1994 General Meeting in Quito, Dr. Jaime Ross Bravo suggested that it was difficult for TAs to control systems with such a large number of taxpayers that were so scattered, which led to the establishment of systems for withholding at source or advance taxes, which required TAs to be adequately equipped, from a technological standpoint, and to have the required information.

At the 1994 Technical Conference in Bariloche, on the application of withholdings to the agricultural and farming sectors, Horacio Castagnola explained that Argentina was characterized by a high level of geographical dispersion, with a strong concentration of ownership and high levels of noncompliance, so that the withholding system offered many benefits of varying nature, and represented a means to secure tax collection.

Several countries apply advance taxes mechanisms both for IT and for VAT, although it is worth noting that the use of these mechanisms has spread to many other taxes.

Withholding systems raise concerns in connection not only with the ensuing social cost, but also –and especially– with the contribution to voluntary tax compliance.

Some legal regimes include them as a solution to some of the difficulties posed by certain tough-to-oversee taxpayers or economic sectors; however, for Sevilla (2004), their implementation reveals the TAs failure to cope with tax collection issues resulting from the large number and dispersion of taxable events, by choosing to shift the associated costs onto economic agents.

At the same conference, Horacio Castagnola explained that, in Argentina, withholding breaches were punished with strong penalties such as a suspension of slaughter activities by the authorities of the National Beef Institute (*Junta Nacional de Carnes*) and the SENASA (National Service for Agrifood Health and Quality.)

Adapting withholding regimes to society’s culture was a difficult task. From their inception, they caused a reaction that resulted in increased complexity of tax regimes and higher social costs.

Samanamud (2013) argues that it is hard to set up withholdings to become a part of social taxpaying practices. The withholding regime has brought about increased complexity of tax regimes which requires TAs to offer better services and show enhanced dissuasion powers.

Employer withholdings constitute true “clamps” for many socioeconomic sectors, especially the most vulnerable ones. In authoritarian States, these regimes may prove to be highly effective to restrict free economic activity.

Social resignation over its implementation originated in exceptional circumstances which, at the time, demanded greater resources than those provided for in the government budget, and they then remained in place for they were a handy tool to TAs.

Although it is true that withholding regimes have aided in securing the revenues required to overcome financial problems, it is also true that they shifted additional costs onto society; they have affected economic neutrality and have resulted in temporary financial flows to withholding agents.

b. Extensive Controls

These are strategies on the part of the Tax Administration to reach the universe of any taxable party through a massive approach with media impact, through persuasive or dissuasive methods, showing its capabilities, powers and the political will to resort to coercive mechanisms, if necessary, to drive voluntary compliance with a minimum repercussion on its regular economic activity.

In the 80s, the CIAT conducted several initiatives to support TAs management through large scope community actions aimed at bridging compliance gaps.

Gunter Shakov, in his presentation “*Possibilities of simplifying tax audit procedures in Germany*” made at the 1986 General Meeting held in Buenos Aires, recalled that “even when a small number of taxpayers are audited, nobody in the universe should feel safe; it is not the purpose of the audit to collect as much as possible, but to send a message to the whole universe of taxpayers, for the ultimate purpose is to drive voluntary compliance.”

In his presentation to the General Meeting in Montevideo in 1989, Jorge Cosulich and Jorge Corradine argued that no administration is efficient if it fails to reach the universe of taxpayers to know who they are, how much they owe and when they are supposed to pay.

Juan Guillermo Amaya Salcedo, from Colombia, in his presentation “*Ambiente ideal para la adopción y transferencia de tecnología*” forecasted at the same meeting that when we get to know the region’s tax system in depth and are equipped with adequate tools to do so, change will come as a natural process.

The use of equipment and the development of systems to reach taxpayers were inevitable conditions to evaluate the efficacy of the TA in fostering voluntary compliance of tax obligations.

Under tax regulations, the TAs are generally granted the power to demand from taxpayers all the information required to identify and locate taxpayers, to know the activities they perform, evaluate their economic reality and determine the truth of their tax returns, as well as to validate such information.

This allows identifying any events of noncompliance through the electronic processing of heaves of data that flow into the TA, by means of consistency and adequacy checks which underscore any discrepancies between the amounts reported and the economic position of the taxpayer reporting them.

In their presentation at such meeting, Jorge Cosulich and Jorge Corradine commented that Chile was already analysing 100% of VAT tax returns for consistency back at that time, and was also analysing invoice authenticity, which contributed to voluntary compliance with the resulting increase in tax revenues.

At the General Meeting in Santiago de Chile in 1993, in his presentation, “*Apoyo informático de la AT al contribuyente*”, Michel Delattre anticipated that an electronic transmission certificate would be issued facilitating the filing of tax returns, and announced that France was

already analysing the possibility of an electronic VAT tax return.

These processes send scattered signs throughout the taxpayers’ universe, systematically acting on it to improve compliance.

Once the data infrastructure has been established, the next step is to run matching processes and consistency checks. The results of these processes must be compared against information from other available and reliable sources (such as property records and the financial system) to identify the existence of any invalid data and differences which may only be accounted for by high social mobility. Discrepancies may also arise from other sources, the availability and transparency of which varies significantly among countries.

According to CIAT/IBFD (2011), Jean Baptiste Colbert –a precursor of interventionism and minister of Finance of Louis XIV- held: “The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing. The people are but a giant goose to be plucked as efficaciously as possible.”

The TA must define a strategic risk approach, enabling it to show society that it is aware of the events of noncompliance, that it is in a position to recover unpaid amounts and to enforce sanctions increasing such amounts. All of its actions must be in line with this strategic approach, evidencing planning, transparency and efficiency with a view to strengthening institutional credibility.

Héctor Jaime Duque Arbeláez, at the 1987 Technical Conference in Madrid, explained that the reforms introduced by Colombia’s Tax Administration had resulted in an increased number of documents received; therefore, they were forced to suspend thorough audits to engage in massive controls of minimum compliance by taxpayers, and they sped up controls of taxpayers to accelerate massive programs for arithmetic adjustments.

At the same conference, Rafael Sagrario explained that these changes to the Tax

Administration procedures and the creation of a new verification position for tax agents in a category below inspectors had made it easier to incorporate millions of taxpayers to their databases.

In his presentation “*La integración de la administración del sistema tributario*” at the 1994 Quito General Meeting, José V. Sevilla Segura stated that, back in the 60s, tax revenues in Spain originated in a limited universe of taxpayers and inspections were key to the system; however, as from 1977 inspections lost relevance vis-à-vis administrative areas and the number of taxpayers increased significantly.

At the 1994 Bariloche Technical Conference, Fernando Díaz Yubero explained: “The worst that can happen with mass controls is the same as with traffic violations; so many of them are issued, that most of them are not ultimately collected.” With this he stressed that any procedure that begins must be completed. He added that massive controls supplementing in-depth oversight actions offer several advantages, since they may be carried out by low-skilled personnel and lead society to perceive there are fraud controls in place, which constitutes a key element of voluntary tax compliance.

Striving for a better quality of data to feed their audits, towards the 90s, TAs implemented rules regulating the documentation required to support the legality of economic transactions and transportation and storage of goods, and set up procedures to oversee compliance of said rules.

In certain countries such as Peru and Ecuador, purchase simulation programs were created to verify that adequate receipts were delivered for every purchase and sale transaction; road checks were made to verify that goods in-transit were accompanied by adequate supporting documentation and warehouse inspections were conducted to oversee compliance in the storage of goods.

These oversight techniques resulting in close-downs and seizures in the cases of non-compliance, which are very simple and dynamic

in nature and may move at a very high speed, had a strong social impact.

Surprise, simulation and publicity of the sanctioning power by visible signs constitute inherent characteristics of this type of procedure, thus provoking strong media repercussion of administrative actions in areas prone to severe tax informality.

Additionally, other less repressive techniques were established to promote voluntary compliance, such as those described by Yu Ming Yang, from the People’s Republic of China, at the Taipei Technical Conference in 1991. He explained that his country printed invoices supporting transactions and encouraged their delivery through sweepstakes and games.

When non-compliance is due to socioeconomic or cultural causes exogenous to the TA, the efficacy of the institutional dissuasive capacity and the influence of the media to disseminate such efficacy among the people are essential.

Having defined the social stigma through severe disapproval of certain characteristics or beliefs that are perceived as contrary to predefined cultural standards, it is worth diving in greater depth into the effects of tax actions on certain emerging subjects in society.

With no objective other than to attribute the reason for a change in behaviour to the effects of an extensive control strategy, I would like to refer to a legend I often use for clarity: “Once upon a time, there was a mayor who, concerned about the pigeons that had invaded one of his favourite parks, causing nuisance to passers-by, tourists, painters and customers of the adjoining picturesque cafes, used every means and funding available to eradicate them. He had used whips and the sound of cans to scare the pigeons off, but these loud sounds would disgust the park visitors more than they would scare off the birds, which would return as soon as the noise subsided. The mayor’s last idea had been to grow poisoned plants; a strategy that gave him more than one headache over the death of some pets. One of the villagers, well aware of the mayor’s concern, offered to eradicate the pigeons permanently for

a good price. The mayor, feeling helpless after his repeated failed attempts, accepted. Having shaken hands, the villager took a cage to the park and caught two birds which he took home. He set up a recorder and started to pluck one of the pigeons alive, recording the painful moaning, until there was not a single feather left on the body of the ill-fated bird. Then he did the same with the second pigeon. When he finished, he requested to the mayor that speakers and the necessary sound equipment were set up in the park to play the painful moaning of the birds. No birds were seen in the park ever after.”

At the 1990 Oaxaca General Meeting, Rubén Aguirre, from Mexico, shared an interesting view: *an audit resulting in the imprisonment of one citizen has a stronger social impact than any oversight activities.*

The visible signs that publicly show the events of non-compliance identified and the sanctions enforced are a supplementary and effective tactic of these actions because of the potential for stigmatization of the individuals involved.

Administering the tax system requires knowing the economic, legal and sociological characteristics of the social group involved in order to understand and act on the motivations for tax non-compliance, and requires a risk prevention and dissuasion strategy aimed at mitigating such risk.

The TA constitutes a large audit system that must operate based on large volumes of data on economic activities for purposes of identifying events of non-compliance and tax fraud.

The different ways of accessing the information sources that feed TAs’ control processes and the required technical support have been a shared concern of tax administrators, who have found in CIAT a forum to share experiences and obtain support through project development.

c. Third Party Information

During the 80s, CIAT was an enthusiastic champion for the development of data matching systems that enabled comparison of taxpayers’ data and matching such data with other external sources to verify the accuracy of their tax returns and/or identify omissions.

CIAT focused its efforts mainly on providing support to Latin American Countries by sharing the experiences of more developed countries that had strengthened their own TAs aided by technological support, seizing the benefits technology offers to curb evasion.

In 1985, at the Port-au-Prince General Meeting the participants felt that inadequate technological resources and scarce development led some TAs to think that the growing amount of data they were demanding from taxpayers was more than they could handle or audit, and that they needed to limit such data requirements to a select number of taxpayers rather than demand it from all taxable subjects.

When they gave their presentation “*Sistemas de información de las AATT de los países miembros del CIAT*” at the 1989 General Meeting in Montevideo, Jorge Cosulich and Jorge Corradine explained that the tendency to streamline tax administration systems had grown over the last few years, although electronic tax return filing was not available in most member countries.

While Spain was already performing parallel tax settlements based on consistency checks of taxpayers’ returns and the US was collecting tax return data by optical character recognition and experimenting

with microcomputers, some Latin American Countries, poorly equipped with technological resources, barely had some checks in place to compare data such as Employer v. Withholdings, Supplier v. Purchaser, Total Assets v. Real Estate and Personal Property and Dividends v. Banks and Financial Institution.

At the same meeting Gustav Hubner explained that 50 years earlier there was no ADP in Germany, but there were certain TA procedures that led to the implementation of the tools that resulted in the creation of the information system and ultimately supported the development of such system. In this regard, he suggested that information systems should be viewed as tools and never as an end in and of itself.

VAT was conceived by the French economist Maurice Lauré back in 1954 and introduced in France in 1968. With the establishment of the EEC, the introduction of VAT spread to other European countries.

Spain introduced VAT in 1986 and in 1987 databases were set up to feed inspections; however, already as early as 1970 there was matching of a person's sales against another person's purchases.

The information used by tax audits is built on the VAT taxable base, supported by billing control systems with documentary support of domestic sales and purchases and exports and imports, at international trade level. Systematization, storage and availability of the supporting details of these transactions provide more "transparency" to economic activities.

Few economic units that compose the segment accounting for most of a country's revenues constitute a rich source of data, priceless, both in terms of the number of transactions reflected and the support and technology they have to provide such information. Their accounting systems evidence sales and purchases used for the assessment of taxes, which allow TAs to validate those records and match customers' and vendors' information to verify the accuracy of the information submitted and demand that any identified discrepancies be cured, if necessary.

Accordingly, massive audits by TAs must therefore rely on the information obtained from VAT tax returns to identify differences that would also permit correcting the information reported in IT returns with a certain degree of objectivity.

In 1990, in his presentation "*Las nuevas tecnologías y la gestión tributaria*", Jaime Gaitero explained at the Madrid Technical Conference that the problem of TAs was trying to explain the auxiliary nature of information technology as an aid to the core function of tax management. He held that the system architecture entailed obtaining the information from taxpayers' returns, information obtained from third parties related to such taxpayers and information from other agencies which had to be processed and added to databases.

Gaitero listed among the requirements for computerization in a strategic plan for its development: the intent to embrace technology, a fiscal model to which it could be integrated and TAs' stability.

At the same meeting, the esteemed and well-remembered Jorge Corradine summarized the progress made by TAs and pointed out that CIAT member countries began to computerize their systems in the 60s, particularly in support of taxpayer census, tax assessment, collection and—in some cases—for compliance oversight. Many changes have taken place since then, such as structural techniques for system design, automated file management, data management tools that support modular databases and the emergence of microcomputers, which have revolutionized information technology.

The United States Internal Revenue Service (IRS) had implemented electronic data entry by hiring companies that transmitted processed information, thus eliminating the need for TAs manual processing, by replacing output account lists by access to debits and credits, using telephone network transmissions and satellite communications. It also performed automated collections of overdue balances, used microcomputers for large taxpayers' audits and used a discriminating feature for audit selection.

Word Perfect and word processors had brought ease to IT communications.

In 1991, in his presentation “*Estrategias de la AT para la década del 90*”, Edison Gnazzo noted at the General Meeting in Washington D.C. that there were more and more countries using technology to obtain third parties’ information, including Argentina, Bermuda, Brazil, Colombia and México.

At the 1992 General Meeting in Montego Bay, R. M. Beith, from Canada, explained that the electronic filing of tax returns was becoming common practice, as well as telephone data collection through the use of electronic tools.

The old times where it was necessary to request information have been long left behind by the use of technology. Nowadays, economic production and commercialization chains in several countries are directly connected to the TA over electronic billing systems.

Internet has facilitated communication between TAs and taxpayers. TAs use these channels to disclose and disseminate applicable laws, support compliance with tax duties, notify administrative resolutions and obtain tax return details.

We are living in the “global village” envisioned by Mc Luhan back in the 60s, a global world communicated electronically which facilitates permanent conversations. Virtual connection is now a reality, and taxpayers may feel both supported and controlled by Web services. There is no argument to the contrary, since control is as extensive as direct personal actions, or even more.

We have discussed the emergence and evolution of certain methods for the elaboration of data to feed TAs’ processes. The results obtained through these methods must be corroborated against other databases to verify them, and refined accordingly. The main and usually the most available and relatively reliable data sources include property registrars; financial system records and credit card usage data, investments in securities and mortgage loans, among others.

Countries have made huge efforts to overcome tax non-compliance factors that are exogenous to TAs, and to dissuade such violations. However, informality persists and this affront to the State has become a cultural habit, as reflected in the news on a daily basis. The time may have come for us to change our approach to voluntary compliance, appealing to the conscience of a society ever more concerned about economic downturns, insecurity and poverty.

Today’s technology enables full transparency of taxpayers’ records, leaving no reason for a TA to exclude them from random audit programs as long as there are no elements requiring it. The goal is to build new relations of trust which may be achieved by enhancing TAs’ efficacy in fostering voluntary tax compliance.

Finally, accepting the restrictions imposed in our countries for the development of systems to improve tax culture, I would like to borrow the words used by Jorge Corradine to conclude his 1990 presentation: “*Embracing change is as complex a task as change itself.*”

d. Large Taxpayer Units

The idea to set up special units to control large taxpayers was first introduced in Argentina back in 1974. It was inspired in the Pareto principle (or 80/20 principle) enunciated by Italian economist Vilfredo Pareto in 1896. This principle states that 80% of the consequences result from 20% of the causes. Pareto applied this principle to analyse land ownership concentration in Italy. Around 80% of the land was in the hands of 20% of landowners. If we apply this principle to TAs, we could say that 80% of tax revenues are paid by 20% of taxpayers. It thus follows that if the TA manages to oversee its major taxpayers adequately, it can control most of its revenue.

This is a general principle and does not accurately reflect tax revenue concentration, which used to be higher in CIAT countries in the 1985-1994 decade. Most of the countries presented (and still present) a high concentration of revenues in a small group of taxpayers. Table 1 shows that, generally speaking, a very small universe of taxpayers (namely, between 0.01% and 0.93%) contributes between 47% and 85% of total tax revenues.

There were several reasons for the introduction of Large Taxpayers Units (LTU) in CIAT countries and around the globe. In addition to controlling those responsible for the greater share of tax revenues, other motives were identified. First, the application of adequate control systems on large taxpayers causes effective positive results in tax collection in the short term. The computerization of the LTU in Uruguay in 1988-1989 resulted in increased tax revenues from that group. A survey revealed an increase in VAT revenue in excess

Table 1: Tax revenue concentration in some CIAT member countries/¹

Country	Concentration of revenue (% of total revenues collected)	Number of large firms (% over total taxpayers)
Argentina (2010-11)	81,6	0,02
Bolivia (2013-14)	83,2	0,93
Brazil (2013)	74,0	0,01
Canada (2007-11)	n.a.	0,90
Chile (2010-13)	85,0	0,05
Colombia (2010-11)	79,8	0,03
Costa Rica (2013)	64,4	0,10
Ecuador (2013-14)	59,0	0,02
El Salvador (2010-13)	77,5	0,16
Spain (2011)	n.a.	0,01
USA (2007-11)	n.a.	0,08
France (2007-11)	n.a.	0,09
Guatemala (2010-13)	73,4	0,08
Honduras (2010-11)	85,0	0,65
India (2011)	n.a.	0,04
Italy (2011)	n.a.	0,01
Kenya (2008)	n.a.	0,09
Mexico (2013)	62,3	0,04
Nicaragua (2010-13)	72,9	0,23
Netherlands (2007-11)	60,0	0,02
Paraguay (2013)	67,4	0,18
Peru (2013-14)	73,9	0,20
Portugal (2011)	n.a.	0,02
Dominican Rep. (2010-14)	75,0	0,44
Uruguay (2011-13)	46,8	0,02

Source: IDB, CAPTAC-DR, CIAT (2012), RA-FIT, OECD (2009), OECD (2013), SIN, DIAN, SUNAT, TADAT, ADB (2014), ITD (2010)

1/ From the presentation by Miguel Pecho at the 2015 Lima General Meeting, "La gestión de riesgos de cumplimiento de las grandes empresas."

of 22% at constant values from 1989 to 1991. Economic growth over the same period was 4%. The survey was conducted again in 1993 with new taxpayers incorporated to the system, and the results obtained were similar.

Another strong justification was that these units could serve as pilot units for the implementation of reforms. The purpose was to test new ideas at the large taxpayers' unit, and then apply those ideas to controlling other taxpayers. In 1992, Argentina introduced a reform of its LTU following a model used in Uruguay with the support of CIAT, the IDB and the IMF. Uruguay's experience was studied and served as the basis for the development of a modern IT System for large taxpayers' control (Dosmil System). The system was so successful with the LTU at the former DGI that it was subsequently extended to over one hundred DGI branches to control small and medium-sized taxpayers.

Another relevant factor was the availability of accurate and timely information on large taxpayers' returns and payments. The delay in identifying breaches by those taxpayers may have a significant impact on tax revenues and make it very hard to collect overdue amounts. The same holds true regarding the availability of information on large taxpayers' clients and suppliers.

Another reason considered by TAs at the time was that large taxpayers are different from others and must thus be treated differently. They manage a large number of transactions, often engage in complex international transactions that may involve transfer prices, they are importers or exporters and have highly skilled professional accountants and attorneys to device their tax structure. For all of these reasons, in order to ensure adequate tax compliance control, it was necessary to offer appropriate services to aid them with any complex issues affecting them.

Despite all of the reasons above, it must be noted that large taxpayers' control cannot be an isolated strategy. In CIAT countries, this control was part of a wider strategy which also featured control of unregistered or undocumented taxpayers, control of small taxpayers as well as

control of medium-sized taxpayers. Of course the priority was to oversee large taxpayers. A good example of that strategy was that established by the SUNAT at the onset of their first reform in 1991-1992. Simultaneously with the overhaul of its LTU, the SUNAT conducted immense control operations targeted at informal taxpayers and small taxpayers not issuing invoices, ordering temporary shutdowns of establishments found to be in violation, and control over Self-Declared Transactions (COA Program) based on cross-checking of invoice information. In this way, different categories of taxpayers sensed an increased risk of detection of violations.

The establishment of LTUs between 1995 and 2004 encountered many difficulties. Some renowned tax specialists were skeptical about this strategy. In the early stages of these units, their detractors (some of them well-known leaders of the international TA) held that this was barely a partial solution, because it failed to solve tax non-compliance as a whole. These experts clearly failed to realize that this was just the beginning (with the highest marginal productivity) of a segmented taxpayer control strategy and that it was also an opportunity to try new procedures. Some of them held that specific large taxpayers' control was too expensive and was unwarranted because these taxpayers complied with their tax obligations. Others used commercial banks as a benchmark and argued that banks did not use special agencies or branches for their large clients (something we see in many countries today.) Some argued that by setting up these units, excessive powers were granted to a small group of officials who would in turn control most of the country's tax revenues. Finally, some experts argued that LTUs would become a parallel TA in addition to the tax directorate.

Another challenge was defining the scope of LTUs. Some specialists argued that they had to have audit powers, others stated that they had to control compliance with tax return and payment obligations, and others held that they should oversee all aspects of large taxpayers' compliance. This last alternative has generally prevailed. However, in the period analysed, Uruguay was the only country that maintained audits outside the scope of the LTU. Four countries in the group

did not have any special procedure in place to control large taxpayers' compliance with their reporting and payment obligations (Brazil, El Salvador, Spain and USA).

As regards functional dependency, LTUs did not necessarily report to the General Directorate. Administratively, they reported to an Operations Director and, functionally, they were under the scope of Central Regulatory Offices, which were in charge of defining Plans and their Charters, to be transmitted through the Operations Director. This structure was the one adopted in most countries, although some LTUs reported to the General Director, such as those in El Salvador, Nicaragua, and Paraguay. It is necessary for Central Regulatory Offices to have functional hierarchy over all TAs Operating Units, including LTUs.

Moreover, another challenge was to define the coverage or jurisdiction of LTUs: nation-wide or only over the country's capital. Smaller countries, such as Uruguay, chose to have a single LTU. Larger countries such as Peru, for example, chose to have regional units to control each region's large taxpayers. The idea was to maintain direct contact with taxpayers located in other urban centres.

Finally, another challenge was to set up selection criteria for large taxpayers. In the late 80s, few countries had reliable information on their taxpayers' transactions. The best information available was that on taxes paid during previous years. Therefore, that became the prevailing criterion in that period. Today, some TAs also consider the volume of sales or revenues, assets and—in certain cases—some special characteristics of taxpayers (exporters, payers of selective excise taxes, etc.).

Since one of the goals of LTUs was to have accurate and timely information on tax returns and payments, tax returns and payments were received directly at the LTU. Accordingly, the taxpayer or its agent had to go personally to the LTU offices to file the tax return and make all applicable payments. Tax return information was then digitalized and validated before taxpayers and was immediately available for audit. In many

countries, LTUs were used as pilot tests for the implementation of diskette electronic tax returns in the 1995-2004 period. Argentina's DGI was a clear example in this regard.

As for payments, LTUs in some countries used their own payment counters, but others negotiated the installation of bank branches at the LTU. In this case, LTUs were used to implement new systems. Ecuador's SRI LTU innovated in the early 90s offering its taxpayers the possibility of paying through the Central Bank of Ecuador.

In the field of IT, there were significant breakthroughs in the 1985-1994 period in connection with the development of large taxpayer systems. International agencies operating in Latin America articulated their efforts in promoting the development of those systems throughout the region. After the implementation of these systems in Uruguay and Argentina, the CIAT was in charge of computerizing large taxpayer systems in several countries, including Peru, Venezuela and some other countries in Central America. A need was identified to design a standard, customizable IT system to control large taxpayers. In 1993, the CIAT conducted a noteworthy initiative to adapt the large taxpayer control system designed originally for El Salvador to be used in Nicaragua. That adaptation took just a few months. The adaptation was possible because when the system for El Salvador was designed, the approach was mainly table driven, i.e., many of the system's features were customizable and set as parameters, instead of being part of the software code. When it was necessary to set up the system in Nicaragua, the conversion work consisted basically in changing the parameters on the tables and performing the necessary system tests. That was the blueprint for much of the software commercially available to TAs around the world today.

CIAT countries played a decisive role in the development and expansion of the notion of large taxpayers worldwide. The international experts from the CIAT, IADB and IMF involved in the implementation of Latin American large taxpayer systems spread the word to other parts of the world. Today, LTUs are an integral part of most TAs. The pioneering countries in our region

were Argentina (1974), Bolivia (1988), Colombia (1988), and Uruguay (1988).

The results of the efforts made by countries to establish their LTUs with the support of the CIAT, the IDB and the IMF are incontestable. Today, the strategy of special control over large taxpayers is more widely known, accepted and used worldwide. LTUs have industry specialists that enable more targeted control of large taxpayers based on industry. Additionally, significant progress has been made in terms of international taxes focusing on large companies.

Large taxpayers' compliance has improved significantly. All omission and delinquency levels have been dramatically reduced in virtually every country where the notion of LTU has been adopted. Moreover, the services provided to these taxpayers has improved considerably.

Following the successful experience of the special control over large taxpayers, some industrialized countries decided to change their business models. Those countries were reorganized by taxpayer category.

The success of the large taxpayer control strategy supported by the CIAT, the IDB and the IMF is undeniable. This strategy has been adopted throughout the world by both industrialized and developing countries. Operating conditions have evolved. In many countries, tax returns

are filed and payments are made electronically, and taxpayers do not have to go personally to the LTU to do so. Likewise, there is no longer a need to have a bank branch at the LTU.

Large taxpayers' audit has made significant progress. At present large taxpayers audits are industry-specific (finance, oil, telecommunications, etc.), and international audits have also become more specialized with the emergence of specialists in transfer pricing audits.

Baer (2002) points out the risks associated with the success of any large taxpayers' strategy. One of them is that LTUs may not assume all of the TAs duties over their taxpayers, or may not control all taxes. Another one is for the TAs regulatory framework not to define adequately the powers of the LTU or taxpayers' rights. Particularly, it is necessary to define very clearly the selection criterion for the taxpayers to be included in the LTU.

Moreover, LTUs' officials must be adequately compensated and trained, especially on the audit of the country's most relevant economic sectors and transfer pricing. Finally, in terms of management, it is essential that LTUs follow the guidelines set up by central functional offices (compliance control plans, selection criteria, etc.) rigorously, and that they be systematically evaluated based on objective performance indicators.

e. Tax Intelligence

The progress in trade and economic transactions over the last few decades has progressively created a need for TAs to develop capabilities and models different from those used in the past and capable of meeting the growing challenges in terms of efficacy and efficiency of their activities both in the area of services provided to taxpayers and in the area of actual fraud and evasion detection, avoiding massive operations that have a negative impact on the market.

Accordingly, and to be up to the new challenges associated with the growing need to fight increasingly more sophisticated forms of fraud and evasion, many TAs in the region began to develop more and more advanced methods to obtain, analyse and disseminate news that are conducive to generating "finalized knowledge" in order to prevent and punish those behaviours.

It is this need to generate a “finalized knowledge” that has led to the creation of intelligence roles in many TAs, in an attempt to find the best possible way to obtain, analyse and use information to improve their auditing capabilities and, to a certain extent, improve the relationship with other government agencies such as the Judicial Police and Prosecutor’s Offices.

CIAT was a pioneer in this process from the very beginning, creating a working group that prepared the 2006 Manual on Tax Intelligence, thanks to the contribution of international experts under the RFB coordination which has been working for decades on developing a tax intelligence model more focused on the performance of specialized tasks by punishing criminally financial and economic behaviours, inspired in the experience of the Investigation Unit of the IRS in the United States.

On these basis, many countries have created FIUs to enhance their capacity of selecting taxpayers through the development of risk analysis methodologies, building ties with other government agencies involved in fighting crime, not only tax crimes, or attempting to articulate both functions.

Since 2010, with the delegation of Italy’s representation at the CIAT on the Guardia di Finanza, the notion of tax intelligence has evolved in an attempt to introduce the notions applied by that agency over virtually 100 years of tax investigation.

In this regard, CIAT has developed a tax intelligence approach with the purpose of including in the usual processes of TAs the method for collecting, analysing and disseminating tax intelligence. This approach cannot be deemed to be exclusively for State’s strategic intelligence agencies, but a tool that is useful to all agencies with audit and law enforcement powers charged with analysing and rationalizing news from different sources with the purpose of producing actionable knowledge.

This knowledge is essential to a TA to identify signs of fraud and evasion and to follow up on transactions and adopt a strategy in line with these purposes.

It is essential to take into consideration that any process of analysing and treating information to create knowledge must arise from a strong commitment on the part of TAs’ authorities, given that the intelligence cycle must developed and be practically applied across all of the TAs processes, ranging from taxpayers’ assistance to audit and collection. That is why it is essential for that commitment on the part of the TA to be reflected first in the definition of the goals of the tax intelligence and, second, in the incorporation of those goals in an intelligence gathering plan aimed at adequately directing and focusing available material and human resources.

Once such plan has been defined, the TA may then proceed to collect intelligence from the different sources available to the TA. It must be noted that these sources are those usually known to the entity (tax returns, public records, public or commercial databases, etc.) and, in most cases, it is not necessary to access sources of a different nature (human, reserved, etc.).

This must also be borne in mind when considering the following classification of sources of useful news¹ for tax intelligence purposes:

¹ Another alternative classification, albeit partly similar to the one presented here, may be found in Marcon-Moinet, *Intelligence économique*, Dunod, Paris, 2006.

- **First level tax intelligence:** information characterized for maximum availability. Executed based on information available in hard or electronic copies accessible through basic procedures. It does not require sophisticated data processing. Scarcity is minimum because there are multiple sources that may provide such information.
- **Second level tax intelligence:** it includes information that presents easy to medium difficulty to access it, but which may be unknown or restricted. It includes, for instance, information on companies, such as that offered by databases with fee per access, databases of a different TA requiring some sort of procedure to request information, etc. Scarcity is considered medium, since the information is provided only by certain public or private sources.
- **Tactical tax intelligence:** it uses information that is harder to access, such as the information obtained through interviews with taxpayers or human sources, and it thus entails a greater degree of complexity in understanding and treating it. Scarcity is more relevant, since it may be confidential information revealed over an interview with a client or a classified meeting.
- **Strategic tax intelligence:** it is based on collection and treatment of information characterized by being difficult to access. It includes, for instance, information on the future intentions or the criminal plans of a certain organization. The difficulty results from the scarcity of information sources or the need to apply an analysis which requires considerable effort. Scarcity is high since, by nature, this information is available only to a few individuals in an economic organization and the cost of acquisition is thus high, and requires access to human or technological sources (such as telephone tapping) the management of which is not always available to TAs.

Once the information has been acquired from the different available sources, it has to go through a processing stage before it may be available for the following analysis stage. Processing must take into consideration the need to prepare large volumes of data and may be organized following typical risk analysis procedures. In this regard, it must be noted that it is now possible to use expert systems to collect and process the information in very short timeframes. The quality of a TAs storage systems and databases is essential to determine the quality of the body of information available for intelligence purposes.

We then get to the fundamental stage of analysis and production. Once the information deemed to be necessary has been obtained, the analyst's job is to produce a document that creates knowledge or contributes useful value added to direct the contrast to the most salient tax evasion and fraud phenomena or to propose measures to avoid any procedural or regulatory loopholes that may result in tax evasion or fraud cases in the future. Determining clearly the knowledge to be produced by the FIU is one of the fundamental determinants of success and usefulness, underscoring its role as an "aid" to the other areas in the institution, particularly management and audit.

Once that knowledge has been produced, it needs to be disseminated to the area of interest to provide feedback on the analysis conducted and thus refine procedures and analysis techniques to obtain a product that is more in keeping with the needs of the TAs core functions. The cycle is completed by reporting to the directorate on the success of the various individual intelligence actions.

Clearly, the application of the intelligence cycle for tax purposes does not imply covert activities or powers of other State agencies other than those of the Tax Authority. It is only a matter of organizing and rationalizing differently the considerable information analysis capabilities and information sources already available to TAs as input for a production focused on identifying concealed data or, even better, to creating knowledge that would be useful in identifying the most harmful cases of evasion and fraud.

These notions have spread to many TAs that are part of the CIAT through multilateral exchange initiatives and specific technical assistance programs that have allowed many countries to develop knowledge and build their own experience, and these countries have begun to promote tax intelligence products within their organizations and, even more importantly, they have commenced to disclose the tax intelligence culture in their procedures.

Economic developments over the last decade have also brought about another change in the way TAs interact in the institutional scenario of each country. The evolution of trade relations and the ensuing capital flows have given rise to new and important challenges for States in terms of economic crimes. In this regard, it is worth noting that there is a need to optimize investigation capabilities in a setting characterized by the high level of sophistication of the tax evasion/fraud schemes conducted by increasingly complex criminal organizations. In effect, resources may appear limited in number and in terms of the quick response capacity when faced with this organized economic crimes which are more often than not developed through sophisticated fraudulent methods and through the use of international platforms.

At the same time, this progressive creation of international platforms aimed at channelling, disguising and protecting illicit financial flows generates numerous ties to the official economy. The depth is of this relationship is such that *“the underworld has become inextricably tied to the global economy, through the illicit trade of licit goods or through the use of commercial banks and legal communication networks that move growing number of licit assets and thus benefit from crime.”*²

It is thus essential for States to strive to streamline and update their administrative and legal structures to be up to these new challenges. It is necessary to create highly specialized economic and financial investigation/audit units to analyse and define risk areas, distribute the outcome of those analysis to the Judicial Police and Prosecutor’s Offices, to adopt a multidisciplinary and highly specialized approach to investigate and identify tax crimes and financial flows resulting from such crimes and which are also related to other criminal activities such as money laundering, terrorism financing and corruption, as explained above. Additionally, TAs must seek new ways of interacting and exchanging information, techniques and experiences with other key players in institutions such as Intelligence and Security agencies, Prosecutor’s Offices, Market Regulation Authorities, Fiscal Investigation Units, etc.

In the recommendations of the OECD Council dated October 14, 2010 to foster cooperation between tax authorities and other law enforcement agencies to fight serious crimes, the OECD recommends that the members establish, pursuant to their legal systems, an effective legal and administrative framework, and that they offer guidance to make it easier for tax authorities to report to the applicable law enforcement agencies any suspicion of a serious crime, including money laundering and terrorism financing crimes identified in the course of their duties.

Seeking to implement that recommendation, in March 2011 the OECD established the “Oslo Dialogue”, which seeks to promote the development of a global action approach by the Governments to fight financial crime. There are three pillars to this task: 1) strengthening cooperation among government agencies at the national level; 2) improving cooperation at the international level; and 3) supporting developing countries, especially by offering training in financial investigation techniques to prosecutors in charge of investigating economic and tax crimes.

² Preface by the interim director of the United Nations Office on Drugs and Crime to the report entitled “Crime globalization.”

This initiative includes a large group of developed and developing countries, which represent investigation agencies, prosecutors and anti-laundering and anti-corruption agencies, and it is designed to exchange experiences and mechanisms for cooperation and multi-disciplinary investigation to strengthen the fight against financial crime.

The CIAT has supported this process from its inception and has been actively involved in the initiatives presented in the framework of that dialogue, sharing the contents of the work prepared at the meetings. As a result of that newly-found international awareness, the Latin America and the Caribbean region has taken a proactive role since the beginning, and the CIAT has already launched joint training initiatives with the assistance of the Guardia di Faenza, from Italy, and the GIZ, to discuss tax evasion issues under a multi-disciplinary approach.

At the same time, the CIAT is also involved in an initiative led by the COMJIB in the EU, called EURO social II, for the purpose of improving inter-institutional coordination mechanisms and the efficacy in the fight against economic and financial crimes involving corruption of public officials.

In this program, CIAT is part of a network consisting of representatives of multilateral institutions such as Prosecutors' Offices, Ministries of Justice, Higher Audit Agencies, etc., operating in the sector, for the purpose of issuing recommendations and suggesting actions to enhance coordination across institutions to fight economic and financial crimes in Latin America.

As explained above, the TAs of the 21st century play a key role in executing tasks designed to protect the security and best interests of the State. They do this through innovative use of tax intelligence tools and by forging close ties to the country's other law-enforcement agencies. To succeed in this endeavour, it is essential to know the tools and to foster dialogue. The CIAT has demonstrated over many years that it is present and plays a key role in the region. Intelligence and cooperation are essential elements of the daily work of tax officers. The CIAT offers TAs the assistance essential to understanding one another and to communicating in this new world.





6 GLOBALIZATION AND TAXPAYER TRANSACTIONS

6

GLOBALIZATION AND TAXPAYER TRANSACTIONS

Isaac G. Arias

Just as Jules Verne in his time envisioned a future that is not too different from the present, in the world of taxation, some authors have also anticipated the challenges that face TAs currently. One such author is Vito Tanzi, who at the 2000 General Assembly in Washington D.C. referred to the so-called “fiscal termites”. He was referring to e-commerce and transactions, e-money, trade within a single MNE, extra-territorial financial centres and tax havens, derivative instruments and speculative hedge funds, the impossibility to tax financial capital, the growing activity abroad and foreign purchases. In concluding his presentation, Vito Tanzi raised the question of whether it is possible to exterminate such fiscal termites. Almost 16 years later, despite numerous international efforts aimed at studying each one of these issues, it is still not possible to reply this question unequivocally. Moreover, there are mixed views among the different authors of the international tax community.

a. The International Community Recognizes the Need to Review Current Regulatory Frameworks and Propose Solutions

From the beginning of the 20th Century, efforts have been deployed to mitigate the undesired impact on taxation from cross-border economic transactions. Proof of this was the work at the League of Nations, where the Financial Committee replied to a call by the International Conference in Brussels in 1920 by undertaking an analysis of the issue of international double taxation. From 1925 on, Latin American countries such as Argentina and Venezuela joined in these discussions. The first bilateral DTA models were created in 1928, which already considered assistance in tax collection.

In the 1940's, a series of regional conferences were conducted with participation from Latin American countries including Argentina, Bolivia, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay and Venezuela. As a result of these, the 1943 Conference adopted a bilateral DTA model for direct taxes and a bilateral model for the establishment of mutual technical assistance on the collection of direct taxes. At the sub regional level, the Cartagena agreement introduced a multilateral DTA in 1971. ALALC further adopted criteria to avoid double taxation in 1976.

The work evolved constantly in different spheres, mainly within the OECD and the UN. It is worth highlighting the efforts made by the UN in creating documents for developing countries such as the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, published in 2003.

Despite these efforts, certain aspects continue to be discussed to date, such as the distribution of taxable income between source and residence, methods for preventing abuse by DTA provisions and the effectiveness of DTAs in meeting their main goal, namely to improve the climate so as to attract or retain foreign investment.

It is clear that most countries in the region face significant challenges when it comes to negotiating and enforcing these instruments, the latter aspect being particularly complex, since it calls for designing robust administrative systems, effective risk models and adequate, timely, reliable and suitable information.

There have also been numerous experiences since the turn of the century in the area of international cooperation to combat tax evasion and fraud. In terms of assistance for tax collection, we can quote the agreement between Germany and the current Czech Republic in 1921, or the Benelux Convention of 1952. Paradoxically, although we have witnessed regional efforts in this sphere such as the inclusion of Article 21 in Decision 578 of CAN in 2004 and other recent bilateral instruments signed in the last few years by countries in the region, Latin America still lacks practical experience on the matter.

The area of exchange of information for tax purposes dates back some 100 years worldwide, although in Latin America it has evolved slowly. In this sphere of action, CIAT published its first model agreement in 1990, which was the first in the region. Said model was put together in the framework of a working group that involved representatives from numerous countries in the region. The model had highly advanced features for its time, and it met almost all of the current “standards of transparency and exchange of information”. Nine years later, CIAT called the working group again with the purpose of adjusting the original model. As published in 1999, the Model presents a wider spectrum of cooperation mechanisms, it changes a few terms considered ambiguous or inaccurate, and it includes more detailed commentaries that shed light on the interpretation of its provisions. The model was adopted by Argentina in the 2000’s in its negotiations with several countries in the region, such as Brazil, Spain, Peru and Chile,

and its content is still valid today on account of its conformance with the latest international standards.

In 1986, the OECD and the Council of Europe promoted the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (hereinafter “the Multilateral Convention”), which only accepted OECD and Council of Europe countries as its signatories. In 2011, such restriction was eliminated to make the instrument available to all countries in the world. To this date, 90 jurisdictions have signed it globally, including 17 from Latin America.

Both the OECD and the UN have gradually relaxed Article 26 in their respective DTA models, progressively expanding their scope to include other taxes and taxpayers different from those foreseen initially, and enabling the use of the exchanged information for purposes of enforcing domestic tax law in addition to other non-tax issues.

In the spirit of creating tools that facilitate the effective implementation of exchange of information, both the OECD and CIAT have cooperated mutually in the preparation of their respective manuals. Both were published in 2006.

The Global Forum on Transparency and Exchange of Information in Tax Matters (hereinafter “the Global Forum”) has 129 member jurisdictions and was created by the OECD in 2009 upon a mandate from G20 countries. This global platform for boosting transparency and exchange of information, which in turn receives the support from CIAT in the region, has driven the necessary political will for countries to make firm progress in this field. The most remarkable regional progress has been made in the last decade, more precisely starting in 2008. The number of international instruments has increased exponentially since that date and many countries have implemented reforms aimed at achieving further transparency, such as by accessing banking information, identifying partners in corporations or owners of property. Furthermore, several have relied on this practice to solve complex cases involving international transactions. For example, in recent years Argentina has issued 1800 requests

for information, whose replies have enabled the solution of different cases. Mexico has been the country in the region with the longest standing in this regard, having solved numerous cases through exchange upon request, spontaneous and automatic exchange.

Despite the efforts deployed by certain countries and the significant progress made in specific cases, generally speaking, we can continue to claim that the region is making slow progress. Practices such as Automatic Exchange, simultaneous or joint – bilateral or multilateral- audits, foreign country audits, exchange of information on specific economic sectors and spontaneous information exchange are still far from pervasive in most countries.

Another issue that is not new to the international tax community but continues to trouble both taxpayers and the TAs is the effect from transfer pricing agreed between related parties on the distribution of tax bases among the States. MNEs usually operate on a global basis and have the capacity to structure themselves in the most efficient manner with the goal of accessing the advantages provided by the different markets. As a result, there is a risk for them to distribute global profits to members of the group in low taxation territories without matching economic activity, assets, risks and functions in said territories. In this area, the League of Nations has also played a decisive role by contemplating the PLC in their model tax convention. This principle requires MNEs to assess their internal transactions for tax purposes and to compute profits as if the transactions had been conducted at arm's length. Transfer pricing rules exist to control potential inconsistencies between the profit and asset distribution, functions and risks of the group.

Currently, there is some sort of global consensus on PLC. The OECD has taken a leadership role on the matter by including this principle under Article 9 of its Model DTA in 1963. Likewise, the UN adopted the PLC in Article 9 of its Model DTA in 1980.

In 1979, the OECD developed practical guidelines on transfer pricing and MNEs to orient tax

experts from both the private and public sector on the implementation of this principle, which is so straightforward in its design but raises a host of questions in the area of enforcement. Said guidelines underwent changes in 1995 and 2010.

On the other hand, with a view to orienting developing countries on the implementation of the PLC, the UN published a Practical Manual on Transfer Pricing for Developing Countries in 2013.

Since 1992, Latin American countries have maintained domestic regulations to control abusive transfer pricing. Currently, all the countries in the region have provisions in this regard, while in almost all of the countries in the Caribbean it continues to be an open issue. Only a few –including Jamaica and Trinidad and Tobago– have shown special interest in the subject and voiced their expectation to implement regulations.

The region has shown some immaturity in applying these rules. Most of the countries that adopted them in the 90s have failed to implement them effectively until the beginning of the new century. Others are still trying to overcome barriers to their effective enforcement. Clearly, the main challenges are in connection with access to information to enable the identification of comparables and the TAs own capacity to identify the risk of abusive transfer pricing, conduct audits and take litigation cases to court. The challenge is even greater when the justice system is not specialized in taxation and / or lacks adequate knowledge to understand the tax authority's actions.

Regional transfer pricing abuse is currently one of the main risks in international taxation and, thus, one of the issues with most requests from Latin American countries at CIAT's Executive Secretariat.

Despite repeated efforts deployed by the international tax community to protect global tax bases, it has been recognized that these have been insufficient and would call for a revision from a more holistic perspective involving all stakeholders. Thus, with a view to addressing

the issues derived from tax base erosion and profit shifting to other jurisdictions, G20 countries have voiced the need to carry out coordinated efforts between different players of the international tax field. Action 1 in Annex 2 of the Declaration issued from the Summit held in Seoul in November 2010, which aimed at supporting the development of more effective tax systems, mentions CIAT as one of the relevant players in driving this process. We now quote the relevant pieces of the above-mentioned Declaration from June 2011:

“...We ask the expanded OECD Task Force on Tax and Development, UN, IMF, World Bank and regional organizations such as the Inter-American Center for Tax Administration and African Tax Administration Forum and other relevant organizations to: (1) Identify key capacity constraints faced by developing countries in their tax systems and make recommendations on capacity building to (i) improve efficiency and transparency of tax administrations and (ii) strengthen tax policies to broaden the tax base and combat tax avoidance and evasion (June 2011); (2) Develop a knowledge management platform and promote South-South cooperation to support the capacity of developing countries in tax policy and administration systems (Medium-term); (3) Survey and disseminate all G20 and international organizations’ actions on supporting tax systems in developing countries (June 2011); (4) Set up objective measures to track progress in the capacity improvement of LICs’ tax administration systems (June 2011); and (5) Identify ways to help developing countries’ tax multinational enterprises (MNEs) through effective transfer pricing. (June 2011).”

In this context, CIAT has responded to the G20 mandate by meeting the priorities, interests and needs of its member countries and the efforts deployed by international organizations and the civil society, while promoting a climate of mutual cooperation and trust among the stakeholders involved in said mandate.

b. Two Priority Issues for Latin America: Exchange of Information and Transfer Pricing

As a result of higher commodity prices before the 2008 financial crisis and the efficacy achieved by several TAs in the region, the average tax status of several countries has improved in the last 20 years. Thus, the tax burden has grown more in Latin America than in other regions. However, it is not all good news for the region, since it must also be noted that tax revenues are extremely volatile in the region, especially in countries that rely on non-renewable natural resources. If we consider the degree of development and unmet spending needs, in most countries the precautions have been inadequate.

According to CIAT’s most recent estimates on the region, IT evasion ranges from 30 to 70 percent, depending on the country.

Another aspect to consider is the remarkable concentration of the most relevant economic sectors in each Latin American country, where very few large corporations are active providing, at least in theory, the largest share of tax revenues for the countries. These corporations are usually part of international conglomerates and carry out numerous cross-border transactions.

The above indicators show that there is plenty of room for improving the efficiency and effectiveness of TAs, even without resorting to extensive tax policy reforms.

In this context, the need to improve TA capabilities to access information from abroad becomes relevant for purposes of using the information in tax control processes on global taxpayers.

In absence of a standard definition of “tax base”, the relative composition of the IT differs from country to country. However, all countries pursue the levy of a similar “taxable event”. This situation, associated to the so-called “harmful tax competition” among countries, raises the risk of transfer pricing abuse, both domestically and internationally. For this reason, it is essential to implement regulations that aim at controlling transfer pricing and are commensurate with the possibilities and needs of the TAs in the region and current international instruments.

Exchange of information

Historically, the culture of secrecy ruled the handling of information obtained by tax authorities in the framework of their oversight and auditing powers. For different reasons associated with each country’s context, some tax authorities lacked – and some still lack – the power to directly or indirectly access taxpayers’ financial or banking information or identify certain property owners.

This has raised – or continues to raise – barriers when it comes to controlling international transactions or the holding of assets in foreign countries. It has further harmed the internal work of the tax authority, for it is not possible to access information that might be considered basic to controlling tax obligations.

At the regulatory level, exchange of information has existed in most Latin American countries for several decades. However, progress has been slow. As stated in previous sections, before 2008 the networks of instruments that enabled exchange of information in tax matters were either very small or non-existent. Many of the DTAs did not foresee the possibility of exchanging information for purposes of enforcing domestic tax law or fighting tax evasion or fraud. Following the actions taken as from that year by the international community in order to gather political will in favour of greater transparency and exchange of information, the countries in the region deployed significant efforts whose results are beginning to be noticed.

TAs from countries including Argentina, Brazil, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Jamaica, Mexico, Peru, Panama and Uruguay have dedicated units or teams

for Exchange of information with other States. Many of them also keep IT systems to manage said exchanges. The existence of these units or teams, associated with strategies to promote identification in cases when it is essential to access information from another country has led to an also exponential growth in the number of requests for information from Latin American countries to the world. CIAT, in cooperation with the OECD, GIZ, EUROsociAL II, WB and their member countries has coordinated various actions to meet the efforts of the TAs in this field.

Following this trend, several Latin American countries have adopted and created regulations to meet a maximum level of transparency for tax purposes, while others are deploying considerable efforts at present to promote reforms. It is important to stress that these reforms, which usually apply to aspects regarded as “rights” by the citizens of a given country or even by the country’s constitution, cannot be implemented without strong political will, considerable political power and generalized understanding by the citizens as to the importance of said changes. To this end, in recent years, the international community – especially the countries of the G20 and the Global Forum – have provided enough arguments and tools to enable the countries to boost this process appropriately.

One indicator of the political will to reach effective exchange of information has to do with the level of adhesion of the countries in the region to the Global Forum. In the spirit of assessing compliance with the transparency and exchange of information standard, the Forum has implemented and coordinated two peer review phases. The first of them focuses on regulatory

aspects, while the second phase focuses on administrative aspects. The results of the “peer reviews” updated as at October 2015 present an optimistic outlook for the region. Of the 18 CIAT-member countries of Latin America that were reviewed, five countries have been through Phase 1 and 13 countries have undergone a combined review – Phases 1 and 2. Three of the five countries reviewed in Phase 1 have moved on to Phase 2. Of the 13 countries that underwent a combined review, two were compliant, seven complied by a wide margin and four complied partially.

The following are some of the most relevant obstacles that prevented a few countries from moving on to Phase 2, or led to partial compliance in the combined review:

- **Availability of information:** significant or minor adjustments are needed to improve the identification of property owners, the availability of and access to accounting data.
- **Access to information:** significant or minor adjustments are required to adjust TAs oversight and auditing powers, in addition to the safeguards and rights of taxpayers relative to exchange of information.
- **Exchange of information:** it is necessary to strengthen instruments and / or agreement networks for exchange of information. Countries need to improve their responsiveness relative to information requests.

Given the varied menu of cooperation options, it is clear that Latin America has a long way to go in this regard. Except for one case between Argentina and Brazil of more than two decades ago, there are no precedents of the effective implementation of simultaneous audits conducted either abroad and / or jointly. Neither are there any precedents of cooperation for the notification of actions, the enforcement of cautionary measures or coercive collection procedures.

In the region, the prevalence of information on request was followed by automatic exchange, although its enforcement is still significantly lower. While the former started developing gradually since the beginning of the 2000’s and proliferated starting in 2008, automatic exchange started to be observed and studied more extensively in the last five years. This is no coincidence. Several initiatives have promoted political will in different countries. For example, in 2010, the US passed FATCA, which basically requires that financial institutions report to the IRS the financial accounts maintained by US taxpayers or foreign entities exceeding a threshold of U\$ 50,000 where US taxpayers have a substantial share. Failure to report results in a significant source withholding of 30 percent Income Tax on the value of transactions. Most countries in the region have either taken action to start providing this information or are in the process of doing so, either through the TA or directly from the financial entities involved. In some cases, the exchange would be mutual.

Based on this experience and with the purpose of creating mutual automatic exchanges of financial information among all countries worldwide, in 2014 the Global Forum started developing the so-called CRS, which implemented in December 2015. This standard provides for exchanges on an annual basis and includes information similar to that defined by FATCA (identity and residence of account holders, account details, reporting entity, account balance, etc.), the taxpayers liable to reporting being similar to those encompassed in FATCA.

It is clear that the implementation of automatic exchange of information will not be immediate. Most developing countries need time and resources to adjust their regulations (mainly in cases in which it is necessary to justify requests for banking or financial information, or when the Judiciary is called to intervene) and build administrative capacity to sort, process and analyse information.

Following this trend, new standards are expected for the future to rule the exchange of information under the automatic procedure, including other categories of income or assets.

Transfer Pricing¹

In the experience of the most developed TAs in the region, one of the mechanisms that has further eroded the tax bases has been abusive transfer pricing. This risk was identified by the countries in the region several decades ago already, although the way it should be treated remains a challenge to date.

As regards controlling transfer pricing, it is impossible to refer to the region without considering the differences between sub regions and countries. For example, in the countries of the Caribbean there are almost no domestic regulations on the matter. Central American countries and the Dominican Republic have implemented regulations for approximately the last 10 years. The countries in South America and Mexico have had rules since the 1990's. It can be stated that currently all Latin American countries have such rules and most countries in the region include the PLC in their DTAs. In general, the countries in the region that implemented rules have adopted PLC. These include Brazil, despite its having own methods based on fixed margins – which distance it from this principle – for its legislation sets forth the possibility of applying the “uncontrolled, comparable price”. Now, such consensus is not there at the time of applying the principle.

A detailed assessment of the existing rules in the region shows significant differences are creating great asymmetries at the regional level. For purposes of determining the taxpayers and transactions reached by the transfer pricing system, all countries define as a requirement the existence of a relationship and most consider as related the transactions with jurisdictions deemed uncooperative or with low or null taxation. However, it is worth noting that not all countries use the same criteria for designing their lists. Some countries, like Colombia, define thresholds to exclude from the transfer pricing system the taxpayers whose property or gross income are considered immaterial to this end. The difference in the definition is even greater when associated to the definition of “related party”, which uses differing criteria among the countries in the region as well as different percentages ranging from 10 to 50 percent when it comes to establishing the cases where there is a relationship based on direct or indirect share ownership, decision-making or control, or other criteria.

Reporting systems also vary from country to country, both in terms of their content and in the submission form and frequency. For example, the time during which information should be kept ranges from three to 10 years depending on the country and only in few countries such as Colombia and Argentina are there any specific sanctions on the non-compliance with the transfer pricing system. The latter issue becomes relevant by virtue of the high cost of meeting said reporting systems.

Regarding the methods, there are no major differences. However, it is worth highlighting that Brazil uses fixed margins based on the Cost Plus and Resale Price methods. Argentina has developed the so-called “6th Method”² to control export transactions of “commodities”, mainly grains and oilseeds. It is not exactly a method, but a unique anti-avoidance measure or “safe harbour”. This mechanism has spread across most countries in the region, with a few significant differences. For example, Uruguay also uses it for imports and the way of calculating prices is very different. To date, Argentina, Uruguay and, to a lesser extent, Ecuador have been successful in enforcing this method effectively. Like Argentina, the Dominican Republic has also developed a very unique mechanism based on public

1 The data quoted in this section were extracted from the paper called “El Control de la Manipulación Abusiva de los Precios de Transferencia en América Latina y el Caribe”. GIZ-ITC-CIAT, 2013.

2 First implemented in October 2003 in Argentina in the paragraph following the fifth paragraph of Article 15 in the Income Tax Law. Its purpose was to control transfer pricing used in commodity exports, mainly of agricultural products, by invoice routing involving intermediaries lacking economic substance.

information and anticipated price agreements (APAs) by industry in order to curb the “all inclusive” hotel activity. This method has resulted in the industry starting to pay taxes after several years of resorting to abusive transfer pricing.

There are additional differences when it comes to establishing the hierarchy in the enforcement of the methods. Most countries have adopted the best method rule, while others use a precedence criterion in the style of that provided for in the 1995 OECD Guidelines. Such is the case of Mexico.

Although practical experience is limited to Mexico, Uruguay and Colombia, ten Latin American countries have the possibility to conduct APAs. Most believe that these can be unilateral, while Chile, Ecuador and Mexico accept the possibility of bilateral or multilateral agreements of this kind.

Regarding the simplified transfer pricing systems, some countries have alternative measures, including exemptions on the transfer pricing system (Brazil, Colombia and Mexico), exemption on documentary evidence (Colombia, Mexico and Ecuador), “safe harbours” from method (Mexico and Brazil) and “safe harbours” from interest types (Brazil and Bolivia).

In the practical sphere, the date when the rule was implemented becomes less relevant. For example, the Dominican Republic, Uruguay and Ecuador implemented rules in the 2000’s – almost a decade later than other countries in the region – and have secured good results in the short and medium term. Other countries have delayed the enforcement of their rules, obtaining results almost a decade after their implementation. Others have not shown any significant progress to date. A unique case is Costa Rica, which starting in 2006 and prior to passing its administrative rule applied a general anti-avoidance rule which has been in place since 1971 (Article 8 in the Tax Code), based on the principle of “economic reality” and another one relative to “agreements between individuals” (Article 12 in the Tax Code) for purposes of controlling transfer pricing. As a result, 3 out of 7 cases were ruled in favour of the tax authority, and one case was settled voluntarily.

The experience garnered by TAs on this matter is closely linked to the most relevant economic sectors in the economy. For this very reason, it is difficult to compare the degree of experience of some of the countries. By way of example, one of the valuable regional experiences has been Argentina’s grains and fisheries, Ecuador’s bananas, flowers and oil, Mexico’s *maquilas* and oil, Chile’s mining, the Dominican Republic’s all-inclusive hotels and Uruguay’s agricultural sector.

Controlling transfer pricing calls for a certain institutional maturity to develop and maintain both experts and multidisciplinary teams, manage robust information systems, conduct adequate risk management, study economic sectors, access foreign sources of information, seek funds for purchasing and efficiently using commercial databases, etc. However, the main challenge faced by the region lies in identifying information, in particular that from “comparables”. It is not impossible to secure funds or manage a TA more effectively, but unless the market offers enough information to enable PLC, justifying transfer pricing adjustments in line with said principle becomes very complex.

Currently, 15 TAs from Latin America have a division in charge of transfer pricing or international taxation issues in general. Depending on the TA, these areas have a staff of three (Guatemala) to 47 officials (Mexico). These areas are mainly focused on planning, advisory, review, technical support or auditing.

The most audited sectors in the region are the pharmaceutical industry, hotels and the food industry. These sectors are subject to more than 40 percent of all control processes.

Taxpayer selection criteria used more widely by the TAs in the region are: matching financial, tax and customs information, assessment and trends in taxpayers' tax behaviour, identifying exporting taxpayers with profit margins lower than their industry average, values declared in transactions with related parties, foreign currency outflows, loans with foreign countries and customs value, review of profitability lower than industry averages, transactions with tax havens and taxpayers' capital structure.

In 2011, the countries in the region conducted from three processes (in the Dominican Republic) to 130 processes (in Argentina) of transfer pricing control.

Actions 8 to 10 in the BEPS Plan of Action seek to prevent misuse of international standards with the purpose of obtaining results where benefit allocation is misaligned with the triggering economic activity.

As a result of these efforts, the following are the main new concepts introduced in the OECD guidelines regarding transfer pricing for MNEs and TAs:

- The “behaviour” shall complement or replace the contractual terms whenever the latter are incomplete or prove incompatible with the parties' behaviour. Together with adequate application of the valuation methods for transfer pricing, this shall determine the allocation of benefits to businesses performing the corresponding business activities. Whenever the transaction between related enterprises lacks business rationale, the guidelines shall allow the bypassing of agreements for transfer pricing purposes.
- To respond to cases where the risk is inconsistent with the profits resulting from the business, those undertaken contractually by a party that has no capacity or financial position to conduct specific and significant controls on them shall be allocated to the party that indeed exerts said control and has adequate financial capacity.
- The guidelines clearly establish that legal ownership of intangibles does not in itself create the right to receive the total benefits arising from their use. The entities in the group that perform significant functions, contribute most assets and control economically relevant risks shall be entitled to a remuneration commensurate with the value of their contributions, according to the nature of the effectively conducted transaction.
- In cases where a business of the group with high equity holdings provides funding but conducts little activity, lacking the necessary capacity to control the financial risks associated with said capital investment, it shall not be attributed the benefits arising from the financial risks, being entitled to receiving strictly the profits exempt from the risk of the funds contributed, or even less in cases where, for example, the transaction lacks business rationale, in which case the guidelines allow the possibility of overlooking the transaction.
- Transfer pricing methods shall attribute benefits to significant economic activities. Into the future, synergic benefits shall not be attributable when derived from the group's activities to the members that do not contribute to raising such benefits. Thus, for example, discounts obtained on the volume of goods requested by a number of companies in the group shall be attributed to those businesses.

In the framework of Action 13 of the BEPS Plan of Action, a new reporting system is proposed, whose operation calls for smooth international exchange of information processes. In this regard, three levels of documentation were defined to be provided by MNEs:

- Country by country report: it requires information on the location and placement of income, taxes and other geographic indicators of its business activity and the multinational group. This information is to be treated confidentially.
- Master file of transfer pricing documentation: it gathers general MNE information, its businesses, transfer pricing policies and agreements with tax authorities. In principle, this document shall be available for all TAs involved in the BEPS project. The purpose of this document is to obtain more consistent and transparent information.
- Local file of transfer pricing documentation: it refers specifically to significant transactions carried out by the local taxpayer and reflects detailed information about related transactions.

This information is relevant in assessing the risks associated with transfer pricing, the risks for base erosion and profit shifting in general and, when applicable, the economic analysis of statistics. In addition, current systems of transfer pricing reporting shall be maintained and complemented by the new system.

In view of this new development, the TAs that wish to implement these reporting systems shall analyse the possibility of introducing legal and / or administrative reforms to access the information, exchange it and process it. In the following chart, we show the situation of eight countries in the region in connection with the need to change rules to implement the new reporting system:

c. **The BEPS Plan of Action: Actions deployed by CIAT to meet it and support Latin American countries**

From a net tax perspective, one of the effects of globalization consists in raising similar tax risks in all countries worldwide. This gradually aligns the priorities of the TAs to the control of international transactions.

Although the interest of the countries in the region relative to the different actions of the BEPS is quite balanced, a considerably greater interest is seen on issues relative to abusive transfer pricing. In this sphere, as shown in the paper published by CIAT in January 2013³, most Latin American countries have started a path and only a few have achieved significant development. It is worth stressing that the region has successfully created a few tailor-made tools to meet its needs. The following sections will comment on those.

In other spheres of action under the BEPS Plan of Action, there is either less or inexistent experience in the countries of the region. Studies need to be conducted to determine the impact of the issue and reach internal diagnoses to assess the TAs capability to tackle the risks identified.

It is clear that developing countries share many features, but it is not possible to measure all Latin American countries with the same standard. The region is heterogeneous in many regards. The weight of the BEPS problems in their lists of priorities differs considerably and, in turn, there are huge differences in their capacity to assimilate and implement the rules or practices arising from the Plan of Action. In this connection, it is worth stressing the importance of non-BEPS issues that bear significant influence on BEPS issues, such as the taxpayer registry, information sources, risk management systems, technology, and the collection process, among others. Specifically, developing

³ El Control de la Manipulación Abusiva de los Precios de Transferencia en América Latina y el Caribe. ITC, GIZ and CIAT, January 2013.

countries face some or all of the following difficulties when it comes to tackling the “BEPS issue”, the first of them affecting all countries alike:

- Difficulty in obtaining information, either because of the regulations available or because information does not exist, is scarce or of poor quality.
- Difficulty in developing the necessary competencies to enable implementation of complex rules and face MNEs.
- The rules, the context and the lack of administrative capability promote the design of simple but highly aggressive harmful tax planning schemes.

The results of the BEPS Plan of Action, published in November 2015, represent a very significant step that has called for a huge effort by the OECD and the most relevant players of the international tax community. However, this huge effort is inadequate relative to the complexity - both in the formulation of solutions and in their effective implementation – which the issue poses, especially considering the differences among the regions, sub regions and countries.

The main legacy of the BEPS initiative consists in having identified the tax risks – many of which are new to Latin American countries – that affect every country in the world, and structured them into 15 well-defined actions. This has placed the respective discussions in the international agenda and guided coordinated efforts among developed and developing countries, international bodies, the business community and civil society.

CIAT has coordinated forums with the common purpose of discussing the progress of the BEPS Plan of Action and hearing the perceptions of its member countries about it. The first of such meetings took place in Bogota in 2014, and was supported by DIAN from Colombia and the OECD. As a result, with sponsorship from the IRD from Trinidad and Tobago and support from the GIZ, a Consultation Panel on BEPS was conducted in 2014 aimed at Caribbean countries. In October of that year, AEAT from Spain, the ITC, OECD and the WB supported a workshop⁴ on the same subject matter. This latter meeting had global scope, since delegations from various continents attended. In February 2015, Lima was the venue of the Second Meeting of the “Regional BEPS Network” for Latin America and the Caribbean with support from SUNAT from Peru and the OECD. The third meeting was held in San Jose in November 2015 under the auspices of the OECD, the IDB, CIAT and the DGT from Costa Rica. The purpose of this meeting was to disseminate and discuss the latest achievements under the BEPS Plan of Action, further noting the feedback from the countries in the region on such progress.

Aware of the importance of providing a space for dialogue for all stakeholders on the “BEPS Issue”, CIAT co-organized in Buenos Aires (2014) and in Quito (2015) regional round tables. The co-organizers were LATINDADD, the Fiscal Justice Network, the Coalition for Financial Transparency, AFIP from Argentina and the SRI from Ecuador. These round tables enabled discussions between government representatives and civil society about the challenges and regional outlook in connection with the “BEPS Issue”. As a result of the meeting in Quito, a summary was published with the main conclusions from the participating countries and organizations. Moreover, mention was made of the need to promote regional discussions aimed at achieving better mutual understanding to harmonize and coordinate regional actions.

4 CIAT-BM-OECD-ITC-GIZ-AEAT workshop on Base Erosion and Profit Shifting, “Benefits and challenges of implementing the BEPS Project from the G20-OECD”. Santiago de Compostela, October 2014.

From 2010 to date, with the support of strategic partners, CIAT's Executive Secretariat has coordinated more than 75 technical assistance initiatives that have followed up the countries' development on the following issues: transfer pricing, auditing of economic sectors – including financial, telecommunications, agriculture, hotels and the extraction industry – transparency and international Exchange of tax information, negotiation and application of DTAs, fiscal intelligence techniques and risk management. These efforts have been complemented with actions from other regional players and served in gradually building the necessary platform to enable effective enforcement of regulations aimed at controlling international transactions and understanding the BEPS Plan of Action and its outcomes.

CIAT has further developed virtual and face-to-face training courses on Transfer Pricing and Exchange of Information, which in the last two years resulted in training more than 234 TA officials.

In 2015, CIAT published the most recent version of its Tax Code Model, which presents news about BEPS, provisions on international cooperation and a proposed anti-abuse general rule.

The main problems facing the countries in the region are financial inadequacy and the deployment of domestic resources. Although it is clear that the BEPS problem has to do with these situations, there are many other causes. For example, harmful tax competition to attract foreign investment, difficulties in accessing information, informality, capacity constraints and other institutional conditioning factors indicate that it is necessary to continue providing fiscal policies beyond BEPS.

The relative disparity in the development of the fiscal systems in the region, especially regarding international taxation, shows that the issue is not unique and, thus, solutions should be geared at the different situations. Treaty shopping, for example, is a problem for the countries that have a relatively extensive treaty network, while other countries face the opposite problem, namely the absence of such a network.

For developing countries, it is crucial for tax policy measures to be applicable in practice, considering the current limitations about the capacity of TAs and access to information.

The use of the Transfer Pricing Method called “profit split” and the difficulties arising from its distribution formula have raised broad discussions, with Uruguay being one of the pioneer countries in using this method in the region when it signed its first APA. The different alternatives regarding the treatment of low-value-added services and work performed in the area of “transaction reclassification” have also proved extremely relevant.

The countries in the region have agreed on the need to maintain discussions to harmonize tax regulations, prevent abuse, conduct detailed analysis and a regional discussion on the potential for the so-called “Sixth Method” on the taxation of “commodities”, assessing the implementation of APAs, discussing cases of thin capitalization, observing the latest developments in terms of the definition, identification and valuation of intangibles; discussing aspects relative to the control of businesses in the extraction sector, as well as analysing tax legislation with a more economic-oriented perspective.

Regarding transfer pricing and income reclassification risks, the countries in the region stated the need to access more and better information during transfer pricing audits. In this area, the main problems are in connection with the lack of comparable data and the handling of cross-border transactions with raw materials, as well as tax incentives granted to multinational groups.

In terms of the digital economy, although there is limited experience, the need persists to tackle the issue and raise awareness in the political sphere. The countries in the region have admitted that the digital economy poses issues that are not limited to BEPS, namely those inherent to the connection and tax treatment of the data.

Automatic exchange of information is a relevant topic for several countries in the region. However, there are difficulties when it comes to adjusting

the legal framework and developing the necessary administrative capabilities and competencies to meet international standards on the matter.

Aspects related to transfer pricing documentation and in particular adoption of country-by-country reports are further priorities for most countries, who have welcomed the proposed three-tier approach and stressed the need to make consistent, confidential and appropriate use of the information provided for risk assessment purposes. Some countries in the region raised concerns about the mechanism for information access suggested in the documents

regarding country-by-country reports, the content of the reports, the appropriateness of the threshold proposed for declarations of regional multinational groups (which would be too high for developing countries) and how to process the information received in an efficient and effective manner.

As to the treatment of transactions involving raw materials, several countries request more in-depth discussions on the key features of the so-called “Sixth Method” with the purpose of classifying it as a special measure.

d. Conclusions

The great merit of the G20 and OECD countries has been to place the BEPS Plan of Action on the discussion table. However, the results presented in November 2015 were insufficient relative to the complexity, both in terms of formulating solutions and their effective implementation, of the issue. Into the future, it is essential to join efforts to continue working on the actions set forth.

Regional organizations face the challenge of supporting decision-makers so that they become very familiar with the BEPS Plan of Action and its results, while promoting a favourable climate for the exchange of ideas that lead to regional harmonization. Training programs and forums could help meet this goal. Furthermore, support tools that enable diagnoses of the feasibility of implementing a BEPS measure given the resources and maturity available would be more than timely.

It is necessary to continue discussing the distribution of tax powers in the framework of existing model conventions – OECD, UN, Andean Community, Pacific Alliance, etc. Maintaining a distribution of powers perceived as inequitable brings about the risk of multiplying standards and the ensuing conflicts derived from it. It is worth stressing the relevance of this matter in the framework of taxation of the players in the “digital economy”.

The solutions proposed relative to controlling transfer pricing abuse provide considerable improvements. However, many of the issues persist, since they use as a platform the current mechanisms for transfer pricing calculation, and these need to draw from scarce or inexistent information in developing countries. It is important to have simplified rules for low-value-added services and to deepen the knowledge on the valuation of intangible assets.

It is mandatory to achieve an acceptable level of access to banking information and enough regional coordination to ensure exchange of information, in addition to efficiently implementing international standards such as CRS and CBCR. It is also necessary to work on the mechanisms to ensure high quality information.

In parallel to the progress of BEPS actions, it is essential for countries to strengthen their risk management systems and the processes that are not part of BEPS but whose implementation aids in the success of BEPS implementation. All of these efforts should be aimed at building a sound foundation for BEPS.

With a view to building a better relationship with taxpayers that will allow more efficient and effective controls, it is essential for TAs to promote dialogue through initiatives aimed at cooperative compliance.

Regardless of the degree of regulatory reforms implemented by each country to improve their tax system, it is important to consider that many countries in the region have traditionally experienced serious difficulties in conducting tax reforms. In this regard, it is likely that the reforms needed to implement BEPS results will not happen immediately.



7 A BRIEF HISTORY
OF TAX
TRANSPARENCY

7

A BRIEF HISTORY OF TAX TRANSPARENCY

Alberto Barreix, Jerónimo Roca and Fernando Velayos

a. The Beginnings: The Exchange of Tax Information up to 2009

The history of the international exchange of tax information is, until the onset of the twenty-first century, a history of opacity. There has been very little in the way of tangible results that show the contrary. We can record only a gradual—but always deficient—building of global awareness of the problem from 1989 onwards, when the European Community tried to “harmonize” taxation on savings as one of the challenges of its economic integration and, in general, of globalization.

In any case, the historical-political context has not been conducive to progress.

The world emerged from the Second World War in a state of disintegration:¹ (i) there was little interdependence among national economies, high levels of mistrust among countries and/or blocs, and a relative dearth of multinational companies; (ii) there was no true world financial system as we know it today; (iii) the public mistrusted financial systems and banking; (iv) technology was ill-prepared for global interconnections in real time; (v) the focus was on reconstruction and economic recovery—which, in truth, was extensive and successful: “the thirty glorious years” period² that diminished concerns about tax fraud; (vi) in the tax field there was a complete absence of international, inter-institutional collaboration; and (vii) except perhaps in the advanced economies, the paradigm was one of banking secrecy.

In sum, there was no awareness that taxation was becoming an intrinsically global phenomenon and, even if there had been, there were no mechanisms to change the status quo. Tax havens began to develop in this period and the world-wide lack of tax solidarity became more marked. This caused a triple “misalignment”: country relative to country (or, if one prefers, opaque countries or jurisdictions relative to other countries); multinationals relative to local businesses; and large fortunes relative to the middle class and less advantaged citizens.

Albeit slowly, however, the seven phenomena mentioned above inexorably began to become blurred or disappear, and by the 1980s global circumstances had become very different. Growing awareness (academic, political, economic, financial) that

1 For example, the European Economic Community in its most elementary phase was a creature of 1957—that is, 12 years after the war. In Latin America, Mercosur originated in 1985 and the Andean Community only took steps towards economic integration in the 1990s.

2 The term given to the period 1945–1975, when there was very strong economic growth in the Western democracies (Piketty, 2014).

the tax phenomenon is global, and that evasion is related to the financial system in at least two respects,³ coincided with the end of the golden age of growth, economic crises (the oil crises of 1973 and 1981, and in Latin America the “lost decade” of the 1980s), the consequent increase in public deficits, and thus the urgent need for public resources.

At the end of the 1980s, therefore, the first political effort was made to associate the phenomenon of financial globalization with tax erosion: the failed European Directive on taxation of savings of 1989, the Scrivener Directive,⁴ so named after the French minister who proposed it. Germany’s announcement that, on the basis of the Directive (which was not approved), it would withhold 15 percent on dividends and interests paid to other member states, caused capital flight amounting to US\$43 million between the end of 1988 and April 1989, when the measure had to be ruled out.⁵

The liberalization of capital movements has accelerated since the early 1990s, and there has been a worsening of the problem of tax resources lost to jurisdictions with low or no taxation for mobile sources of direct taxation. Hence the Organization for Economic Cooperation and Development (OECD) took steps on the matter from 1996 (transcending the European framework), and in 1998 managed to secure approval of a first study of harmful tax competition.⁶ We should also mention the Inter-American Center of Tax Administrations’ Model Agreement on the Exchange of Tax Information, which dates from 1990 and was revised in 1999.⁷ Its merit lies mostly in its early identification of a conceptual problem and its provision of a solution whose practical application, as we know, was limited.

Viewed from a historical perspective, the OECD’s studies between 1998 and 2008 were not effective in resolving the problem.^{8,9} The European Union (EU) was somewhat more effective (though also with substantial limitations, as we shall see below):

- 1999–2000: Code of Conduct (also known as the Primarolo Report) to avoid harmful tax competition in the EU¹⁰ (about 70 preferential tax regimes abolished in all member states, without exception). Nonetheless, see below for a critical review of the outcome of this exercise.
- 2003: Approval of the EU Savings Directive, which entered into force in 2005 and was amended in 2014,¹¹ and which shares mass information on cross border savings in the EU.
- 2006: The EU’s Joint Transfer Pricing Forum. Apart from its concrete achievements,¹² its historical importance lies in the fact that for the first time, transfer pricing was put on the agenda of international and inter-institutional cooperation in the fight against tax evasion.¹³ In other words, it identified a problem in how multinationals manage these operations.

3 One is the opacity of the financial system (it shelters evasion); the other is the unhindered movement of capital in the financial system (it fosters evasion, since it favors forms of planning that previously were unthinkable).

4 This Directive was based on the understanding that the complete liberalization of capital movements that the then-European Economic Community (EEC, now EU) was moving towards, thanks to Directive 88/361/EEC, could distort tax systems: “the Commission shall submit to the Council ... proposals aimed at eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems.”

5 Walter and Smith (2000).

6 “Harmful Tax Competition: An Emerging Global Issue,” OECD, 1998. www.oecd.org/tax/transparency/44430243.pdf

7 CIAT (1999).

8 Nonetheless, some formal progress was made, such as the first OECD report on access to banking information (2000), the first lists of tax havens and preferential tax regimes, and the inclusive undertaking with the creation of the Global Forum, whose participants include non-members.

9 The 1998 report on harmful tax competition was not approved by neither Switzerland nor Luxembourg (the OECD operates by consensus). And the report on access to banking information, which these two countries did approve in 2000, does not contain timeframes for implementing the commitment. Additionally, at the start of 2001 the Bush administration took office and with that there was a radical change in the policy of the United States, which no longer wanted to move towards cooperation and caused the endeavor to founder (Maldonado, 2002).

10 http://ec.europa.eu/taxation_customs/resources/documents/primarolo_en.pdf. For a history of this struggle and the “Code of Conduct,” see http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_10_history_en.pdf.

11 Directive 2003/48/EC, (<http://eur-lex.europa.eu/legal-content/ES/TXT/?uri=URISERV%3A131050>).

12 See http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/forum/index_en.htm.

13 To that point, international cooperation had been confined (in the OECD) to highly technical discussions of the methodology used to set such prices.

Mention should also be made of other interesting regional exercises in this field, since there had been attempts (and some formal progress had even been made) at a Code of Conduct to avert the use of harmful tax practices among neighbors. For example, for Central America, Panama and the Dominican Republic—sponsored by the Council of Finance Ministers of Central America, Panama and the Dominican Republic and with the technical coordination of the International Monetary Fund and the Inter-American Development Bank—in 2008 a draft Code of Conduct was drawn up but it was never enacted because of a lack of political will. By contrast, the Caribbean Community did manage to approve a code in 1973.¹⁴ Its practical results, however, are not clear.

It is also important to recognize the drive for transparency of the Financial Action Task Force on Money Laundering (FATF) process, which has sought to end banking secrecy and to promote the registration and control (beneficial owner) of ownership in businesses.

b. 2009, a Great Leap Forward: Exchange on Request (or the first standard)

If something can be said of this panorama as a whole it is that it was disappointing: (i) the OECD exercises were ineffective; (ii) the EU's efforts, aside from the fact that they were not global in format or mission, suffered from significant technical limitations;^{15, 16} (iii) there was no other regional endeavor of any significance—especially none in Latin America, where in general the tax systems and administrations had only a modest degree of internationalization;¹⁷ (iv) bilateral cooperation on information exchange, which existed on paper, was very rare in practice; and (v) perhaps the most fundamental factor, unlimited access to financial information for the part of tax administrations, which would require international consensus, was blocked by a minority of states or jurisdictions.¹⁸ We can say that there was a “blocking minority.”

The situation changed, however, with the financial crisis of 2008. The drive emerged in the developed countries because of the fiscal requirements spurred by the crisis and the pressure of public opinion, which reacted to the bailouts of the financial sector and the revelations of aggressive planning on the part of big companies. In the large majority of developing countries it was the influence of the developed nations that impelled a move towards transparency, which still faces resistance from economic interests, including with appeals to sovereignty. First, the G20 made the earliest mention of tax issues in November 2008. The first G20 statement was followed by a much more detailed declaration in April 2009¹⁹ and by the declaration of the G8 in L'Aquila in July 2009.²⁰ These statements immediately found expression in concrete events: (i) Switzerland, Luxembourg, Austria and Belgium withdrew their reservation to article 26 (exchange of information) in the OECD's Model Convention on Income and Capital; this implied the beginning of the end of banking secrecy world-

14 Agreement on the Harmonization of Fiscal Incentives to Industry (http://www.caricom.org/jsp/secretariat/legal_instruments/agreement_fiscalincentives.jsp?menu=secretariat). Also to be recalled, this time from outside the region, is the 2002 Memorandum of Understanding on Cooperation in Taxation Related Matters in the Southern African Development Community (SADC): http://www.sadc.int/documents-publications/show/Memorandum_of_Understanding_in_Cooperation_in_Taxation_Related_Matters.pdf.

15 The three main failings of the Savings Directive—which were largely rectified with the amendment of 2014—were that it did not cover legal entities or “paying agents” located outside the EU; it did not cover all possible forms of (risk-free) saving, only interest and some investment funds; and the alternative system of withholding at source for Luxembourg, Belgium and Austria.

16 The Code of Conduct (the Primarolo Report) did not define areas such as what constitutes passive income (for instance, it did not appraise international tax transparency regimes or CFC), and did not address the taxation of expatriates within the EU, thereby raising the possibility of migration for tax purposes, not only because of skilled and well paid work: HNWI regimes (tax regimes for high net worth individuals). Additionally, progress on transfer pricing in that period was timid and procedural.

17 For a summary of the international tax situation in Latin America and the Caribbean, see Barreix et al., 2013.

18 Switzerland, Luxembourg and, to a lesser extent, Singapore, Hong Kong and other financial centers.

19 Of particular interest is the declaration of London on strengthening the financial system (April 2009): <http://www.oecd.org/g20/meetings/london/Annex-Declaration-Strengthening-Financial-System.pdf>.

20 http://www.g8italia2009.it/static/G8_Allegato/G8_Declaration_08_07_09_final%2c0.pdf.

wide, given that other jurisdictions, to avoid lifting their secrecy, had alleged that there was no level playing field if Switzerland and Luxembourg did not make the commitment; (ii) the commitment of other important financial centers, such as Singapore, Macao and Hong Kong, in favor of exchanging information on request; (iii) the publication of the list of the Global Forum on Transparency and Exchange of Information for Tax Purposes (GF), led by the OECD, of uncooperative jurisdictions in April 2009 (the Progress Report),²¹ and the onset of efforts by many jurisdictions to be removed from the list. In Latin America and the Caribbean (LAC) this publication marked a turning point, because two Latin American countries (Costa Rica and Uruguay) appeared among the four blacklisted, and 18 (especially in the Caribbean) were among the 39 listed in grey.^{22, 23} In other words, 46.5 percent of the jurisdictions listed throughout the world were in LAC. Today, only Guatemala and Trinidad and Tobago are unauthorized to advance to a Phase 2 review of effective information exchange,²⁴ and Anguilla, Antigua and Barbuda, Barbados, Costa Rica, Curaçao, St. Lucia and Sint Maarten appear as being only partially compliant with the standard.²⁵

In any case, it is worth mentioning that other countries in the region have not joined the Global Forum, which now has 130 members. They are Bolivia, Cuba, Ecuador, Haiti, Honduras, Guyana, Nicaragua, Paraguay, Suriname and Venezuela. In the cases of Bolivia, Cuba, Ecuador, Nicaragua and Venezuela, this circumstance could be the result of a political decision (although not all of them could easily meet the standard), but in the cases of Haiti, Honduras and Paraguay there is a condition of historical, international financial and tax isolation (for example, this situation can be traced in the lists of the International Financial Action Task Force or FATF, where Honduras and Paraguay appeared until 2012).²⁶ Because of their tradition of scant transparency and institutional weakness, therefore, these countries will have to revise some aspects of their regulatory frameworks to enhance transparency and reach the international standard.

Additionally, some that have decided to join the Global Forum could find themselves in difficulties because of their institutional framework as regards banking secrecy. Hence Peru faces a possible constitutional constraint (see below) and Panama faces difficulties in determining how to treat the financial statements of companies created in Panama that engage in no activity on Panamanian soil, as well as foundations and trusts.²⁷

21 <http://www.oecd.org/ctp/42497950.pdf>.

22 Anguilla, Antigua and Barbuda, Aruba, Bahamas, Belize, British Virgin Islands, Cayman Islands, Dominica, Grenada, Montserrat, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos Islands, and Netherlands Antilles, as well as Chile (the latter listed under “other financial centers”).

23 The jurisdictions on the grey list had committed to exchange of information but had not implemented the commitment effectively.

24 Phase 1 reviews the country’s legal framework.

25 <http://www.oecd.org/tax/transparency/GFratings.pdf>.

26 And certainly some others were or are, such as Nicaragua or Guyana, Ecuador or Panama.

27 See pages 28–29 of the report: http://www.eoi-tax.org/peer_reviews/aa557ea9221d653369f4011848457bfc#default.

Two Speeds to Combat Fraud: EOIR and AEOI

1. Exchange of information on request (EOIR):

Concept and use: this is the exchange of information on a concrete case, requested of one tax administration by another tax administration, when it is foreseeably relevant in applying the tax regulations of the requesting country. This information might be financial, accounting-related or concerning ownership (beneficial owners).

Once the relevance of the information has been justified to the requested administration, whether the requested country does or does not have a domestic interest in that request or its definition of tax fraud is irrelevant. It is also irrelevant whether the requested tax administration already has the information and, when it is in the possession of financial entities, in no circumstances can the request be denied on the grounds of banking secrecy. Full confidentiality in the handling of the information transmitted must also be guaranteed.

Legal basis: (i) article 26 (or equivalent) of the Bilateral Agreement on Double Taxation regarding the exchange of information; (ii) a tax information exchange agreement (TIEA); or (iii) article 5 of the OECD/Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters (2011 amending protocol for its universal adoption and update).¹

Statistics: see the mention of the Global Forum's 2015 Progress Report in this same document.

Final note: while the automatic exchange of information is gaining ground, technically EOIR remains the universal standard and is the option used by the Global Forum for its peer reviews of jurisdictions.²

2. Automatic exchange of information (AEOI)

Concept and use: this is the periodic and systematic transmission of non-preselected information from the State of the source to the State of residence, relative to a series of pre-established categories of income: dividends, interest, royalties, salaries, pensions and so on.

This information is gathered from paying persons or entities in the source, such as banks, employers and so forth, and is transmitted in line with standardized and secure protocols between tax administrations. Once the information has been filtered and processed, tax administrations can begin control actions towards their residents or request more information from the sending administration.

Legal basis: it can be: (i) article 26 (or equivalent) of the Bilateral Agreement on Double Taxation regarding the exchange of information, when thus provided for; (ii) a tax information exchange agreement (TIEA), when thus provided for; or (iii) article 6 of the OECD/Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters (2011 amending protocol for its universal adoption and update).

Statistics: according to a survey carried out by the OECD (31 participating countries), the results are starting to be very significant: 17.8 million records exchanged. In some countries, such as Norway and Denmark, it was found that their residents were under-declaring or failing to declare about 40 percent of income abroad.

(1) In the European Union there are specific additional instruments.

(2) "Implementing the Tax Transparency Standards". OECD, 2010.

c. 2014, the Missing Link: Automatic Exchange (or the second standard)

Very substantial progress has been made on exchange of information since 2009. Today there is a dense network of bilateral agreements²⁸ and a multilateral instrument has been ratified by almost 100 countries: the OECD/Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters (2011 amending protocol for its universal adoption and update). Moreover, according to the Global Forum's 2015 progress report,²⁹ a survey of 32 jurisdictions revealed that taxes totaling US\$703 million had been recovered on average in the 2012–2014 tax periods, only as a result of the international exchange of information on request that these 32 countries have implemented.

There were also, however, voices that were critical of the achievements of the exchange of information on request. One of the most prominent was the Tax Justice Network, which called for the automatic exchange of information from a very early stage (2005) and repeated this call in 2012 when the Global Forum's success in information exchange on request had been achieved.³⁰ These criticisms were partly unfair because they ignored the huge progress entailed by the events of 2009 and the importance they could come to have in the medium term. Additionally, and this is particularly true in Latin America with its sorry history of banking secrecy, because of international pressure many countries lifted the domestic legal barriers to transparency. And in the end, the world divided into two groups: those that collaborate and those that do not. Today the former are a clear majority, though it is acknowledged that not all of those collaborating do so with the same eagerness.

To some extent, however, it should be said that the critical voices were right. Looking back, it is possible that the pressure of the activists, combined with the tax authorities' urgent need to find large-scale financial resources and the difficulty of implementing the exchange of information on request quickly and effectively,³¹ triggered the most recent and most important change in the history of international tax transparency: the acceptance, which we can say is now widespread, of the new standard of automatic exchange. Together with the foregoing, moreover, the Foreign Account Tax Compliance Act (FATCA), which transformed the international landscape, must be accorded particular merit.

This law modifies Chapter 4 of the US Internal Revenue Code. It was enacted on March 18, 2010, although its full application has been delayed by the US government's practical difficulty in implementing a law with so many tax subjects that do not fall under US sovereignty. Under FATCA, Foreign Financial Institutions (FFIs) must identify the accounts of US citizens or persons, and periodically or automatically they must report information on those accounts to the US Internal Revenue Service (IRS). FFIs that do not report information face a 30 percent tax withholding on certain payments to them from US sources. Later, the Treasury decided to begin collaborating with various tax administrations throughout the world to ensure that FATCA was implemented better. To that end the United States offered some degree of information exchange—albeit not entirely reciprocal (see below)—or other advantages by signing Inter-Governmental Agreements (IGAs).

28 All the tax information exchange agreements (TIEAs) signed by the member countries of the Global Forum can be consulted interactively online at: <http://www.eoi-tax.org/#default>.

29 <http://www.oecd.org/tax/transparency/global-forum-annual-report-2015.pdf>.

30 The Tax Justice Network called for a move to the automatic exchange of information from a very early stage (2005): http://www.taxjustice.net/cms/upload/pdf/TUIYC_2012_FINAL.pdf.

31 For sophisticated tax administrations, with an appropriate system of risk control and audit selection, exchange on request was a very important step because the announcement effect was more powerful. For poorly organized tax administrations, however, the availability of this information was not real given that very few cases of fraud were uncovered in practice—simply because very few cases were investigated (in Latin America, no more than 2 percent of taxpayers are audited, on average!).

The act broadened and clarified the landscape of tax transparency only a few years after the progress made in 2009, since: (i) it showed that the automatic exchange of information was possible, both politically and technologically; (ii) it established very high standards of data transmission both in the objective sense (essentially, the bulk of the information held by banks, insurance companies and other financial institutions) and in the subjective sense (the concept of a “US person” is very broad, covering nationals, residents and a significant number of “interposed” or “shell” entities); (iii) it paved the way for certain countries, which did not comply with the transparency standards or did so with difficulty, to take advantage of FATCA to improve their legal frameworks and, in particular, their institutional arrangements for exchanging information. And this is very important for Latin America because several countries (Chile, Uruguay or Costa Rica), in order to meet the on-request standard and relieve themselves of internal political pressures against the lifting of bank secrecy, had used the Swiss system of a review judge or supervisory judge to oversee the exchange (as a guarantor of legal protection), and by definition this figure is incompatible with automatic exchange; and (iv) it creates a shared technological standard of data transmission among tax administrations, since the IRS took responsibility for standardizing the transmission technologies with the International Data Exchange Service.³² In all, a revolution within the revolution that now operated with the information-on-request standard.³³

Nonetheless, together with these clear advantages—which as we will see had an immediate and natural corollary in the Common Reporting Standard or CRS (see the box)—we must also record some weak points.

The first is the risk that this pace of (technical) change is too fast for some jurisdictions. By that we mean that forcing the financial centers, which have a more than extensive degree of legal, institutional and technological sophistication, to exchange information automatically and to start doing so in a short period is possible and salutary. But when certain States have sociopolitical and institutional constraints on moving quickly towards transparency (in Latin America there are clear examples), including doubts about the need for constitutional reform (as in Peru and Guatemala), the imposition of FATCA places the countries in the quandary of either being non-compliant or reforming at a dizzying speed, which is not always possible or desirable.

The second question is the ambiguous position of the United States³⁴ in the global environment of automatic information exchange: on the one hand, it gets great credit for having helped surpass the on-request standard through FATCA, but on the other hand the country does not provide the same information as it requests. The main problem is that the United States requires foreign financial institutions (or countries, in the case of an intergovernmental agreement, IGA 1) to send information on balances, interest and dividends received and gross proceeds (amounts received for the sale of assets). On the other hand, in the United States and as regards payments to non-residents, the IRS has information on dividends (through withholding) and interest (since 2013, though interest remains exempt), but US banks still do not provide mass information to the IRS on the balances

32 <https://www.irs.gov/Businesses/Corporations/International-Data-Exchange-Service>.

33 In this sense the importance of the United States in the process is striking, first for being able to slow it down (see footnote 10) and later for acting as a catalyst. More significantly, this shows the importance of concerted action: if Switzerland and Luxembourg had not yielded it would not have been possible to get the other tax havens on board in this endeavor; without pressure from the OECD (with the United States in the lead), not as much progress would have been made.

34 The United States, aside from its economic and political significance, has been a pioneer in international transparency and taxation, from its citizens' world income, set out in the Revenue Act of 1861 amid the Civil War, to the prosecution of criminals for tax offences in the 1930s, the professionalization of the IRS in the 1950s, and finally FATCA (automatic information exchange) more recently. Its leadership in international tax transparency is crucial—hence the need for it to secure legislative approval of the common standards and reports, and to eliminate opacity in its state regimes.

or gross proceeds³⁵ of non-residents.³⁶ Additionally, they do not demand transparency of offshore platforms.

This creates a competitive advantage for certain financial centers (several US states: see footnote 36) that fall under the sovereignty of the United States. International tax advisers are seeking to exploit that circumstance using new planning arrangements.³⁷

Third, there are technical risks that automatic exchange will end up having little effect. It must be completely effective in three respects: (i) no jurisdiction can escape; (ii) it must cover all income streams, be they from business, capital or labor; and (iii) the stock variable must improve, making ownership transparent up to the ultimate beneficial owner of any entity. There are various means of meeting this basic objective. Our clear preference would be that the national registries should demand, on pain of severe penalties, to know each ownership chain up to the ultimate beneficial owners of all registered entities. This would allow each jurisdiction, consulting with a second jurisdiction (or more if desired), to verify the true sequence of ownership. This procedure was adopted by the Global Forum (Tax Transparency, 2015) in October 2015 and is similar to that recommended by the Financial Action Task Force to foster implementation and enhancement of policies to combat money laundering and the financing of terrorism. Complementarily, a global public registry could be created, building on the achievements of LEIROC (www.leiroc.org), and its mandatory updating could be regarded as part of the standard of transparency. Access to this information must be justified. Furthermore, recently five EU member states demanded as a condition that the beneficial owner be made known: in April 2016, France, Germany, Italy, Spain and the United Kingdom announced a pilot initiative for the automatic exchange of information on beneficial owners (swiftly supported by another 35 jurisdictions), with a view to providing their tax and other relevant authorities with full knowledge of a wealth of information, and to fostering monitoring of the complex offshore routes used by criminals.³⁸

All in all, this progress is phenomenal in historical terms, giving rise to the approval in 2014 of the OECD's CRS³⁹ and the later signing, by almost 100 jurisdictions, of the Multilateral Competent Authority Agreement that links the CRS to the Multilateral Convention on Mutual Economic Assistance in Tax Matters. The world is moving more decidedly towards the adoption in 2017 or 2018 of the automatic exchange of financial information as the new standard of universal tax transparency.⁴⁰ And although the undertaking is essentially designed for the control of the direct and asset taxes of multinationals and large fortunes, there is a spillover effect on the tax system as a whole—especially in developing countries where personal income tax is not so significant—because it also strengthens VAT and other taxes.

35 The analytical outlooks for the US budget (the most recent in February 2015) always address this matter but Congress never agrees on anything:

"The proposal would require certain financial institutions to report the account balance for US financial accounts held by foreign persons, expand the current reporting required with respect to US source income paid to accounts held by foreign persons to include similar non-US source payments, and provide the Secretary of the Treasury with authority to prescribe regulations that would require reporting of such other information that is necessary to enable the IRS to facilitate FATCA implementation by exchanging similar information with cooperative foreign governments in appropriate circumstances. The proposal would also require that this information, as well as information reported by foreign financial institutions to the IRS, be furnished to the account holders in order to encourage voluntary tax compliance. The proposal would be effective for returns required to be filed after December 31, 2016."

36 There are also transparency problems with companies set up in some US states (Delaware, Nevada, South Dakota and Wyoming, especially in their "shell companies"), but that are in the process of adapting to the exchange standards of the Global Forum (Common Reporting Standard, CRS) and the OECD.

37 http://itep.org/itep_reports/2015/12/delaware-an-onshore-tax-haven.php#.VpK6TRXhC71.

38 On April 15, 2016, after a meeting of the G20 Finance Ministers and Central Bank governors, a statement was issued requiring that by July 2016 the OECD should publish objective criteria to identify jurisdictions regarded as uncooperative in matters of tax transparency. See also: <https://www.gov.uk/government/publications/beneficial-ownership-countries-that-have-pledged-to-exchange-information/countries-committed-to-sharing-beneficial-ownership-information>.

39 See box.

40 In Latin America, the following countries have made a commitment to adopt the new standard in 2017: Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Uruguay and Panama (within certain limits). A total of 13 Latin American and Caribbean countries will have adopted the standard by 2018.

d. ... And the Icing on the Cake in 2015: BEPS and its Importance in Transparency Endeavors

The problem of harmful tax competition in its various forms and degrees is not solely a problem of those US states that comprise financial centers. What is worse, often the problems of low revenue do not stem from the non-disclosure of information. In reality, large corporations have used the differences of legal treatment between jurisdictions to optimize their tax bill without scruple. These are aggressive tax planning formulas that skillfully skirt the line separating fraud (avoidance) from licit practices (tax mitigation). In fact, there have been cases of aggressive planning in some countries of the EU, such as favorable treatment in Ireland (Apple, Fiat, Chrysler, and so forth); the Netherlands (Starbucks); Luxembourg, in a case known in the media as “LuxLeaks” (Pepsi, Ikea, AIG, Deutsche Bank, and so on); and more recently Belgium.⁴¹ But according to Jean-Claude Juncker,⁴² these and similar practices are present in as many as 22 EU member states and there is every indication that, if the cases in the EU have been brought to light, it is because there is a strong institution such as the European Commission that prosecutes such practices.

In any case, a brief additional parenthesis on these matters seems opportune.

1. Multinational companies’ web of international tax evasion involves sophisticated technical expertise (it does not consist, to be clear, of carrying the cash to a bank account in a briefcase and hiding it in the dark). The documents reveal various structures of fiscal engineering whose complexity is growing, such as the use of “hybrid” instruments—that is, those that receive a different tax treatment in two countries, which allows an income to avoid taxes; or the use of clauses that offset revenues and expenses by means of an accounting device that makes it possible to control the final benefit freely—that is, when there are revenues, a fictitious book expense is generated as an offsetting factor to leave the profit at zero; and when there are losses the reverse mechanism is set into motion by means of the “claw back provision”.
2. There is a necessary cooperation from tax advisory businesses, among them the biggest multinational companies engaged in accounting-legal-tax consultancy, and also various international law firms.
3. Much worse, there was (and there is?) an active complicity between various countries to foster such practices. Hence it is no longer simply a matter of there being a norm (banking secrecy, or a legal exemption) to shelter income: a country’s authorities have to know the operation to perfection, and thus be aware of how another country’s tax base is being eroded. This is explicitly or implicitly revealed in every consultation or ruling of “LuxLeaks,” but there are various means of achieving it and the EU is not the only transgressor.
4. What was said in the preceding point is even more serious if we keep in mind that, as we have seen, the fight against opaque tax practices in general has been continuing since at least 1997. In the European context (not hard to extrapolate, we fear), the initial success of the Code of Conduct has come to almost naught. It could even be said that the European

41 For more information and as examples of the statement above, see the following files on state aid available on the European Commission website: Apple case: state aid SA.38373 (2014/C); or the Starbucks case: state aid SA.38374 (2014/C). Those interested can also visit the following site to analyze the “LuxLeaks” affair in greater depth: http://www.icij.org/project/luxembourg-leaks?utm_campaign=lux_release&utm_source=email&utm_medium=button_middle&mc_cid=28019c7941&mc_eid=80ffe22bbd. Finally, the news on the Belgian case is more recent: <https://es.noticias.yahoo.com/la-ue-estima-ilegal-el-r%C3%A9gimen-exoneraci%C3%B3n-fiscal-111512708.html>.

42 “LuxLeaks”: Juncker contre-attaque. *Le Figaro*, November 12, 2014: <http://www.lefigaro.fr/conjoncture/2014/11/12/20002-20141112ARTFIG00258-luxleaks-je-suis-politiquement-responsable-admet-jean-claude-juncker.php>.

Code was counter-productive because it left a sense of control and monitoring of harmful regimes on the part of the European Commission, and thus perhaps led to some loss of vigilance.

In this context, the works of the OECD and the G20 emerged in July 2013 to eliminate the base erosion and profit shifting (*BEPS*) carried out by multinationals. The *BEPS* project is a notable effort to deal with the maximum possible number of factors identified as potentially determinant of or contributory to international tax avoidance. It consists of a total of 15 actions that can be divided very schematically into four blocks:

1. Combating aggressive tax planning in general (actions 2 to 5, and 12).
2. Combating the abuse of double taxation agreements and improving their implementation (actions 6, 7 and 14).
3. Strengthening the regulation of transfer pricing (actions 8, 9, 10 and 13).⁴³
4. Implementing the political agreements of the 14 preceding actions through a multilateral treaty (action 15).⁴⁴

From the viewpoint of transparency, *BEPS* project offers substantial progress on:

1. The obligation to measure and monitor the concrete results attained by countries after they have adopted some or all of the proposed measures.
2. The obligation of companies (and tax advisers) to reveal aggressive planning arrangements to the tax administrations before putting them into practice, or otherwise face a penalty.
3. The standardization, improvement and country-by-country reporting of tax information on multinationals' transfer pricing.
4. The establishment of flexible mechanisms to settle disputes related to double taxation between countries, including tax arbitration in the last instance.

The future success of *BEPS* will depend on:

1. The speed with which it is transposed into the corresponding legislation (political obstacle).
2. The coherence or symmetry of its regulation in all countries (technical-tax obstacle).⁴⁵
3. Its enforcement (administrative obstacle).

Because of the institutional weaknesses of emerging countries (and several in LAC) in each of these levels, and because of the latter's scant direct commitment to the process, this is a particularly daunting challenge for them. Moreover, skeptical opinions are being voiced about the usefulness of

43 We should also mention other progress in the field of information technology such as electronic invoicing, which has now been implemented in seven Latin American countries; and electronic receipt of wages, which is underway in three jurisdictions. These are fundamental steps forward in tax control of domestic economic activity. It will also be very useful when there is international electronic billing, a control instrument with several applications such as the review of transfer pricing and combating "missing trader" fraud in the VAT on exports between EU countries.

44 Action 1 on the digital economy is crosscutting in nature and makes quite general recommendations without concrete outcomes. All the material on BEPS can be consulted at <http://www.oecd.org/tax/beps.htm>.

45 Thompson (2016) states that BEPS seeks to prioritize the elimination of international double non-taxation, even at the cost of causing international double taxation, which becomes tolerable collateral damage for the post-BEPS regime.

the exercise for emerging countries in general. Nonetheless, we believe that international cooperation between countries and multilaterals is very important in ensuring the global success of this initiative, given its crucial contribution and its complementarity with the tax transparency efforts fostered by the Global Forum on Transparency and Exchange of Information for Tax Purposes (banking secrecy, determination of ownership to the final beneficiary, and information exchange). Furthermore, the *BEPS* proposal has spurred discussions because of the new tax policy alternatives that are consequent on its future implementation.⁴⁶

The main criticisms of *BEPS* from emerging countries are as follows:

- **BEPS** is not a global process: the G8, G20 and OECD have not included all emerging countries and there have never been negotiations with this bloc as such. *BEPS* is a unilateral and hugely complicated package of recommendations on how international tax regulations should change.
- **BEPS** will not put an end to tax evasion. In several cases the proposals are tweaks to the prevailing tax system; it will be difficult for poor countries to put them into effect and curb tax evasion, which is organized today as an “industry” or structured system.
- **BEPS** does not really address the allocation of the fiscal sovereignty of the taxes among countries, but rather discusses the matter in a way that is either marginal (for example, broadening the definition of permanent establishment) or that speaks to the future (for example: Action 1 on the digital economy does attribute a tax to a source but the final policy decision is deferred because there is no “consensus”).
- **BEPS** does not end the race to the bottom, since the countries continue to engage in some form of tax competition. This means that corporate income tax, with its multiple exceptions and benefits, will continue to be eroded and to undermine tax revenues at the global level.⁴⁷

Last but not least, corporate income tax has not undergone any great structural changes (income less costs) since it was conceived in the late nineteenth century, and *BEPS* might be its greatest historical transformation.⁴⁸ Barreix et al. (2016) proposes an adaptation of the income tax system to the changes of the twenty-first century, in which the drive for tax transparency is a crucial force. In other words, changes in tax administration and greater world-wide transparency will make possible new designs for tax policy in the area of direct taxation.

46 As an example, we can cite the important discussion that has been prompted by the impact of the future implementation of *BEPS*—which will make it possible for the authorities to be informed about a taxpayer’s global income, and better approximate the income that corresponds to each jurisdiction—on the application of allocation formulas to divide the income among the countries in which a multinational company operates. The discussion about the use of formulary apportionment for the unitary taxation of the multinational, as against the arm’s length principle, is involving academics (Picciotto, 2012), professionals (Spencer, 2014) multilaterals (IMF, 2014) and social organizations (Tax Justice Network, 2013), among other authors. The authors of this study, moreover, propose a new design for income tax (Barreix et al., 2016) based on this new international situation in which there is real knowledge of capital income flows and their ownership.

47 In sum, according to the more prominent activists in the international tax field: “the measures [*BEPS*] recently announced by the OECD leave the fundamentals of a broken tax system intact and do not stop the race to the bottom in corporate taxation. G20 governments must do more and should strongly support further reforms” (joint agency briefing note from Oxfam, the Tax Justice Network, the Global Alliance for Tax Justice and PSI: <https://www.oxfam.de/system/files/still-broken.pdf>).

48 While there have been occasional changes such as thin capitalization rules, transfer pricing or adjustments for inflation, in practice there have been no substantial structural changes. The proposals of Hall and Rabushka (1995), precursors of the “flat tax”, which proposed moving to a cash-flow type tax and disregarding interest in determining income (that is, ignoring the company’s financial structure), were not implemented.

e. Conclusions

The forward march of transparency is a phenomenon with profound ramifications in many spheres: legal, political, ethical and so forth, with powerful global actors, and where not every formal legal or political agreement will have immediate effect. But it will have broad impacts on economic and social policies world-wide if it comes to prevail. Indeed, the big change is that tax transparency levels the playing field by offsetting the informational asymmetry between taxpayers and their advisers (operating at a global level) and national administrations for tax and asset control. In short, capital (including information on its ownership and yield) remains mobile but now it cannot be hidden or distorted—it can run but it can't hide.

If progress on the international coordination of fiscal and financial transparency proves successful, it is very likely that it will spur changes in tax policy, especially as regards tax on income and capital. It will also pose new technical and ethical challenges to the management of the transparency process for taxpayers, tax advisors and tax administrators. The management of information will offer new opportunities in the areas of services (for companies) and controls (for tax administrations). Moreover, use of the data will impose new obligations on advisors and other public services (not only the tax administrations), and thus it will be necessary to draw up regulations governing the management and control of their activities.

Finally, a cultural perception is emerging that the informational asymmetry stemming from international tax opacity leads to inequality of treatment among citizens.⁴⁹ Lower-income taxpayers—who largely bear the austerity policies that followed the 2008 financial crisis in the advanced economies, and in the developing countries are suffering the demand adjustments attendant on the recent fall in commodities prices—are being affected by personal income tax, social security contributions, and all indirect levies, etc. While the wealthiest, with professional advisers and access to opaque jurisdictions, can reduce or hide their assets and income, to which is added the perception that they were not always acquired licitly. Lack of tax transparency, therefore, calls into question the market economy as a fair system, and even democracy itself as a competent regime.

⁴⁹ The influence of capital mobility is evident in political economy models. A pertinent example is the additional condition to the Median Voter Theorem (which suggests that a majority-rule voting system will choose the outcome preferred by the median voter). This condition postulates that the richest sectors of a society avoid taxes and confiscation by means of capital flight, and thus the democratic process avoids opposition from a powerful pressure group and at the same time achieves the coexistence of formal democracy with tax regressiveness (Mahon, 2016). Additionally, the literature on the reactions of welfare states to globalization points out that governments respond with tax incentives to attract and retain multinational or multiregional companies, which are crucial economic agents in the mobility of corporate capital (Tanzi, 2000).



8

PLANNING, MANAGEMENT CONTROL AND STUDIES

8

PLANNING, MANAGEMENT CONTROL AND STUDIES

Andrea Lemgruber

Tax Administrations in Latin America have started to show interest in management by results and analytical studies since the 90s. However, the strengthening of strategic planning functions and fiscal studies has been heterogeneous in the region. Gradually, over the last two decades, a clear trend towards establishing those functions at most Tax Administrations in Latin America arose, which translated into results such as: widespread adoption of concepts of mission, vision and values; the publication of formal strategic plans; and the dissemination of economic and tax compliance – for instance, tax expenditure studies and, more recently, studies on fiscal gaps.–.

The main drivers behind the growing focus of Tax Administrations on planning and studies fall within an international context demanding greater efficacy, transparency and professionalization of public administration. Particularly:

- **Adoption of strategic planning tools in organisational practises and in the government reinvention movement.** Strategic management, as an independent and consistent discipline, started in the mid-60s and developed throughout the 70s and 80s. (Herrmann, 2005, Melé and Gillén, 2006, Cerniauskiene, 2014), with strong orientation towards the private sector. The goal of defining organisational challenges, resource allocation and result measurement became an essential component towards higher business efficiency and competitiveness. Over time, societies started demanding similar changes in public administrations, particularly that they should be more result-oriented and less focused on traditional bureaucratic processes. The ‘reinventing government’ movement, in the early 90s in the USA, is an example of this vision of a more efficient and efficacious public sector, under the general concept of performance orientation. These factors led to significant change in public administrations towards better management methods and accountability.
- **Availability of data and instruments of analysis enabled by the technological revolution.** With the widespread use of personal computers in the 80s and of Internet in the 90s, public administrations, and Tax Administrations in particular, started using electronic government strategies and solutions. Large-scale access to high quality data, thanks to the gradual introduction of electronic tax returns and payment, enabled more detailed and analytical studies, including micro-simulation of data and immediate response capability, which was not previously possible. More recent studies, such as those on non-compliance gaps, rely on high computer power and long data series.
- **Political and legal context leading to greater transparency and decision-making based on analytical studies.** Since the 90s, government data transparency increased and consequently economic policy decisions have

become more related to technical studies. Legislation in several countries (such as Brazil) was amended to demand, for instance, income loss estimates to accompany tax incentive proposals, and the obligation of submitting tax expenditure estimates to back the official budget. Some countries, such as the United Kingdom, adopted compliance gap measures as official statistics required by law.

All these factors encouraged Tax Administrations in Latin America to organise their planning and study areas in line with the international trend. The exchange of experiences and know-how in these areas also supported this process. It is worth pointing out, in particular, the significance of events organized by CIAT, which have addressed these issues, for instance: The 2009 General Assembly in Santo Domingo, the 2009 Technical Conference in Naples and the 2006 General Assembly in Florianopolis. Efforts by international bodies also enhanced the exchange of experiences through research and technical assistance – such as the IMF VAT gap estimation program, which has developed a detailed methodology and supported several countries (including those in Latin America) in estimating non-compliance.–.

a. Strategic Planning Function

Tax Administrations receive growing public pressure to increase their efficacy, transparency and accountability. Especially after the financial crisis in 2009, Tax Administration budgets have dropped drastically, both in advanced and in developing countries¹. At the same time, higher performance in terms of taxpayer satisfaction and taxpayer compliance is expected. In other words, doing more with less. Responding to these challenges in large and complex organisations such as TAs, with responsibilities and credibility risks, is only possible with strong leadership combined with the analytical and disciplined process of strategic planning.

In fact, modern Tax Administrations use strategic planning as a systematic process to (1) adopt institutional frameworks (mission, vision, values) to create strategic references which provide a sense of identity and belonging throughout the organisation, (2) define objectives, in general based on the analysis of internal strengths and weaknesses, and on the external context, (3) develop and implement operating plans, creating top-down impact and alignment through all hierarchical levels, (4) monitor and assess performance to ensure the organisation heads for the right course, or to make course adjustments whenever necessary.

However, in the long-lived work by IMF on technical assistance to developing countries, it was made clear that management by results and performance is no common practise, which significantly impacts the effectiveness of Tax Administrations. Three of the most debilitating factors of modernization reform processes in Tax Administrations are: low management skills, absence of a structured reform strategy and the absence of a performance measurement culture. For instance, in the CIAT and IMF survey on Tax management 2011-2013 using the RA-FIT platform, some countries found it difficult to report basic fiscal process indicators. This shows that ongoing performance indicator capture and monitoring are not widespread in the daily operations of many Tax Administrations.

In Latin America, although progress in recent years must be acknowledged, it should also be admitted that strategic management is not yet inherent in institutional decisions. This is due to it being a relatively new process in organisations with no previous strong planning culture. In fact, CIAT's Specialized Course on Tax Administration indicates that the “issue of design, adoption, implementation, follow-up and control of strategic plans is relatively recent in Tax Administrations.

¹ OECD (2013) mentions that the Tax Administration budgets in Australia and Canada suffered a 4% reduction in 2012-2013; the Netherlands saw its budget cut down by 12% between 2010-2015; other Tax Administrations (such as those in Austria and France) have seen reductions in their number of officials.

Most started to ponder on the need to introduce strategic plans, operating plans and control and follow-up mechanisms, as well as performance measurement, in the 90s.”

Progressively, since the 90s, management good practises evolved in the private sector towards public administration.² In Tax Administrations, these processes gradually adjusted to the fiscal business focus (for instance, looking for specific management indicators to measure tax compliance, taxpayer satisfaction, auditing effectiveness). A significant point is that, unlike in business, the definition of the public agency mission will largely be given by the legislation or by a norm issued by the national government, orienting strategic planning to compliance with the mission imposed by the legal system. (Díaz Yubero, 2009). The social demand for efficient and efficacious governments guided modernization reforms in many Tax Administrations. As USAID indicated, “Management is assuming a more holistic approach in many Tax Administrations as compared to past practises focusing only on income. Strategic plans play a significant role in this holistic approach on organisational management.”

Presently, as a result of this evolutionary process, almost all Tax Administrations in Latin America count with strategic planning. According to BID/CAPTAC-DR/CIAT (2012), all Tax Administrations counted with a declaration of mission and vision, except for Panama and El Salvador. Likewise, according to CIAT and IMF surveys on tax administration 2011-2013 using RA-FIT platform, all respondents indicated that they have strategic and operating plans. These results are very positive and pave the way forward.

In fact, some Tax Administrations in the region (for example, AFIP in Argentina, RFB in Brazil, SII in Chile, DIAN in Colombia, SUNAT in Peru, DGI in Uruguay) presently count with comprehensive models of strategic management, including the use of internationally renowned tools (such as Balanced Scorecard), strategic maps and closer links among all levels of planning – from institutional to individual (officials assessment and its connection to organisational strategic challenges). At the 2009 Technical Conference in Naples, the practical study presented by Colombia showed that evolution (Díaz, 2009). It was shown how DIAN’s strategic planning model is aligned with the National Development Plan and includes all the fundamental pieces of strategic management, accompanied by a process plan (mission, control and support), a result assessment method and strategy communication.

In other cases, the adoption of practises seems to be more superficial than for effective support of decision making and result attainment. There are cases of disconnection between strategic and operational plans, material and human resource allocation running against strategic priorities, and the adoption of short-term measures which derail the mid-term and long-term planning effort. In fact, BID/CAPTAC-DR/CIAT (2012) concludes it is necessary for “planning and management control systems to stop being mere theoretical concepts with no connection with the actual functioning of organisations and no useful indication to its management to know if they are moving in the right direction and at the desired rate.”

In spite of these challenges, it is possible to identify some interesting evolving issues in recent decades:

- Gradually, organisational structures have changed to provide specific space to the planning function and a higher level within the TA hierarchy. For instance, the function was introduced into the RFB structure in Brazil in the early 90s, but its scope was not national (it was rather a consolidation of a set of local and regional initiatives). From 1994 to 2000, planning was included in the competencies of the study unit. It was only in 2001 that an area devoted to planning was created, but still subordinated to the Collection Department. In 2005, the area became an independent department and linked to the most strategic level of the administration. This shows

² Díaz Yubero (2009) mentioned that while the concept of strategic management, management by objectives and management control had significantly developed in the business world, in the arena of Tax Administrations these ideas had been introduced, albeit with some reservations.

the increasing significance of the function over time, and in fact, has become a support area for high-level decisions.

- TA missions also went through an evolutionary process in recent decades, which gradually started to be concerned about service rendering and social welfare. This also reflects significant change within TAs, which went from a traditional model primarily based on auditing or control to a model of voluntary compliance more in balance with the function of taxpayer service and fiscal education work.
- Performance indicators went from an approach restricted to revenues (collection) and production measures (*output*), to a more balanced approach on all TA functions and on result (*outcome*) measurement. At top level, nowadays it is increasingly common to see advanced countries using compliance indicators (for instance, VAT gap) and satisfaction survey of officials, taxpayers or TA credibility.³

b. The Function of Economic Studies and Research

The area of economic studies and research in TAs has gone through a very similar evolutionary process to progress in the strategic planning function. In particular in the 90s and 2000s, several TAs in Latin America started to develop analytical capabilities for studies and research, with initial focus aimed especially at supporting tax policy decisions. However, perhaps the evolution of studies has been even more heterogeneous than the dissemination of strategic planning in the region, since the strength of analytical skills is closely dependent on high-quality internal and external data – which is still very weak in several countries.⁴–

The study units in TAs developed based on the vision of preparing four basic products: (1) revenue forecasts and analysis, (2) tax expenditure estimates, (3) economic simulations of tax reforms and legislative changes, and (4) non-compliance and evasion estimate. All these activities are fundamental inputs for supporting the TA role in tax policy creation and for improving its efficacy in the fight against tax noncompliance.

At the 2009 Technical Conference in Naples there was in-depth discussion on the role of TAs in supporting good design of the tax system. Stress was made on the fact that policy and TAs are interconnected functions and, therefore, design and implementation of tax systems should be done in coordination (Lemgruber, 2009). In spite of there being different models – of greater or lesser TA participation in policy creation– in practise a more active role of study units role prevailed in Latin American TAs. The reasons for this are:

- TAs in Latin America are acknowledged as one of the soundest public institutions in their countries, in terms of their human resource capabilities, data access, technical analysis and public credibility. Given the absence (or weakness) of macro-fiscal units and tax policy at ministry level in many Latin American countries, TAs were called to occupy this space–in many cases being the only institution in charge of this function–.
- Given poor administrative capability and high informality in developing countries, it is important to consider these limitations upon designing the tax system, so that its implementation is viable.

3 It is interesting to note that focus on results is also changing the models of technical assistance of providers such as the IMF. IMF is implementing a new model of management by results which seeks to assess the effective impact of technical assistance (for instance, better control of large taxpayers) and not only production measurements (for instance, number of support missions to large taxpayers).

4 Information, which is the most important input for a reference study area, is not only relative to the internal or specific aspects of the TA (tax returns, payments, third-party information) but also depends on the quality of macroeconomic or sectorial databases in a country (national accounts, input-product matrices, price indicators, among others).

Thus, TA participation in designing systems which are simple and administratively feasible has always been considered crucial in Latin America. A clear example has been the extension of presumed estimate systems in the region.

In Latin America, study units are very widespread. Out of the 17 countries participating in BID/CAPTAC-DR/CIAT (2012) only 2 indicated not having a specific unit (Bolivia⁵ and Nicaragua). Some countries, such as Argentina, Brazil, Chile and Peru, have had those operating units for nearly three decades. The size of the units varies from about 5 officials (Costa Rica, Honduras, Panama and Paraguay) to about 30 officials in Argentina and Brazil. In most countries, the units are at high level in the organisations and have responsibilities of their own. In others, they operate below or are integrated into the planning function (Chile, Guatemala).

In terms of results, the region has advanced in creating general products such as tax pressure studies, fiscal expenditure budgets and compliance gap estimates. The latter is a very positive trend.

Average tax pressure in Latin America grew about 4 percentage points of GDP in the past decade and is about 20% of GDP. Although the trend goes in the right direction, tax pressure in Latin America is still lower than the average in more advanced countries. A deeper problem lies in the big heterogeneity of taxation in the region, with countries with revenues below 15% of GDP (Panama, Guatemala, and the Dominican Republic). Those levels may be considered low compared internationally – even relative to the African average, region with revenue level in general lower than Latin America – to support State funding. That level of tax collection shows how fragile tax systems are in many countries in the region, which still present high levels of informality and non-compliance.

Tax studies in several TAs in the region have helped better understand not only the value of tax pressure but also its make-up. For instance, the tendency towards higher relative indirect taxation in the region (which reflects strong use of VAT as revenue source, which has reached roughly 7% of GDP), or low taxation of personal income, which points towards tax collection gaps, if compared with the level of per capita income in some countries in the region in the international comparison. Corbacho et al. (2013) estimate the deficit of the Income Tax to be above 4.5 percentage points of GDP in Argentina, Costa Rica and Uruguay). Studies also offer a perspective of distribution per income groups or consider the staggering of systems. Corbacho et al. (2013) also show there is an anti-work bias in the structures of the region, where countries such as Brazil, Colombia and Guatemala have effective tax rates on labour which almost double those on capital. Finally, there are also studies on federal revenue allocation at different government levels (especially in the case of Argentina and Brazil, the countries in the region with greater fiscal decentralization).

CIAT permanently monitors the evolution of tax expenditure in Latin America, task which is facilitated by the great dissemination of this statistics in the region – which is very positive–. Nine out of the 17 countries which have participated in BID/CAPTAC-DR/CIAT (2012) indicated their TAs conduct expenditure studies (Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Peru, Dominican Republic and Uruguay). In the cases where the TA does not do the estimate, they are generally conducted by the ministries of finance or independent entities. There is a very rich historical series in the region, with countries such as Brazil estimating and publishing the statistics annually since 1989 (by constitutional mandate).

According to CIAT/SET/GIZ (2015) average tax expenditure in Latin America was 4.60% of GDP in 2012, or a third of tax collection. Based on the study, those countries which present historically the highest expenditure values are Guatemala, Honduras and Uruguay, while the lowest are Peru and Paraguay. Naturally, the methodology is not the same and countries such as Brazil do not present

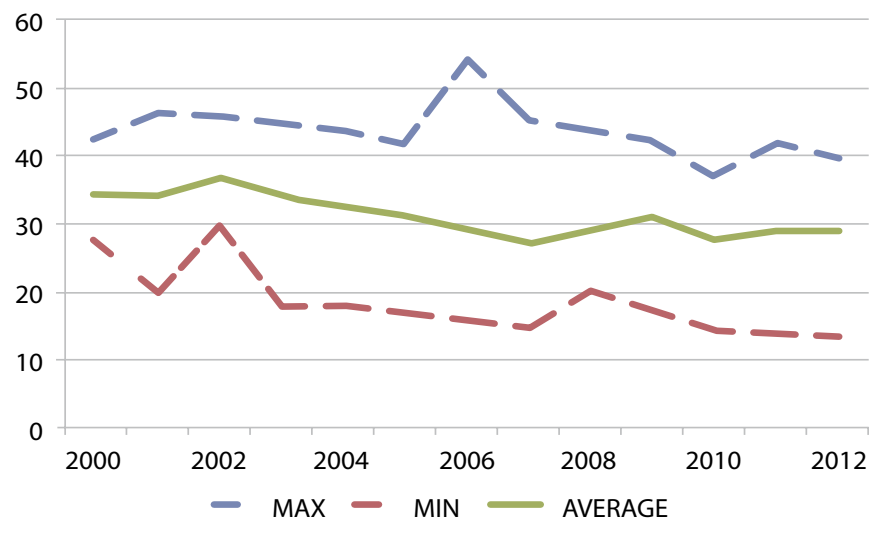
5 Presently and for some years, Bolivia has had the Tax Research Unit in the Ministry of Economy and Public Finance fulfilling those functions.

integrated data of state and municipal tax expenditure. For this reason, comparisons should be analysed with caution. For 2016, several countries have already published their estimates, such as Brazil (4.33% of GDP), Chile (4.20% of GDP) and Dominican Republic (6.5% of GDP), for instance. Availability of all that information supports fiscal transparency in the region and offers alternatives to collect revenues beyond tax rate increases or the creation of new taxes.

Evasion estimates are the most demanded from the technical (in terms of preparation) and political (in terms of publication) point of view. These are: Argentina, Chile, Colombia, Ecuador, Guatemala, Paraguay, Peru, Dominican Republic and Uruguay. The trend of an increasingly larger number of countries estimating and publishing estimates of their VAT gap is welcome and shows maturity in many TAs in the region. Compliance gaps are extremely important estimates to know the tax potential in the region and seek revenues which are not subjected to taxation. At the 2006 General Assembly in Florianopolis, the significance of knowing the tax potential was described as a challenge to TAs.

Based on available information, it was noted that the average gap of VAT compliance dropped in Latin America in the past decade, from roughly 40% of potential revenues to roughly 25%. However, there seems to be growing increase in non-compliance as a consequence of the financial crisis. Studies in Latin America are vital to understand those trends and support decision making in TAs to fight against non-compliance in the region. Compared with other European countries, non-compliance in Latin America remains high, and therefore, there is room for working towards reducing that indicator.

**Chart 1: Non-compliance with VAT
(As a percentage of potential revenues)**



Source: González and Pecho (2014)

It is also worth stressing initiatives such as the CIAT Tax Studies and Research Units Network, which grew out of the International Meeting on Tax-Economic Studies, carried out in 2005 in Brazil. This meeting was attended by Argentina, Chile, Mexico, Peru and Dominican Republic, besides the host country. The goal was exactly to facilitate contact, for the first time, among the team in several administrations which had a relatively developed study unit, to exchange experiences and working methodologies. After this first event, other events organized by the countries were held (in Argentina, Chile and Dominican Republic), until in 2010 the Network under CIAT was created⁶. The network was launched with the aim of supporting the Exchange of experiences, mutual cooperation and training of officials in charge of analysis and evaluation of tax policies in Latin America.

⁶ In its first edition (Panama), the meeting focused on micro-simulation methods and their usefulness for policy and TA analysis. In 2011 (Colombia) the meeting discussed the possibilities of reforming Individual Income Tax design and management in Latin America. In 2012 (Dominican Republic) the main topic was the estimation of effective tax burden on investment. In 2014 (Uruguay), the new approaches on behavioural economy were explored to analyse tax non-compliance. Finally, in 2015 (Chile), the meeting focused on methodologies which assess the impact of voluntary compliance programs.

Considering that relevant role of study units in TAs, down the road there will be a need for greater and better institutionalization of this function. In fact, in many cases, the units are still under-sized, with insufficient personnel or necessary resources for supporting institutional decision making. Some basic criteria for institutionalization of the area were also discussed at the 2009 Technical Conference in Naples, for example: specialized and trained human resources, last-generation technology (data warehouses, statistical and econometric programs, etc.), updated internal and external databases, strategic position in the organic structure and excellent communication with other government or academic study units.

In spite of all the progress in the study units in the region, some significant challenges to be addressed are:

- Preventing political cycles in the region from interfering in the work of the study units, which should be technical and impartial. In past decades, some TAs which had already seemingly consolidated areas faced external limitations. The degree of independence in study and research units should be assured.
- Compared with more advanced countries, data availability and publication for external research (academicians, independent committees, press, etc.) is still low in Latin America. It is important to continue investing towards greater transparency of fiscal data.
- It is necessary to keep on following international trends and produce deeper studies. Beyond the extension of estimation of non-compliance indicators (such as the VAT and Income Tax gap) for all countries in the region, there is room for investing in modern research on ethical and social behaviour (for example, Ireland) and compliance cost studies (for example, U.S.A⁷). These studies presently base compliance strategies on several developed countries and would provide a rich source of information to guide the action of TAs in a region with problems of informality and other forms of non-compliance. The use of *big data* is also a challenge ahead.
- Finally, greater integration among study units and basic TA functions may also be strengthened. Non-compliance studies are a good example of upholding actions of control and services, but also of support to risk management models, strategic planning, identification of legal gaps and so many areas of the TAs which may benefit from greater analytical capability in their study unit.

c. Conclusions

TAs in Latin America have considerably developed in their areas of strategic management and tax studies in recent decades. In spite of the still existing heterogeneity, there has been a clear trend towards professional management models, seeking to integrate the stages of strategic, operating and individual management cycles at all institutional levels. All TAs in the region have published mission, vision and values, and seek to increase their transparency and accountability through the dissemination of their strategic plans and annual activity report. Study units have also evolved institutionally, with permanent and specialized groups of officials supporting strategic decision making. In particular, tax pressure and expenditure studies, and more recently those on non-compliance gap measurement, have stood out in the region.

This evolution in both areas occurs in TAs with sounder governance models, greater transparency with accountability to society and external control bodies, more professionalized and qualified management and, finally, a working approach based on a more scientific, analytical and technical

7 Following an Alliance with the UN, CIAT has been providing technical assistance for compliance cost estimation in small and medium sized businesses in different countries, such as Brazil, Chile, Costa Rica and Uruguay, and will be doing it shortly in El Salvador and Panama.

approach, that is, based on data and actual knowledge. In spite of the still existing heterogeneity, it is positive to note that the region has matured in this sense.

In spite of progress made, it is important for the region to keep working following the modern trends of management and studies. Seeking effective integration of strategic management in institutional decision making, and linking it to the budget and human resource allocation, remains a priority for many TAs. As is performance measurement and monitoring. In the area of studies, there is room for strengthening compliance analysis and expanding research towards behaviour and compliance costs.



9

**AUTONOMY WITH
ACCOUNTABILITY**

9

AUTONOMY WITH ACCOUNTABILITY

Paulo dos Santos and Juan F. Redondo

a. **Greater Autonomy or Independence of Tax Administrations**

Historically, Tax Administrations have been part of the structure and have been under the scope of the Ministries of Finance, and therefore subject to the rules generally applied to the public sector. In many cases, particularly in developing countries, the fact that the TA belongs within the structure of the ministry and it is governed by the rules of public service has been considered the main reason for its lack of flexibility in terms of management and the administration of human and material resources. In turn, this lack of flexibility has been identified by some as the reason for the low effectiveness of some TAs. Silvani (1997) argues that “the greater the organization’s autonomy with respect to the rules of public service, the greater the flexibility it will have to make the organizational and procedural changes needed for modernization”.

As was mentioned before, the purpose of autonomy is to enable TAs to operate in a more flexible manner. Taliercio (2004) divides autonomy in three categories – management autonomy, administrative and financial autonomy, and autonomy in the management of human resources.

Management autonomy refers to the power to conduct a series of actions –the power to design a strategic plan and the corresponding annual operating plans without the need of approval from other authorities; the power to define its organizational structure and functions; the power to interpret tax law and set interpretation criteria; the power to participate in the tax policy making process as an advisory agency; and, finally, the power to collect assessed debts without the need to resort to the courts.

Administrative and financial autonomy, in turn, refers to the TAs power to make administrative and financial management more agile. It includes the financial autonomy needed to prepare and, once approved (by the Ministry of Finance or the Legislative branch of power), use its own expense budget. Some TAs have managed to establish as their basic income a percentage of revenues (like Peru’s SUNAT). Others have resources coming from the budget of the Ministry of Finance in addition to a portion of the settlements or fines imposed on taxpayers (like Spain’s AEAT).

Autonomy in the management of human resources entails the power to recruit and select employees, to determine their compensation, and to promote and dismiss them. It also refers to autonomy for the acquisition of material resources and procurement in general, which should be duly supported by control systems preventing any form of corruption in that area.

To address the problem of the lack of flexibility, from 1985 to 1994, some countries granted a certain degree of autonomy to their TAs. According to Taliercio (2004), the authorities established autonomous TAs to show to their citizens their strong commitment to a more effective, fairer and more competent tax management. Some of the countries that accorded a relatively high degree of autonomy to their TAs are, among others, Argentina, Bolivia, Colombia, Spain and Peru. Other countries also considered this option and weighed its advantages and disadvantages. By the early 2000's, several CIAT member TAs had significant autonomy in terms of management, budget and human resources.

Making the TA autonomous may be a good way to increase its efficacy. However, the creation of an administration with the characteristics of an institution completely independent from the Ministry of Finance poses certain problems. One risk is weakening the coordination between the two organizations and, thus, the essential coordination between fiscal policy and the TA. In addition, granting too much autonomy to the TA may create problems for the exchange of information between the TA, the customs administration and the social security administration, which is essential for the operation of the various agencies.

On some occasions, broad autonomy for the TA proved to be successful when granted on a temporary basis. In such cases, broad autonomy was considered to be a radical solution to serious problems. For example, under the profound tax reform made in Bolivia in 1986, an interim autonomous agency was created with a ministerial status, completely independent from the Ministry of Finance. The newly created ministry was responsible for managing domestic taxes and customs duties and for developing all aspects

of tax policy. In addition, it was entrusted with reorganizing the tax and customs administrations. Once such administrations were duly organized, they returned to their original status as directorates general within the organizational structure of the Ministry of Finance.

Modern TAs are empowered to design their multiannual strategic plan, in which they define their strategic objectives, vision and organizational values, as well as the indicators based on which they will evaluate their performance. On the basis of the strategic plan, they also produce annual operating plans with clear goals. This is done without any kind of political interference.

In addition, an autonomous TA has the power to define its organizational structure and functions. This involves decisions about segmenting taxpayers, geographical distribution of branch offices, finding the right balance between service and control units, etc.

Autonomous TAs also have the power to interpret the law. They do so upon their own initiative or upon the request of taxpayers. They also define the criteria for such interpretation.

Even if it is not appropriate for the TA to be responsible for tax policy making, it is advisable for it to be involved in the process. As Milka Casanegra from the IMF said, "tax policy is tax administration". The TA should play an advisory role in the making of tax policy in order to prevent the creation of taxes that are difficult to manage, or easily evaded or avoided.

Finally, the most autonomous TAs have the power to collect assessed debts without the need to resort to the courts. In some countries (like Brazil), this has not been possible given that Brazilian law requires court intervention in enforced collection processes.

In the case of some TAs, the expense and investment budget comes from a share of tax revenues. This option ensures financial autonomy and, in some cases, the availability of plenty of resources, but it may encourage an inefficient use of such plentiful resources. In addition, this kind

of compensation may not bear a direct relation with the TAs efficacy. Economic growth, the enlargement of the tax base, higher tax rates, among other things, may increase tax revenue and, as a result, the TAs budget, without this having any relation with an increase in the TAs operating burden or efficacy.

The allocation of a portion of tax revenue to the TAs budget may be an option to be considered when a comprehensive reform of the tax system and its administration is being undertaken, and it may be appropriate as a short-term measure. However, as soon as the amount of money necessary to meet the administration's needs can be determined, the allocation of fixed percentages should be discontinued and the budget should be covered with the amounts assessed to be necessary.

Finally, some TAs receive part of the funds raised as a result of auditing actions or fines charged. This system obviously encourages tax officials to be more expeditious in such collection efforts, but it also has a negative side effect in that it goes against the TAs main goal of maximizing taxpayers' voluntary compliance. If a TA achieved such goal, its additional remuneration coming from settlements and fines would tend to amount to zero.

To adequately perform its functions, an autonomous TA has the power to hire, retain and promote its most highly qualified employees. In this regard, autonomy may facilitate the establishment of a broad human resource management policy, including its own wage schedule (independent –or at least separate– from that of the public sector), which may compete with market salaries. In principle, this would allow the TA to hire qualified individuals and would facilitate the creation of incentives to improve performance levels. Under such model, recruitment and promotion systems are carefully designed, establishing a control system that ensures the right balance between salaries, individual capacity and the type of task that each employee should perform. The salaries of technical and administrative officials should of course be aligned with those in the private sector for equivalent positions.

It is important to stress the need to promote internal competition and to have a clear policy for regular recruitment of new people who can oxygenate the organization. It is common to see how the payroll ages when the organization fails to hire new people who can bring in new knowledge and experience.

These policies will most probably cause jealousy among other categories of officials, in particular, in other directorates general of the Ministry of Finance. It is necessary to anticipate such reactions and develop strategies to mitigate their effects.

The TA should also have human resource management flexibility. That means that together with the right salary schedule, the administration should have the power to recruit and promote the most competent employees and to dismiss those who are incompetent or dishonest without being subject to the most often cumbersome rules governing public office.

Tax Administrations' autonomy to purchase or rent resources like IT and communication equipment, vehicles, forms, buildings, etc. may of course facilitate procurement. Autonomous TAs can formulate their administrative policies and objectives, use part of their budget to purchase goods and services, and have agile procedures to acquire them. However, if the TA does not have well trained managers and adequately designed procurement systems, autonomy could offer an opportunity for squandering and serve as an incentive for corruption.

Another relevant aspect of TAs is their governance system, in particular as regards supervision by a board of directors. Most TAs around the world are supervised by a board of directors, but that is not the case in most TAs of CIAT member countries. Out of nine autonomous CIAT member TAs, only three are organized under a board of directors.

The main role of the board of directors is to make sure the TA meets its purpose. It should approve the strategic guidelines of the organization, including the multiannual strategic plan and general policies, like the human resource policy.

The board is also responsible for the general supervision of the TAs activities but it should not encroach upon its operation (auditing, collection, etc.).

The board members may be appointed by the Ministry of Finance or by the President upon the Minister's recommendation. In some cases, appointment of the board members, including the Chairperson, requires Congress approval. In general, it is the Minister of Finance that chairs the board, although in some cases, the Minister appoints a high-ranking official of the Ministry for the position. Other members may be a representative of the Central Bank, a representative of the Ministry of Industry and Commerce or equivalent; a representative of the academic world, and a representative of the private sector. The Director General of the Tax Administration is a natural board member. The number of members ranges between 5 and 8.

As regards who appoints the TAs authorities, in some cases, the Director General of the TA, as well as deputy directors, are appointed by the board mentioned above; in others, by the Minister of Finance; and in other, less frequent cases, by the President. Both the Director General of the TA and the board members have fixed renewable terms. In general, the term of office is not clearly defined. Changes in these positions may be made as a result of the failure to achieve the goals set jointly with the Ministry, integrity problems, etc. In general, board members are appointed full time and they are governed by stringent rules to avoid conflicts of interest.

Having a board of directors increases transparency and improves controls of the TAs operation, although decision making may be slower. When SUNAT was created, for example, the idea of establishing a board of directors was considered but was then dismissed, on account of the big decisions that had to be made in those early years of SUNAT. For example, it would have been difficult for a board to make the decision to dismiss around 75% of employees, launch mass control operations on small taxpayers in areas under the control of guerrillas, or impose strict controls on large taxpayers. For that reason, in 1991, the authorities decided not to have a board of directors in SUNAT¹.

See Taliencio (2004) for a discussion about the effect of greater autonomy. By applying an econometric model, the author concludes that the countries that granted greater autonomy to their TAs have a higher degree of development in terms of performance. The model used supports the hypothesis that autonomy has an effect on performance. Taxpayers' perception of higher autonomy is linked to the perception of better performance. Taliencio states that the three elements of autonomy – management, human resources and finance– are statistically relevant to quantify administrative capacity in general.

b. Adequate Accountability

Regulations on transparency and good governance gained importance with the increase in Tax Administrations' autonomy. TAs are now within their scope and are therefore under the obligation to abide by them.

These regulations respect the confidential nature of tax information –whether provided by taxpayers or obtained by the TA– needed for the TA to achieve its goals, so such information cannot be subject to the exercise of the right of access or to pro-active disclosure assumptions, notwithstanding other limitations derived from the confidentiality of administrative anti-fraud and tax control actions. But beyond this general context, meeting the ethical and legal requirements derived from the principle of

¹ SUNAT later established a board of directors.

transparency and the need to achieve good fiscal governance become a basic and inspiring principle for the operation of TAs, providing a foundation and meaning to their daily actions, in terms of both encouraging voluntary compliance and preventing and fighting fraud.

Ultimately, promoting transparency is key when it comes to engaging taxpayers and citizens in general in the construction of a modern, effective and efficient TA, since it leads to greater acceptance of the TAs actions and, thus, more compliance with tax obligations and less temptation to engage in fiscal fraud.

Issues relative to transparency in the management of TAs, with their different profiles and implications, have been the focus of CIAT's special attention since its creation 50 years ago.

It is interesting to remember the first institutional declaration in the history of CIAT, which was made during the General Assembly held in Santo Domingo in 1996, containing the "Minimum Necessary Attributes for a Sound and Effective Tax Administration", in which CIAT called for "a TA that may guarantee the fair, reliable and transparent application of the tax policies and laws, access, reliable service and taxpayer inquiries".

This declaration –fully effective today– is the start of CIAT's efforts in these matters, which were continued in subsequent General Assemblies and in important initiatives like the Working Group on the Promotion of Ethics in the Tax Administration –Phases I and II– or the Permanent Ethics Committee.

In this regard, the rapporteur of the General Assembly held in Cancun in 2003, drew the following conclusion: "Transparency as a principle and social control as a method are extraordinary tools in the fight against corruption. Through the Internet, Tax Administrations should offer society, Parliament and the media permanent information about their administrative actions and tax-related activities that are not subject to fiscal secrecy". The presentations made by the representatives of Spain and Peru during that Assembly are a good example of concrete efforts to make that commitment to transparency effective.

However, it was during the General Assembly held in Buenos Aires in 2005 that CIAT focused on promoting transparency, addressing the issue from a broader and more comprehensive perspective. It is relevant to note the presentation made by the representative of Portugal who, after analysing the conceptual framework of transparency as a major characteristic of the public administration under the rule of law, described and thoroughly discussed the different variables in which a TAs transparency is expressed –the more developed the variables the greater the TAs transparency. Literally, Paulo José de Ribeiro Moita de Macedo, Portugal's Director General for Taxation discussed the following variables:

1. A Tax Administration whose legal framework of operation is clearly defined by law

A clear definition of the legal framework of operation for the TA is the first feature of a transparent TA. Technical and administrative procedures, however complex from the technical perspective owing to their specificity, should be defined by law, as should taxpayers' rights. If this condition is met, the TA knows how to operate and within which limits. In turn, taxpayers are aware of their rights and may control the TAs compliance with the operating rules imposed to it by law.

2. A TA which keeps citizens informed about their rights and obligations in a simple and expeditious manner

In an ideal scenario, the tax system is simple and stable. Taxpayers understand the rules applicable to them and those rules are usually maintained until the need for a "reform" is evident. These two features –stability and simplicity– are essential to ensure that citizens know the tax system and, thus, are aware of their rights and obligations as well as the procedures inherent to these. This leads to further transparency in the relationship between taxpayers and the TA. Conversely, a tax system which is complex and undergoing constant mutation generates uncertainty and insecurity among citizens, and might introduce opacity in their interaction with the TA. Although the TA may contribute toward simplicity and stability of the tax system, it is not the lawmaker, and for this reason it cannot change the law. Hence, its primary responsibilities are ensuring citizens have access to information about their tax status, and supporting them in complying with their tax obligations. In today's world, this function calls for the use of multiple channels (Internet, face-to-face, telephone, e-mail, fax or mail service) to ensure quality, essentially translating into simplification of matters and clarity of response, with the resulting expediency. To this end, it is also essential for the TA to have tools available to assess customer – taxpayers – satisfaction recurrently, particularly at the level of service, and to identify opportunities for improvement and expansion of the services provided.

3. A TA which keeps citizens updated as to its own operation

In parallel, it is equally important for the sake of transparency to keep information available relative to the TA itself in order that citizens can assess its performance. Thus, information regarding resources allocated to the TA, operations and activities it has carried out and the outcome of same should be widely publicized ensuring access by citizens at large. In this context, it is particularly relevant to publicize data regarding taxpayer selection mechanisms for control and audit purposes, average collection times, average response times to information requests and others having a determining role in the perceived equity, fairness and transparency of the system.

4. A TA which proceeds efficiently and effectively

This variable refers to efficacy and effectiveness of the TA since these factors lead to further transparency in the organization. Efficacy is increased mostly by standardization and uniformity of procedures to the extent this is feasible. Uniformity results in a more equal treatment of taxpayers and a better definition of their expectations. In this connection, investments in automation are essential. Automation of all processes and procedures, provided it is feasible, as well as the inclusion into work flow processes of those which cannot be automated, translates into unquestionable advantages in terms of organizational efficacy, thus rendering the respective operations more transparent, since greater uniformity and management control are ensured. I believe it is essential to prioritize automation of the areas of fast-track collection, taxpayer selection for inspection purposes and inspection processing. Effectiveness of the TA is also conducive to further transparency. An effective TA is characterized, among other features, by fighting fraud and tax evasion successfully and collecting adequate / due revenues. This implies proceeding in a clear and uniform manner by punishing taxpayers who incur infringements, on the one hand, and facilitating interaction with taxpayers who meet their obligations, on the other.

5. A TA which avoids or properly manages any “conflicts of interest”

The TA is responsible for meeting the public interest. Relative to this variable, transparency of the TA translates into taxpayers feeling certain that officials working on their tax affairs are not motivated by personal interests and, therefore, enforce the law with integrity. Situations of conflict of interests can be identified, firstly, by defining the clearest and most comprehensive legal framework possible, which ensures citizens that civil service pursues the public interest rather than the specific interests of the official who manages a given situation. In addition, and given that it is virtually impossible for the law to appropriately provide for all situations, it is also essential to implement a system of “good practices” to guarantee the inexistence of conflicts of interest on a case by case basis.

6. A TA with low corruption levels

Corruption undermines citizens’ trust on the work of civil service in general. Perceived or suspected corruption in the TA on the part of citizens triggers lower compliance with law-derived tax obligations. TAs where corruption levels are low can more readily “impose themselves” on taxpayers. In this area, the way the TA interacts with its staff / officials is very important. It is essential for the TA to be at once demanding in terms of ethical behaviour and professional competence and to ensure appropriate professional and ethical training, as well as remuneration according to the technical and responsibility levels required.

7. A TA which fights tax evasion and fraud

Especially in recent years, the phenomenon of tax evasion and fraud has deserved increased attention both from Governments and experts alike, as well as from public opinion itself. The reasons for this are naturally linked to raised awareness in the sense that when these practices reach significant proportions, they pose serious issues in terms of tax and general equity, the efficacy of healthy competition in the economy, morals and desirable social behaviours and, last but not least, the tax revenues needed in public budgets. It should be added that tax fraud and evasion affect voluntary payments and minimize an important instrument of economic policy, with special significance for countries lacking autonomous monetary and exchange policies, as is the case of Portugal and most EU-member countries. Thus, it is essential to fight this phenomenon systematically and effectively. In addition, the fight against tax fraud and tax evasion conveys two messages to taxpayers: on the one hand, that the TA ensures law enforcement and, on the other hand, that abusive or fraudulent behaviours are not tolerated. It is clear that if the levels of evasion and fraud are minimized, the “temptation / opportunity” of deviations from the standards / loops defined for tax administration purposes are likewise decreased due to lack of motivation and the unlikelihood of distortions, inequality and different treatment among taxpayers.”

The paragraphs above reveal how “vital” transparency is for a TA. It must be present in each and every one of its activities, and a particularly proactive attitude is needed to set up mechanisms and initiatives to make it effective.

As Linda Lizzotte MacPherson, Commissioner and Chief Executive Officer of the Canadian Revenue Authority –a particularly active TA in the theoretical and practical development of these matters–, rightly pointed out during the Montevideo General Assembly in 2010, a TAs commitment to transparency and accountability for the results obtained can be shown in many ways and through different instruments. It would be very appropriate to identify each one of these initiatives in the region; however, generally speaking, they could be grouped under the following headings:

- Institutional information about Tax Administrations’ actions.
- Promoting channels for citizen engagement in improving Tax Administrations.
- Providing information about the status of procedures and administrative criteria applied.
- Reinforcing internal control bodies.
- Relations with external control bodies allowing citizens to check the adequacy and efficacy of their Tax Administration’s actions.

CIAT’s efforts to further transparency in TAs go beyond the statements and exchanges of experience within the framework of its General Assemblies. With the support of Canada’s CRA, CIAT has developed a series of products so that its member countries can have practical tools for the concrete implementation of measures in one of the areas that raises most concern in the region –the fight against corruption. Although progress has been made in this area, there is still much to do, as shown in surveys like the one below and in analysis of perceived corruption in the region conducted by organizations like Transparency International.

c. Conclusion

The dependence or autonomy of TAs may be analysed considering two extreme cases. One would be a TA that is completely independent from the Ministry of Finance and subject to the general rules applicable to the public sector. The other extreme case would be a TA with absolute administrative and financial autonomy. The best option for a given country will most probably be somewhere in between these two extremes. Whether granting a certain degree of autonomy is advisable or not will depend on the political context of each country, the TAs institutional capacity, and the possibility to implement adequate control mechanisms.

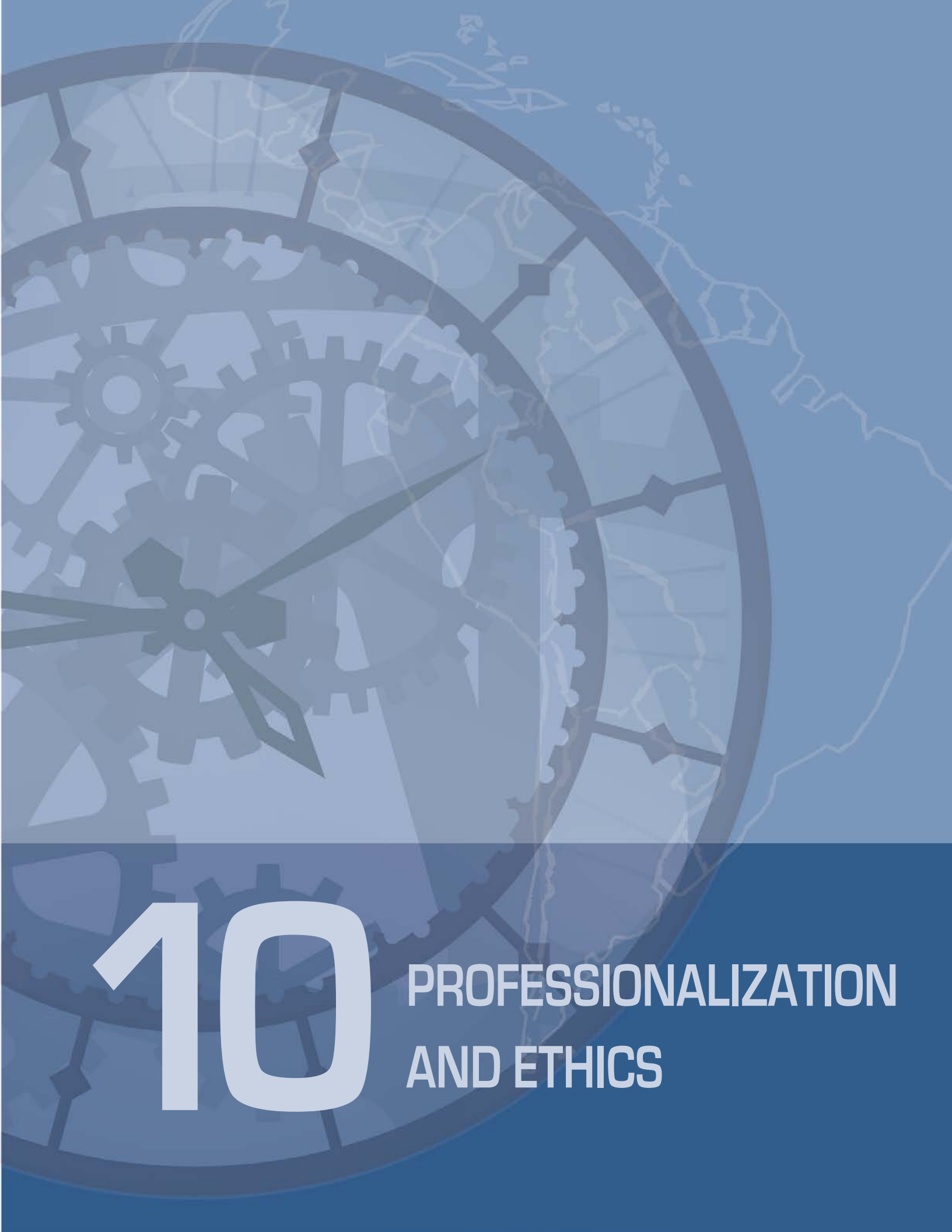
Autonomy must be accompanied by responsibility on the part of both government and taxpayers. An important element in this regard is the introduction of a Code of Ethics, which all TA employees must strictly abide by. To ensure compliance with such Code, there should be an internal audit system operating at a high level in the TA.

We could say that granting greater autonomy to a TA contributes to solving the problem of low effectiveness. However, we should note that autonomy alone does not automatically increase the TAs institutional capacity, and it therefore does not guarantee an effective management. Autonomy should be part of a reform process reviewing the strategies of the TAs critical functions, such as auditing, collection, taxpayer services, IT systems, among others.

It is important to note that TAs must always remain vigilant as regards their autonomy. It is common, as time passes and political changes occur, to see attempts to reduce autonomy in order to introduce or increase inappropriate political interference and to phase out features that are considered a benefit of autonomous TAs. Organizations must be prepared to face such situations and devise mitigation strategies if they cannot be avoided.

The general trend among TAs has been to gradually implement these initiatives, which are even more necessary in the broader context of the duties and obligations imposed by generally adopted Transparency Laws. Because of what it implies for their activity, TAs should not appear as merely obliged to abide by such Transparency Laws, but they should rather act as champions and spearhead compliance with them.





10

PROFESSIONALIZATION AND ETHICS

10

PROFESSIONALIZATION AND ETHICS

Luis Cremades and Alejandro Juárez

In the course of fifty years of CIAT history, which we are presently celebrating, the TAs of member countries have been faced with great and deep challenges among which human resources' development, strengthening and professionalization stand out as strategic elements.

A modern TA is inconceivable without technology, information and human factor capable of granting it independence, professionalism, efficacy and efficiency that modern societies require.

In the realm of different CIAT-member countries such as the USA, Canada, and the countries of the European continent (Spain, France, Italy, The Netherlands and Portugal) professionalization of human resources in their TAs was a fact prior to the creation of the body.

It is worth highlighting that the different activities and achievements in these countries, reached according to diverse outlooks and models in connection with the different forms of approaching human resources' management, have been a source of knowledge and good practices shared throughout the years amongst themselves and with other CIAT-member countries.

Notwithstanding and among other initiatives, the great value of exchanges and technical assistance efforts is specially worth highlighting due to their similarities and closeness, in countries of Latin America that have always understood the effort to achieve professionalization of human resources as a goal and objective.

Such actions and initiatives aimed at professionalization of human resources of our TAs, have been envisioned and channelled across multiple common fora and activities, chiefly the General Assemblies and Technical Conferences, seminars, courses, internships, technical assistance efforts, publications and research, among many others. They have constituted the fundamental elements in the means and instruments for exchanges, learning and advancement for all the TAs integrating the CIAT community.

a. Professionalization as a Need

In the eighties, TAs started a substantial development worldwide, based on factors such as reforms of tax systems, the impact of new information technologies and the investment efforts in technology from these organizations.

This period entailed a before and after for the taxation world not only in connection with regulatory matters evidenced by multiple tax reforms regarding direct and indirect taxes (chiefly VAT) at the time, but also regarding the need to create new TAs capable of articulating such reforms.

Consequently, new tax administration procedures emerged enabling massive data treatment through electronic data processing, as well as enhanced taxpayer assistance and information and better tax compliance control.

All such efforts called for a new strategic response that improved professionalization of human resources and served the new demands.

Issues such as the autonomy of the TAs in managing personnel, the ideal headcount or staff, recruitment, selection and incorporation of staff, technical and management training, the administrative career, system to cover vacancies, compensation framework, etc., constituted fundamental variables to achieve professionalization of the staff serving the TAs.

Presently, many of these issues remain poorly addressed in certain countries and, in particular, in the realm of the TAs of Latin America, which since the eighties and still today, have embraced the strategic concern for professionalization of human resources.

It is worth highlighting that not all countries share this concern to the same extent. Highly consolidated TAs as the ones from Argentina, Brazil, Chile, Colombia, Mexico and Peru, coexist with others, namely Bolivia, Ecuador and Uruguay, whose development in this field came later, but was deep and strong.

The most concerning and weakest situations are visible in certain countries of Central America that sadly feature erratic behaviour and corruption in the sphere of their TAs and customs agencies.

Upon analysing relevant data from Latin America, we may assert a trend towards substantial increase in the number of human resources. Although it is difficult to provide accurate figures for the period between 1985 and 1994 due to the lack of reliable historic time series data in certain countries, we may note the projection from a recent study on the status of TAs in Latin America –*BID/CAPTAC-DR/CIAT (2012)*–, which illustrates a substantial 9.1% increase of TA staff.

Not only the average increase in staff is significant in absolute figures, but also, between 1985 and 1994 up to the present, the permanent employees or officials account for the majority, 80% on average, against 20% of temporary employees. In this context, Argentina (AFIP), Brazil (RFB) and Mexico (SAT) are worth highlighting, since almost 100% of staff-members are permanent employees.

The fact that employees in the TAs of Latin America are mostly permanent, even when this circumstance does not entail per se employment stability, defines it in practice in most countries.

Moreover, this situation may imply certain dysfunctionality if not supplemented with objective selection as well as an administrative career and appropriate training and compensation. Nonetheless, at least it conveys the idea of professionalization and independence of the staff performing at the service of their TA.

Once this growing trend regarding the staff at the service of the Government Administrations of Latin America is identified on average terms, the data must be compared against the population of every country and subsequently, against world standards in order to gain insight on the relative standing of the Latin American region.

In this respect and in line with ECLAC data for 2010, the average in the region ranges approximately at 5,247 inhabitants per TA employee, against 1,338 inhabitants per employee in the OECD sphere for 2009.

Upon further analysing this information, in the 80s and according to the widespread human resources policy that accommodated the new tax administration challenges, TAs not only incorporated more employees but also adapted the existing ones and their distribution in the TAs according to the new functional criteria. Among others, such criteria included taxpayer guidance and assistance, registration and census management, extensive and in-depth audits, collection, information technology and technology, human resources' management and training, planning and strategic development.

In such respect it is important to point out that, overall, TAs staffing in their operative or business areas and the non-operative or support areas, among their central and regional services, as well as the redistribution among the different operative areas, was a clear indication of their priorities and strategy.

Upon observing current distribution data in connection with the different roles of the TAs of Latin American countries, they reflect the trend that originated in the second half of the 80s. On average 10.7% of their staff is focused on taxpayer guidance and assistance; 16.8% on taxpayer registration and collection; 29.0% on audits; 14.0% on technical and enforced collection; 4.9% on IT and technology; 13.5% on human resources and administrative services; and 11.1% on planning and management.

This functional distribution had already incorporated in the 1985-1994 period the idea that modern tax administration needs to combine specialization of tasks with the possibility that in the course of the administrative career, government employees may serve in different functional areas. Such professional objectives are not easy to implement and achieve and in this respect, a long process was undertaken, specially focused on staff selection and training, as explained hereunder.

Precisely, selection and training processes for staff serving in government administration offices have been, and remain, a vital element to achieve a professional workforce, provided they respect the principle of merit and skill in their implementation and incorporate a set of rights and obligations for staff devoted to public service.

This argument is transcendental in the taxation world, where such principles become uniquely relevant to guarantee that the staff serving in the TAs perform with independence, specialization and versatility.

The systems in place to select and recruit TAs staff require, in most roles, an academic degree in line with the role, aptitude and personality tests, personal as well as economic, legal and taxation knowledge interviews. Additionally, in most cases, they are required to pass selective courses for new hires in the training facilities that TAs normally create to such purpose.

In Latin America, and according to recent data, staff with higher university education (Doctors, B.A. , etc.) with roles in line with their education, average 56.4%; the staff with technical background with roles in line with their education average 16.7%; and finally, the staff with administrative background who carry out administrative supporting tasks, auxiliaries, trades, etc., average 27.0%.

By virtue of such data, we may assert that the evolution started in the 80s and continues to date in Latin America, resulting in qualified TAs, even above average percentages of OECD countries.

Selection and recruitment of staff serving in the TAs must be aligned with training plans and programs, an essential element for new hires as well as for ongoing training in the role, education for the administrative career and management and senior roles.

This overall process requires a methodology that, based on the definition of a mandatory training strategy for the staff of our TAs, rests on a procedure to detect educational needs that are subsequently materialized in the creation of

the training plans and actions to be implemented and developed.

In the second half of the 80s, and in line with new information technologies, learning processes strike a turning point. Traditionally until then, training had to be provided in the classroom or train-the-trainer format with facilitators and certain distance education initiatives limited to those who used tutorials, didactic units, self-education manuals, etc.

Starting in 1985 approximately, TAs start developing electronic education plans and programs that coexisted with classroom training initiatives.

In the Latin American region, one of the pioneer TAs at the time was the SAT of Mexico. The Taxation Education Institute carried out initiatives in this area, by organizing online tutorials, conferences and courses very professionally through their own educational television channel, self-education manuals, etc.

Later, in the 90s, online training develops and consolidates worldwide, especially in the sphere of the TAs, where education needs arising from frequent changes in tax laws and the modern conception of the new tax administration requirements, call for effective and efficient responses.

Towards the end of the 90s, the final breakthrough occurs with the advent of education platforms that pave the way for virtual campuses and virtual education. Presently, all TAs rely on education platforms, varying in degrees of development, through which they channel a significant part of their training efforts, conceiving them solely with the role of online training in its different formats, due to the clear universality and cost advantages.

Lastly, this overview of human resources' professionalization from different perspectives in

the period under analysis and the projection to the present would be incomplete without specific reference to the issue of the administrative career and compensation systems.

Relying on a well-designed administrative career and an appropriate compensation system are elements to guarantee motivation and professionalization of human resources. Administrative careers, as mentioned, must undergo good selection processes and be closely related to training and performance assessment processes, and, consequently, compensation systems.

If we analyse these issues in the light of the TAs of CIAT-member countries of Latin America, the situation is unequal and for many countries, such matters are still a pending issue. In Argentina (AFIP), Bolivia (SIN), Brazil (RFB), Chile (SII), Colombia (DIAN), Guatemala (SAT), Dominican Republic (DGII) and Uruguay (DGI), with greater or lesser historical tradition and with different nuances, the administrative career is a reality.

Nevertheless, other countries, namely Ecuador (SRI), Honduras (DEI), Mexico (SAT), Nicaragua (DGI), Panama (DGI), Paraguay (SET), Peru (SUNAT), are still pursuing a final solution, although some of them have attempted such efforts in the past.

Particularly, more efficient and modern TAs should be pursued, with optimal collection and customs processes and with specialized and professional tax and customs officials. On the latter, the SAT Law of Mexico, for example, provided for the implementation of the Tax Service Career that guaranteed equal opportunities in the promotion and entry in the service, professionalization and specialization in every activity, compensation and benefits tied to productivity, training and comprehensive mandatory and ongoing development and integrity, responsibility and appropriate behaviour.

b. Ethics: A Multilateral Concern

For the TAs worldwide, promotion of ethics is a more than vital ingredient in developing a public institution with high performance and social approval standards. In effect, combatting corruption is the counterpart to the promotion of ethical performance.

It is self-evident that beyond conceptual models, ethics stands as an important component to the extent it ultimately reflects the tax administration institutions, especially when the public opinion questions the appropriate use of government resources.

A number of fundamental assumptions apply:

- The ethical behaviour of public servants is a mandatory condition to refer to efficiency and efficacy. This entails strict observation of regulations, processes and values. It requires a solid, clear and equitable corpus of standards (instead of laws that are neither persuasive nor intimidating¹), correctly documented processes and a theoretical framework of institutional values consistent with ethical performance.
- Ethical behaviour goes hand in hand with the management system of human talents in organizations. This requires good human resources' planning, and all the related processes to staff organizations with skilled resources in order to fulfil their purposes. A notion that may seem very simple in writing becomes very complex in the cultural framework of contemporary societies. Just as good taxation processes are necessary, good human capital management is vital.
- Taxation processes that are correctly designed and controlled are less vulnerable, and to such extent, they prevent unacceptable or flagrantly criminal behaviour. Adherence to values is a human dimension, but good taxation processes are the technical components that render ethical performance explicit.
- Ethical behaviour also entails combatting corruption outside of the tax organizations. In other words, it is not a matter of creating a framework of surveillance enforceable only upon officials, but rather, covering a very broad spectrum that includes taxpayers and other agents involved in taxation processes (for example, banks).
- A good internal control system is the first security system of the TAs. Such internal control should include process documentation, professionalization of officials, adoption of ICTs for process control (audit trails and specific user controls), a strict punitive framework for actions and a stern will to operate the internal control system integrally.

Addressing ethics involves a level of abstraction that needs breaking down and addressing by smaller components. It is insufficient to point at individuals as susceptible to fall to corruption as an entity that is unrelated with the other components in their institutional framework.

Contrary to what may be normally assumed, ethics is more related with *improving oneself* (in the human dimension), than with combatting stereotypes of human conduct and their moral deviations. It is not my intention to open a conceptual debate of ethics in this context, but it suffices to admit that as a society, we have placed in ethics all such attributes of appropriate human behaviour and correct working or professional performance.

¹ González (2005).

Ethics is the field of knowledge that studies the attitudes and habits of human beings and classifies them into virtues and vices, in appropriate and inappropriate actions, beneficial and harmful, with a view to building the character of men by showing the habits that are worth imitating².

Moreover, this acquires greater complexity when an ethical referent is created in public institutions. It does not only involve individual constructs, the public life of individuals becomes observable from the notion of “ethics” in their place of work, in a TA with its own rules that go beyond the personal sphere and are imposed and not necessarily developed in an integration process between the individual and the institution.

Ethics has become prescriptive; we must behave ethically just because. It is unusual to see an official asserting that ethics is something undesirable for our societies and our institutions. Contrarily, we notice a great willingness in institutions to promote ethical performance. Training is one the most adopted tools for such purpose, but we do not see many integrated models that articulate with the preliminary assumptions mentioned above. Ethics is deemed a living system in organizations, and to that extent, it is the responsibility of everyone.

Internal control, process-based management and professionalization are just some of many ingredients in a framework that favours ethical performance. It is common to observe internal control with its own models, talent management with others, process planning likewise. Not to mention ICTs, which remain a very useful control and development element, but we find very few documented experiences about their adoption in the promotion of ethics (other than for training purposes).

c. CIAT Role in Professionalization and Promotion of Ethics

The central notion in CIAT Bylaws was “The Role of the Tax Administrator” and the presentations addressed the “Development, Education and Training of Administrators”.

The historical events narrated on the different presentations are significant and relevant, since they set forth the importance attached from the onset to professionalization of human resources of the TAs of CIAT-member countries.

Throughout its history, CIAT has never claimed the role of a TA school, but rather the vocation to guide, enhance and support training processes, plans and actions that the TAs of its member countries implement on their own.

In such respect, it is worth underscoring the clear action course in the traditional and classic classroom training efforts, chiefly aimed at exchanging experiences among the TAs of member countries regarding taxation issues, which has been mostly carried out by way of joint seminars with the IDB, AEAT, IEF, AECID and GIZ.

Notwithstanding, the training initiative through the CIAT virtual platform that started in 2004 was a turning point. Presently, this accounts for the most consolidated option, with an array of education tools to deliver training and advancement activities for professionals serving in the TAs of member countries.

2 Diego (2005).

Different notions regarding ethics have been addressed in the General Assemblies and Technical Conferences for many years.

Owing to a working group sponsored by the Canadian CRA between 2003 and 2007, formed by Argentina, Brazil, Canada, Spain, and Trinidad and Tobago, the Executive Secretariat published the CIAT Model Code of Conduct, which is a guiding and comparison document to develop, review and/or improve the code of conduct of a TA. The document establishes a set of obligations and promotes “good” compliance therewith. Notwithstanding, practical rules may require further elaboration and detail according to the specific characteristics in every TA and its scenario. Its overall purpose is to provide a reference framework for officials on the expected behaviour and promote the importance of integrity in a healthy and effective TA.

This working group also created a Self-Assessment Guide to diagnose the strengths and weaknesses in the ethics’ infrastructure of a TA with a view to identifying the key elements in an integrity strategy within the TAs and diagnosing processes or improvements. Secondly, it seeks to provide a practical methodology to support directors in the assessment of strategies and identification of areas for improvement and, finally, it describes actions to implement this integral strategy.

Likewise, the group developed a Manual for Facilitators, as a guideline for officials who are facilitators carrying out the self-assessment process defined in the Self-Assessment Guide; and proposals for the Management of a Program on Ethics and Implementation of a Communication and Training Strategy for Program Management, aimed at promoting the importance of ethics in the TA among CIAT-member countries.

Once again under the auspices of the Canadian CRA, and after such a successful experience, in 2008 CIAT established a Permanent Committee on Ethics (hereinafter, the Committee), with the participation of CIAT Executive Secretariat and Brazil, Colombia, Costa Rica, Ecuador, Spain, France, Kenya, Mexico, New Zealand, The Netherlands, Panama, Dominican Republic, and Sweden. The purpose was to achieve a standing forum to exchange experiences in this field, enhanced with the contributions from CIAT-member and non-member countries. The specific objectives of the committee are: i) to compile, classify and systematize innovative practices to promote ethics and enhance them with new proposals; and ii) implement analysis and research efforts to produce a theoretical framework.

The Committee has focused its efforts on developing strategic executive documents for directors and managers of the TAs. Such documents systematically address vital decision-making issues regarding matters of ethics and integrity: values, training in ethics for directors, conflicts of interest, risk management, social media and ethics, etc. Such documents are featured on the CIAT Web page. They faithfully reflect the actions that CIAT adopted in an area that spurs ongoing concern for the TAs of the region.

Presently, the Committee members are Canada (main sponsor), Brazil, Costa Rica, Ecuador, Spain, France, Guatemala, Honduras, The Netherlands, Mexico, New Zealand, Kenya, Panama, Paraguay, Dominican Republic, Uruguay and Sweden.

CIAT also offers a virtual course on “Tax Ethics and Fiscal Citizenship”, with five editions until 2015. CIAT has correctly decided to add training specifically centered on promoting and strengthening ethics. The origin dates back to the training activities and subsequent consulting project on such

issue carried out in Ecuador during 2010³, under the leadership of CIAT and sponsored by the SRI of Ecuador. The foregoing Committee endorsed the idea and the initiative. Course materials were presented in the meeting of April 2011 held in Quito, and the first outcomes were presented in the meeting of July 2012 in Panama. Feedback has been always positive and encouraging and the course has relied on the invaluable support of the Committee from the start.

This course entailed substantial methodological efforts as well as the applicable conceptual constructs materialized in the curriculum content. The main course objectives are:

- Contribute to understanding the context in which to construe ethics and the detrimental effects of the absence of ethics in the development of countries.
- Present a practical approach to ethics, highlighting that its promotion in the TAs bears a direct positive impact on countries' development and on the trust of their citizens (taxpayers).

The course has fulfilled expectations. Participants have expressed their satisfaction and stated no complaints. The observations received did not seek to question the substance or objectives of the course, and this confirms its validity and relevance.

Although the universe served is a grain of sand, it is quite encouraging to continue thinking about the contributions that training efforts make in strengthening ethics, but it is not the only tool, as we said in the beginning of this document.

The main difficulty in the field of ethics is not training or dissemination, but rather instilling values in individuals, developing it as a competency but experiencing it from habits until it consolidates in the culture of individuals, and in the best scenario, in the organizational culture.

Future challenges for the ethical strengthening of the TAs mark a very promising path: continuing to produce tools to assess performance, training, internal control, institutional architecture, and IT tools, process documentation, citizen and tax education are simultaneous paths that require further action.

Undoubtedly, international cooperation shall continue being a very valuable asset for CIAT-member countries. In this respect, it is worth highlighting the special cooperation of the Permanent Missions to CIAT of Spain, France, Italy and Germany. They have assumed a special commitment as CIAT-member countries and in such context formed and sustain Permanent Missions to the CIAT Executive Secretariat in Panama, which serve as ongoing liaisons with their respective TAs. Such role of liaison and coordination bodies seeks to contribute in transferring experiences and good practices in tax management among their organizations and the different CIAT-member countries.

3 Between January and June 2010, CIAT participated in three training activities on "Ethics and Values" in the framework of the "Master's Course in Tax Administration" organized by the SRI and the National Institute of Higher Studies of Ecuador. Subsequently, between September 2010 and February 2011, the first phase of the "Self-Assessment Project for the Promotion of Ethics in the SRI of Ecuador" was developed, which required applying the tools designed by the CIAT Committee.



11

TAX
EDUCATION

11

TAX EDUCATION

Alejandro Juárez

Tax education has recently become –particularly in the last three decades– a goal shared by TAs around the world, although its implementation has varied due to different factors, both related and unrelated to taxation. Today, countries must educate their citizens in order to strengthen compliance and contribute to the greater goal of creating a responsible citizenship.

An analysis of taxation history shows that its first precedents date back to ancient civilizations that existed between the years 6,000 and 5,000 B.C. Ancient Egyptian, Chinese and Mesopotamian civilizations left documents describing taxation as a specific and defined part of their social structures. Confucius himself served as a tax inspector for Prince Daschau in 1523 B.C., and even the Bible includes the parable of the Pharisee and Tax Collector in Luke 18:9-14.

Tax collection has been closely related to the development of ancient and contemporary societies, and it has undoubtedly been a part of the various definitions of State and Society developed by Humanity over the last three millennia. Our aim, however, is not to draw a timeline or delve into taxation archaeology, but rather to provide a clear time framework.

Traditional studies have clearly analysed taxation as a social phenomenon at the public level. However, its analysis from an educational perspective is considerably less accurate through history and in ancient civilizations. Indeed, the educational perspective on taxation emerged more recently, as it became clear that education is essential to build citizenship and make citizens understand the importance of paying taxes.

For a long time, taxation was associated with dominance and subjugation. Subjugated peoples were under the territorial, political and/or military control of dominant peoples, to which they paid taxes in the form of labour, agricultural products, equipment, and even slaves, as was the case of King Minos of Crete, who accepted slaves as tribute. Evidently, taxation was managed arbitrarily and with varying styles, causing excruciating needs that for one reason or another led to disagreements and social discontent. In the past, equity of taxation did not exist, and not only in terms of the actual tax burden: in some cases, taxpayers were forced to kneel or ask for grace as a form of humiliation.

Revolutionary ideas that led to the development of democracy slowly evolved towards equity and justice. The Western world redefined public administration

models and tax systems, and it became increasingly necessary to monitor citizen compliance in an orderly and clear fashion— as well as the public allocation of the taxes collected.

However, at this time in history, taxation was still not conceived as an important component of the education of citizens. Its development was mainly the consequence of the consolidation of independent countries and nations, and it had little to do with citizens' awareness of their responsibility to pay taxes, or of the Government's duty to pay them back to citizens in the form of quality services or, even more broadly, the promotion of social development.

The notion that the enjoyment of liberties has an inherent real cost is as unpopular as it is true. The general rule is that citizens have an obligation to pay taxes because it is so established by positive law, but this justification is not enough when citizens believe that taxes are being allocated incorrectly or levied unfairly, or when the ethics of the public servants responsible for their collection and allocation are questioned.

a. Tax Education as Content

After this brief historical reference, a basic question arises: What is tax education? Attempts to define the term "education" have been made by sociologists, anthropologists, psychologists, teachers and professionals from various fields, but no general consensus has been reached. This relative ambiguity allows me to define tax education as a process for the comprehensive education of individuals.

Based on the concept developed by Díaz and Lindenberg (2015), it can be said that tax education is a state-of-the-art democratic tool that contributes to strengthening social cohesion, and promoting collective and interactive debate on the social and economic role of taxes and the efficient management of public resources. Tax education helps to build trust between the Government and its citizens.

Tax education is a teaching and learning process that involves the creation of responsible and active citizens that are committed to understanding their rights and obligations, as well as the critical assessment of the performance of authorities and the use of fiscal resources. Tax education has to do with the basic obligation to pay taxes, but also with the citizens' duty to demand accountability.

Based on the above definition, it may seem that tax education has no mysteries or operating difficulties, and that citizens everywhere in the globe understand the importance of paying taxes. This would lead to the development of a sort of collective set of moral values that would guide people to comply with their fiscal duties. Reality, however, is quite different. Although some may be tempted to conclude that developing countries have low tax compliance as a consequence of their poor level of tax education, this would be a premature and simplistic conclusion. Tax education levels also vary within the countries with the highest compliance levels.

Individual behaviour with respect to the payment of taxes is inevitably affected by the individual's perception of the risk of being penalized for noncompliance (whatever the penalty), as a consequence of being monitored by the authorities. The penalties established by the laws of each country cause citizens to have a sort of love-hate relationship with taxes. There is a certain tax moral, as explained by Feld and Frey (2002), among others, which leads to a reduction in the use of coercive or punitive methods when responsible compliance grows in acceptance. This is not a minor issue, since a great number of the tasks conducted by TAs have to do with monitoring compliance, timeliness, tax assessment and collection. Many efforts for the preventive control and correction of irregularities are

focused on the citizen, who has to learn to deal with them on a daily basis. Even when offered a wide array of possibilities for compliance, it is not unusual for citizens to end up choosing not to pay taxes.

There are various reasons for this. Although noncompliance varies according to the specific circumstances of each country, we share the opinion of Albano Santos (2003) that “while the highest level of delivery is expected from the Government, the inevitable economic consequences of this attitude tend to be rejected.” The promotion of favourable conditions for compliance is a general concern, but there are certain prior notions that have to do with the quality of education systems in Latin American countries and other parts of the world.

Tax education is complex because it is influenced by different factors. Literacy is a key specific reference of the culture of a country and its civic education in general. Poor tax education is usually coupled with an educational deficit in other equally important fields such as maths, hygiene, reading comprehension, writing, history, music, and language. Reading habits in our region are not as good as in other continents.

The Latin American countries with the highest number of books read per inhabitant are Chile with 5.6 books read per person, Argentina with 4.6, Brazil with 4.0, Mexico¹ with 2.9, and Colombia with 2.2. Since it has been demonstrated that literacy and language are related to the development of intellectual skills, we are faced with the challenge of instilling a sense of citizen responsibility and tax compliance in a population with seriously limited reading habits.

Díaz and Lindenberg (2015) have also observed that several variables affect “the behaviour of taxpayers with respect to their tax obligations: social and economic variables (age, religion, gender, employment and education), institutional variables (satisfaction with the democratic system, trust in the government, satisfaction with the quality of the public services received for the taxes paid, and the perception that TAs treat taxpayers fairly and transparently), the perception that others are paying the taxes they deserve or not, and knowledge about how taxes should be paid.”

This is interesting evidence that demonstrates that persons do not necessarily consider their obligations as citizens to be natural or automatic. As a result, a system of positive and negative incentives is required to foster compliance at a first stage, and then a continued response over time, that is, learned behaviour.

Understanding education not only where human capabilities are least developed, but also in the light of the goal of obtaining certain social products (civic behaviour), is a challenge to the effective delivery of tax education for citizens, and many efforts have already failed.

Incentive systems have a close relationship with the response of citizens. When the population receives high-level public services in return for their taxes and considers that the government acts responsibly, the taxation system in force is perceived as legitimate. On the contrary, when tax resources are unclearly managed, the tax burden on different sectors of the population is perceived to be unfair, or the government is seen as inefficient and corrupt, citizens are discouraged and become distrustful and frustrated, which could lead to the individual decision of not paying taxes.

As stated by J. Habermas, laws are obeyed when they are legitimated by the population – and taxation is no exception to this principle. History has proven that demanding compliance in the text of the law is no incentive enough when there is an underlying negative perception in the population.

¹ The national survey on reading habits conducted by Mexico in 2015 revealed that Mexicans read 5.3 books per person a year.

When an individual reaction persists for some years it becomes a habit and, in time, habits become a counter-value, which in turn become part of culture. In educational terms, it is easy to foster positive habits in the early years, but changing the culture of adults is a highly complex challenge, because values are more rigid and alternative interpretations of different situations are far more limited during adulthood.

Taxation is difficult to learn because it involves many fields such as law, accounting and procedural techniques, as well as morals, ethics, social responsibility and the individual conscience. Indeed, matching taxation contents with different profiles based on age, average education level, social and economic situation, geographical location, ethnic background, or ideological affiliation is a complex task.

Moreover, this complexity is matched with that of the fiscal treatment given by countries to their citizens with their different taxation systems, exemptions, incentives and sanctions. As a consequence, it is hard to address the subject from a unified perspective that can be adapted to different products for different profiles.

This challenge can be addressed either from an educational perspective or through government campaigns for tax compliance that focus on (1) taxpayers' obligation to pay taxes and (2) the consequences of noncompliance. In the second case, even the use of advertisements would rely on the audience's sense of responsibility and perception of risk, both of which are low in general terms in Latin America.

Contents require segmentation based on the type of audience, tax, taxpayer profile, or any other parameter that can help create an educational product that meets a specific educational goal. At this point, it is worth asking: should tax education involve building citizen responsibility? Is the education of citizens inherent in tax education?

The goal of tax education, however, should not be limited to achieving a certain level of knowledge and understanding, as defined by B. Bloom's taxonomy. Its main goal should be setting tax education implementation goals aimed at achieving several other intermediate goals that are equally important: understanding the importance of taxes, identifying the role of the individual in taxation systems, and complying with tax obligations.

This content, in turn, requires other contents, in a world where TAs are permanently adapting to the ever-changing dynamics of domestic economies and globalization. The use of electronic tools, methodological support, assessment guidelines, pro forma templates, and several other resources aimed at facilitating the payment of taxes is on the rise.

Literacy rates have increased in the region, but major challenges still lie ahead. According to data gathered from 2011 to 2013, the average literacy rate in 33 Latin American and Caribbean countries is 59.36% for the population over 15 years of age, including praiseworthy Cuba, where the illiteracy rate is 0%. Considering that no information was available for 11 Caribbean countries and Nicaragua, the literacy rate for the region could reach 81.62%.

In addition, we are also faced with a not-so-recent educational variable: technological illiteracy. There is still a part of the population that does not master the skills required to use Internet resources or has no access to them, which means they cannot benefit from the technological instruments we create for them. This makes it even more difficult to impose compliance habits from the top down. Underlying the regulation of taxation habits through formal enactments is an attempt to turn legislation into custom, when the process tends to work the other way round, custom being one of the

sources of law. Barry Schwartz stated, as quoted by Dr. Leen Paape²: that too many rules undermine the development of moral skills. Indeed, the existence of resources does not guarantee that they will be used correctly –let alone increase the effectiveness of tax collection–, as long as taxpayers cannot master the basic skills required.

In brief, citizens must develop a basic set of skills to comply with their tax obligations: literacy, a well-developed tax compliance culture, and basic computer and Internet skills.

b. Tax Education as a Method

After defining the limits on the content to be taught, a method should be defined. How can we make taxpayers pay their taxes? Tax education aims at helping taxpayers have a clear understanding of the concepts taught, with the main goal of achieving a specific desired behaviour from citizens: voluntary, timely and appropriate compliance with tax obligations.

This stage involves the creation of effective teaching strategies that adapt to the geographical distribution of the taxpaying population, as well as their different profiles and education levels. In other words, it is about finding the appropriate solution to a specific problem.

Classroom and distance learning, as well as training on ICTs are traditional resources, although measuring the effectiveness of these training methods is still a problem. We are familiar with some major efforts made to contribute to the strengthening of fiscal culture which were based on advertisement models. These models make it possible to determine that the message has reached many people, but effective compliance is not as easy to measure. Elements such as tax revenue volumes, the number of filed tax returns, or an increase in annual tax revenue (which can be the result of many factors, such as inflation, the reduction of tax rates or an increase in the number of taxpayers) contribute to this measurement, but it is difficult to do so from an educational perspective.

Tax education courses exist at all levels and for different purposes: primary and secondary school courses, college courses, and even courses for exporters, importers and housewives. The impact of these courses on their target population, however, is poorly documented. Over the last two decades, specialized units were created or strengthened to provide assistance to taxpayers in our countries, and their tasks usually include taxpayer education.

Measuring the response to taxpayer education over time requires the longitudinal follow-up of a control group, in order to assess their adherence to the desired behaviour. It is worth remembering that the group will be influenced by (at least) other informal stimuli with respect to taxation, such as the media, their families, and the social groups they belong to. These aspects should not be dismissed, because they are an important learning field for adults.

The Latin American and Caribbean population between the ages of 20 and 64 was 359,242,068 in 2015 and is expected to reach 383,238,513 in 2025, with a marginal increase rate below 7%.³ This means that the largest number of individuals who pay taxes fall within a group that is not expected to show significant demographic growth in the near future. Therefore, TAs wishing to expand their taxpayer base must understand that they will be working with the same people in the next five years. Although the births-to-deaths ratio will have an impact, the gender ratio will remain steady. As regards age, it is expected that in 2035 the population over 60 will surpass those under 15.

² CIAT Technical Conference 2012, Smart Cooperation.

³ UNECLAC data.

The teaching resources available are varied, but tax education requires a multidisciplinary approach that is not restricted to taxes, since it deals with a critical component: human beings.

Education activities include press, radio and television interventions; visits to schools, companies and organized economic sectors; printed, multi-media and online material, and all other solutions that may be available depending on the resources of each country. In general, great progress has been made, although a generalized trend to include tax education as content into official education systems is still missing.

c. Tax Education as a State Policy

Literature on the evolution of tax education can be found virtually anywhere in the world. Certain challenges, however, remain surprisingly unaccomplished. Although no one is against tax education and its benefits, when it comes to measuring its effectiveness, few others than TAs can conduct assessments on specific cases.

International exchanges in this field promoted by CIAT, FIIAPP, Eurosocial and GIZ, among others, have fostered initiatives for tax education from a cooperation perspective, but these initiatives have yet to make their way into national education systems in order for tax education to be promoted at various levels.

Public policy measures are required for tax education to become the responsibility of public institutions in general and not only of tax authorities and education institutions, in all countries. Work must be coordinated and aimed at involving other social sectors in the pursuit of this crucial goal, such as civil society organizations, political parties and subnational governments.

Tax education should be a public policy and, as such, it must be subject to constant monitoring, in order to measure its achievements and adjust it as required to reach public consensus. However, agreement is not enough. Political consistency is also needed.

Tax education efforts, however great, are not enough. Our values on public life in our modern democracies must be strengthened. Efficiency and the fight against corruption are undeniably required to send a clear and straightforward message to citizens, avoiding apparent alternatives, ambiguities and shortcuts in taxation.

In addition to the challenge of turning tax education into a State policy, other challenges remain. Educational and legal frameworks must be strengthened with the contribution of education experts that can design pertinent curricula that include an epistemological and sociological perspective on taxation, as proposed by Eggleston (1980).

Teachers must be properly trained to educate the new generations of citizens of our countries. They should be provided with the infrastructure they need to identify and assimilate this goal, in order to develop the potential in their classrooms, at all educational levels and instances.

The effectiveness of educational actions should be documented, in order to identify and stimulate the areas that better meet the goals set by TAs. Efforts must continue in order to bridge the technological gap in the region, as well as the gap between governments and their citizens. The availability of self-services is not enough for compliance. People need to be heard and understood, something which seems

ever more difficult in the postmodern world. Technology does contribute to operating surveillance, and it can clearly stimulate and promote compliance, but it cannot teach citizens the importance of living in a country with healthy public finances.

The conditions are set to keep working towards the future. Tax education is not a goal in itself, but rather a resource that has to be used wisely.

d. Latin American Experiences

At least fourteen countries in the region have undertaken institutional efforts to implement tax education. In thirteen of them, as previously mentioned, these activities are carried out by tax authorities, except in Brazil, where the National Programme for Tax Education has been run by ESAF since 1996⁴. Tax education activities, which are systematized efforts, should not be confused with the successful campaigns for tax compliance launched by several countries before 1996, such as the *real y medio* campaign (based on nursery rhymes) launched by Venezuela's SENIAT in 1996.

These experiences demonstrate that successful tax education implies great effort, and institutional designs have varied with countries. Costa Rica, for example, successfully implemented the concept of tax citizenship created by its DGT in 2001, but results were not as good with *Tribuchicos*, a computer game for children that turned out to be a failure, partly because of lack of endorsement by the Ministry of Public Education, which considered that the product presented some inconsistencies. The country implemented several other projects until it created a National Plan for the Prevention of and Fight Against Tax Fraud in 2009, which established an inter-institutional group in charge of designing tax education activities. This promoted the creation of the National Programme for Tax Education, as well as the implementation of tools such as Plan 200 to train teachers in this field.

Methodological efforts have also been made at the technical level. Peru's SUNAT, for example, has analysed the reasons for noncompliance and developed its own consistent and robust concept of tax citizenship and tax awareness. Their findings were simple but useful: tax education goes beyond educational systems. SUNAT discovered the perceptions that led citizens to evasion through a tax awareness study focused on the values of citizens, which analysed verbal expressions and regular behaviour related to compliance.

Brazil has extensive experience in this field, mainly built by ESAF (Brazilian School of Tax Administration). After several years of work, this institution reached subnational governments with tax education campaigns. In the state of Tocantins, for example, a decree was issued to create the State Programme for Tax Education, which is jointly run by the Ministry of Finance and the Ministry of Public Education of the State.⁵ Moreover, a working group was created in 2015 to assess the inclusion of tax education in the curricula of the State's public schools.

Another interesting case is that of Mexico, where broader efforts for tax education have been under way for several years. Inclusive models of a broader scope have been implemented, such as the Centres of Accounting and Tax Support for low income citizens, or citizen networking campaigns, which are aimed at “shaping the way citizens think and act through different media and channels, using all resources required for the population to adopt positive tax paying values.”⁶

⁴ Diaz and Lindemberg (2015).

⁵ Government of the State of Tocantins, Brazil. Decree No. 875/99 of 2 December 1999. (Creation of the State's Group for Tax Education).

⁶ Fernando Martínez Coss, *The evolution of tax education in Mexico*.

This initiative coexists with other educational projects in economics and finance, such as those launched by the Interactive Museum of Economics of the City of Mexico for the promotion of saving habits, or the National Committee for the Protection and Defence of Users of Financial Services of Mexico, which, among other activities, organizes the national week for financial education, in order to encourage exchanges between public and private institutions on citizen education and bring people closer to the services they are entitled to.

International cooperation in this field should be strengthened, including the participation of multilateral organizations and stakeholders in general, with a view to sharing best practices on tax education and tax literacy with Latin American countries and, particularly, Caribbean countries.



12

QUO VADIS
INCOME TAX?
TOWARDS THE
PIT-CA

12

QUO VADIS INCOME TAX? TOWARDS THE PIT-CA

Alberto Barreix, Jerónimo Roca and Fernando Velayos

In the three decades following the 1929 crisis and the Great Depression, the market economy was radically transformed with the provision of public services (health care and education) and social security (pensions and social welfare) for the large majority of people in the developed world. This was all financed by strengthening the tax pillars that underpin the fiscal structure to this day: the mass levying of income tax, the comprehensive expansion of social security contributions, and an incipient value added tax.¹ The regulatory frameworks of public services were strengthened, as were regional development policies, and a process of trade and financial liberalization began, including the birth of regional integration in Europe a little more than a decade after the end of the Second World War. All these transformations happened during a period of sustained growth, and within a framework of monetary stability and growing equity.

These unprecedented economic changes and their correlate in the progress of economic theory, especially regarding public finances, contrast with the modesty of economic performance and the development of instruments after the 2008 financial crisis—when the only prominent undertakings were coordinated international efforts to foster tax transparency, bank bailouts, and stronger bank regulation.

Indeed, one of the main causes of the 2008 financial crisis was the regulatory weakness of globalized financial markets, especially the opacity of financial activity,² and particularly in the mortgage markets. Additionally, some financial flows operate by means of legal forms (funds, partnerships, trusts, *stiftungs*) that offer decision-making agility because of the scant public control over them, coupled with a lack of clarity about their legal status. These are ideal vehicles to preserve fiscal opacity. It is not by chance, therefore, that the struggle for financial clarity

1 A tax pillar is a tax that can generate significant and stable revenues, and that is applied on a broad basis, which strengthens its neutrality and income elasticity (Barreix and Roca, 2007). Tariffs were also a tax pillar in the period mentioned.

2 In the United States, the Gramm-Leach-Bliley Act of 1999 formalized the end of the separation of commercial and investment banking that had been established by the Banking Law of 1933 (the Glass-Steagall Act). Thus, driven by the most important financial conglomerates that had been expanding and combining since the mid 1960s, the creation of “universal banking” was legally endorsed. The process had begun more than a decade earlier with the change in the mandate of the Federal Reserve (1987), when the regulator expanded the scale and scope of commercial banks’ activities (Fohlin, 2016). This was supplemented, under the premise of financial sector self-control, by new and complex financial structures, many of them highly opaque and lacking in regulation (Kiff and Mills, 2007), which eventually were lethal for the system—although perhaps this had been foreseeable (Demanyk and van Hemert, 2008).

has been very similar to that fought for some time to attain tax transparency.³ At the same time, until recently there has been negligence towards, and in some cases complicity with, tax avoidance and evasion from within the financial system. Without the universal end of banking secrecy so as to determine income flows and the identity of the beneficial owner of the ownership stock, residual areas of opacity will hamper the determination of capital and income movements, and thereby impede control of their tax consequences.

In this context, financial systems in the developed countries, needing huge bailouts in a context of widespread insecurity (financial crisis, nationalization of and intervention in banks and insurance companies, plunges in stock markets), ran the risk of losing the competitive advantages attendant on their institutional and regulatory stability.⁴ Hence sovereign debt grew dizzyingly in order to recapitalize their capital markets and implement fiscal stimulus initiatives that had little effect on credit and economic recovery. This was accompanied by mounting disquiet about high rates of unemployment, especially among youths and the less educated, and the acceleration of income concentration. Thus there was a convergence of interests among States, civil society and the financial institutions facing competitive dangers that tax opacity should be ended.

This study, on the basis of international coordination for tax clarity purposes (an administrative achievement in the wake of the Great Recession), proposes a new design for income tax, the tax that has raised more than any other in human history. The shock wave triggered by the attainment of transparency will bring about a movement in the core of tax policy. When the system for the mass and automatic exchange of information is rolled out, income tax will radically alter the labor-capital tax mix. The tax, therefore, will be able to wreak a transformation comparable to its great historic changes, with repercussions for its design and economic effects that were unthinkable before the shift in transparency.

In the next section, this study provides a brief description of the evolution and composition of income tax. The third section offers a short history of the architecture of income tax since the start of the 1990s. The fourth section proposes the Personal Income Tax-Comprehensive and Accrual (PIT-CA), and the following section discusses its main technical features. PIT-CA's viability is related to the development of greater tax transparency based on international cooperation.

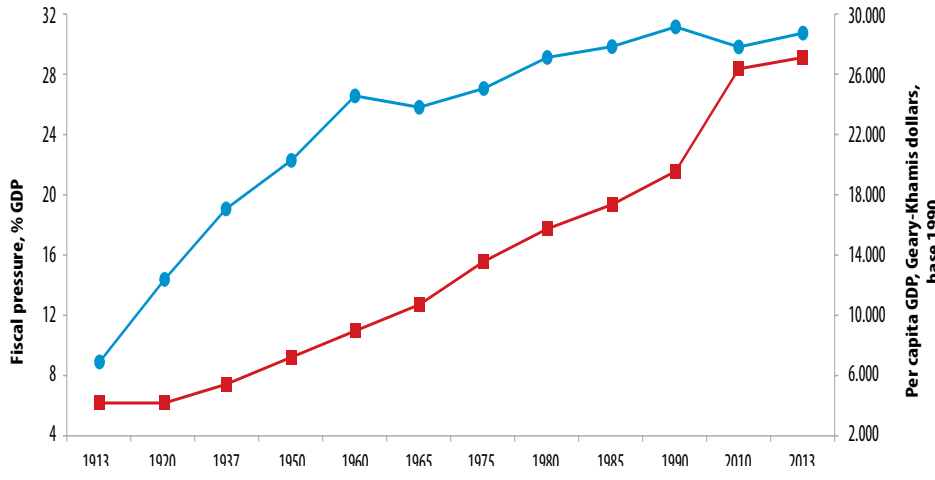
The proposed tax covers the taxpayer's entire world income, without exception, which is levied on an accrual basis and is fully integrated with the corporate income tax. The final tax treatment of the individual's world income will be that corresponding to the country of residence, and therefore movements designed to secure a lower tax at source lose significance. The sixth section examines the role of corporate income tax in the PIT-CA scheme, and the need to review how incentives are designed. The analysis ends with some conclusions.

3 This debate was conducted with dissimilar success in the European Union during the late 1980s and early 1990s: the Savings Directive (which only took effect in 2005) was being developed at the same time as the complete liberalization of the financial and capital market in Europe. Europe has learned two lessons: that a monetary union without fiscal policy coordination causes significant problems; and that it is unwise to allow the free movement of capital and to ease financial regulation without concomitant fiscal transparency.

4 As an example, in the United States the fall in the stock market reached 40 percent of its capitalization value, which was almost 40 percent of GDP in 2008; some 465 banks closed in the following five years, whereas only 10 had fallen in the previous five; five of the seven biggest investment banks disappeared, merged, or sought assistance; and the world's biggest insurance company had to be nationalized by 80 percent. In parallel, a single global bank (competitor) with its headquarters in Europe had a third of the fall in the value of the US stock market (or a quarter of its total value on that date) in wealth and asset management and investment banking.

a. Evolution and Composition of the Income Tax System

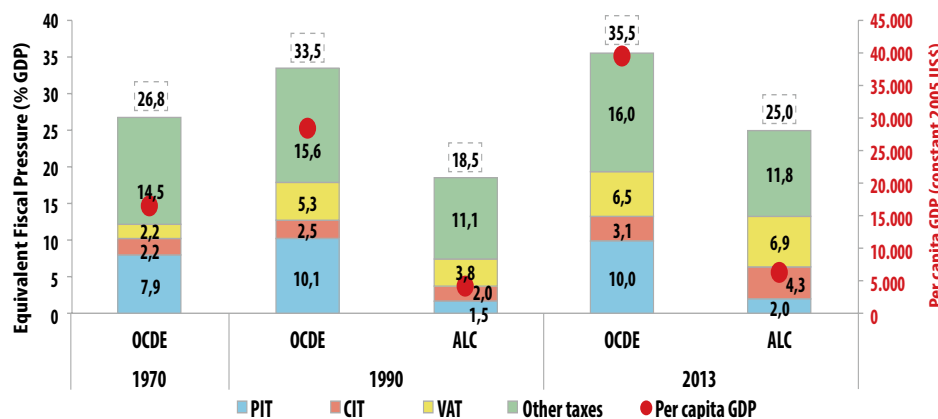
Chart 1: Comparison of the Equivalent Fiscal Pressure (EFP) and per capita GDP of selected developed countries¹



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; Madisson, 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.

In the twentieth century there was an impressive growth of world output, and even greater progress was made in the public sector's⁵ share of economic activity, as shown in Chart 1—which reveals the evolution of tax revenues in the 11 developed countries that account for more than 95 percent of the GDP of the Organization for Economic Cooperation and Development (OECD) (Barreix, Bès Benítez, Pecho and Velayos, 2013). It is also evident that economic growth was almost constant for a century, but the growth of fiscal pressure had two speeds: a very high speed in the first half of the century (up to around 1960), and much slower in the half-century from then until 2013.

Chart 2: Fiscal Pillars, Total Fiscal Pressure (% GDP) and Per Capita Income, 1970–2013. LAC and OECD Countries* (% of GDP, simple averages for GDP and per capita GDP in constant 2005 US\$)



* OECD excludes Chile, Mexico, Czech Republic, Estonia, Hungary, Israel, Poland, Slovak Republic and Slovenia.
Source: IDB-CIAT (2015), OECD (2015), WEO.

In the earlier period, from the start of the First World War to the end of colonialism (the 1960s), real per capita GDP in the developed countries grew by 1.6 percent a year, and per capita tax revenue increased by an annual 4 percent.

In that period, the theory of public finances and the scope and size of the government intervention in the economy gained significant momentum,

5 Not including state enterprises.

especially after the Great Depression, which wrought structural changes in the market economies on such a scale as the creation of mass social security, the almost universal provision of social spending (education, health care, housing and so on), market regulation, the creation of a broad public enterprise sector, and significant progress on monetary and exchange-rate policies. The scale of these changes contrasts with the modest technical progress made since the 2008 financial crisis. In almost a decade, the only prominent achievements have been the bank bailouts and some financial reforms undertaken in a context of fragmented international coordination, as well as the promise of inter-jurisdictional cooperation on tax transparency—a matter to which we will return below.

In the second period, from the 1960s to date, important changes were made to the composition of the tax pillars with the waning of tariffs, which accounted for 4.4 percent of the total pressure in the OECD countries in 1970 but only 0.4 percent in 2013. Around 1970, the tax burden of the OECD countries, which can be regarded as a good approximation of the size of the general government,⁶,⁷ showed signs of consolidation and stable composition based on three tax pillars: value added tax (VAT), income tax, and social security contributions (mostly pensions and health care).

It should be noted that for decades, and up to the present day, revenues from the “income tax system”—the personal component (almost 30 percent of the take and more than 9.4 percent of GDP) and the corporate component (a little more than 8 percent of the take and 2.5 percent of GDP)—account for almost four of every 10 units collected in the OECD. This is in contrast to the countries of Latin America and the Caribbean (LAC), where the average burden on income barely surpasses 20 percent (the annual average between 1990 and 2013) because of the weak performance of the personal component. The latter accounts for just 8 percent of the total, and less than 2 percent of GDP. On the other hand, corporate income tax in LAC accounts for about 14 percent of the total, and as a share of GDP it is only slightly above the level in the developed countries during the period (see Chart 2).

Finally, note that while the total tax burden in the OECD grew very slightly between 1990 and 2013 (a little more than 5 percent of GDP on average), in LAC taxation grew much faster at a simple average of 35 percent, in parallel to the consolidation of democracy.⁸ This development is marked, on the one hand, by the modest share of income tax in Latin America (about 20 percent of the total burden in the past 30 years) and, on the other, by the stagnating share of that tax in the OECD countries (about 35 percent over the same period).

The need to increase revenues and improve the quality of income tax calls for an alternative model with an updated design. To that end we propose a Personal Income Tax-Comprehensive and Accrual (PIT-CA), which is only possible in the new economic, political and technological context of the twenty-first century. The design we suggest covers an individual’s total world income but taxes it on an accrual basis. Thus it is based on the principle of horizontal equity, which fosters progressivity by taxing the capital income that has habitually received beneficial treatment. The proposal’s viability is related to the development of greater tax transparency based on international cooperation.

6 Taking advantage, moreover, of the consolidation of the OECD’s reliable and uniform statistics.

7 The general government sector covers the agencies whose main activity is to perform the functions of government; it includes the central, subnational and state-level (insurance funds and so on) subsectors. IMF (2011).

8 It should be noted that LAC has a much lower tax-to-GDP ratio, almost 25 percent below the weighted average in the OECD; that the OECD countries are emerging from a crisis; and that until 2013, LAC benefited from the commodities “supercycle.” But it is also true that average GDP in the OECD was almost 6.6 times that of LAC in constant 2005 dollars. In 2013 that revenue ratio had changed very little (to 6.2) but relative average tax burdens are only 3.5 percent higher.

b. Developing Income tax Designs

Income tax—or, strictly speaking, the system of taxes levied on income—is the backbone of the tax system because it links savings with investment. Its nature has obliged its structure to evolve as no other tax, adapting to changes in international trade and finance, to different levels of economic and institutional development, to technological advances in administration, as well as to different fiscal policy models. This complex flexibility made it the most important source of tax revenue in history during the twentieth century, which was the period of the greatest growth in tax resources. Since its inception, income tax has been used to finance wars and has spurred social tensions—unlike value added tax, an instrument of efficient commerce,⁹ which was driven by an incipient European Community that put its faith in economic integration as a means of inducing peace after a millennium of conflict (Barreix and Roca, 2010).

The response to competition for investment: the fall in the rates of corporate income tax (race to the bottom)

In the late 1980s, the developed countries began to face competitive pressures for investment—which, as will be seen below, led to a continuous reduction in the tax on business income—as well as for savings, entailing an incomplete “dualization” of personal income tax, that led to a more generous treatment for capital gains and interest in the overall scheme.

The Reagan¹⁰ and Thatcher¹¹ reforms to the income tax widened the taxable bases and reduced incentives for large businesses, and also significantly lowered the rates for both individuals and companies. The aim was to bolster savings and investment in an increasingly competitive world.

Taxing income on broad bases and at low rates favored risk-taking in the new and dynamic services sectors (the “new economy” of that period), especially finance, telecommunications, information technology and leisure. Higher-income groups therefore had more investment opportunities, and technocracies became more dynamic, which was conducive to acceptance of the elimination of incentives (privileges and regulations).

9 The idea of the VAT originated in the documents of the German merchant von Seimens in the 1920s, and it was used for the first time in France during the early post-World War II years. In its version of consumption as a destination tax base, it allows investment and exports not to be taxed or export subsidies not to be hidden.

10 The 1986 reform in the United States can be summarized as follows: i) reduction of the rates scheme for personal income tax, with the upper marginal rate falling from 50 percent to 28 percent; ii) increase in the non-taxable minimum and deductions, freeing 6 million of the poorest taxpayers (12 percent of the total); iii) increase in the rate on capital gains from 20 percent to 28 percent; and iv) cut in the business rate from 48 percent to 34 percent, but eliminating tax spending such as the tax credit on investment. This reform, approved by the votes of the Republican and Democratic parties, significantly increased horizontal equity and maintained the same revenue (with respect to GDP) as under the Carter administration, but had no effect on progressivity. Additionally, the Earned Income Tax Credit (EITC) was expanded. This is a tax credit for low-income taxpayers with children or disabled family members, and has been in force at the federal level since 1975. The idea stems from the Negative Income Tax proposed by the British economist Juliet Rhys-Williams in the mid 1940s and promoted by Milton Friedman in the 1960s. The EITC is the biggest poverty reduction program in the United States.

11 By the end of her administration, after three electoral victories, Thatcher had: i) reduced the upper marginal rate of personal income tax from 98 percent to 40 percent, and that on companies from 53 percent to 35 percent; ii) unified the two VAT rates, 8 percent and 12.5 percent in a single rate of 15 percent, adding previously exempted goods and services to the taxable base; and iii) indexed the cost of capital gains, but made some openings as regards financial instruments and decided to replace the property tax with a per capita “community charge.” This latter initiative was highly unpopular and failed. The subsequent taxpayer rebellion caused local Conservative governments to run short of funds and they lost the elections. This was one of the main reasons for her resignation (Steinmo, 1993).

Moreover, economic trends since the tax came into effect had induced some structural changes in income tax that would not be reversed. Indeed, in 1918 corporate income tax in the United States yielded four times more than personal income tax, which only affected the very wealthy. In 1950 both taxes yielded the same revenue, but by 1980 individuals were paying four times more than companies.

Today, the ratio is slightly less. These disparities reflect the intent to limit tax on the mobile factor (capital) while increasing the burden on the least mobile (labor).

The reduction in rates during the 1980s in the United Kingdom and the United States triggered a worldwide realignment of income tax, given the influence of these two important market economies, and also altered investment attraction and savings in an increasingly interlinked global economy. Hence these two economies, which accounted for about a third of world output, exerted influence—in a kind of leadership position in a Stackelberg oligopoly model for capital attraction¹²—and by the start of the 1990s the reduction in corporate tax rates in the OECD countries was 28 percent on average, and there was an average 34 percent reduction in the upper marginal rates of personal income tax relative to the previous decade.

As regards the competitive pressures for investment, in the 30 years from the start of the 1980s to the present day, the average corporate tax rate fell from 47.6 percent to 28.5 percent in the OECD countries, reflecting tax competition among countries to attract investment. This trend is accentuated in successful integration processes, as other important policies such as trade and monetary/exchange-rate policy are harmonized (Overesch and Rincke, 2011). In the European Union, therefore, the rates of business income tax were cut by about 45 percent in the final quarter of the last century, while in the other OECD countries they were cut by 25 percent.^{13, 14} Additionally, in the final third of the twentieth century there was a move towards a more financially globalized world, with electronically integrated banking systems and freer exchange rates. Hence credit, at different risk premia, became much more accessible worldwide. Thus the differentiating factor among economies (the “scarce” good, as it were) is the endowment of business capacity. As a corollary, competition increased among countries to attract (and retain) business venture capital, and tax became one of the incentives in that competition.

The response to savings flight: the dual tax

As mentioned, the competitive pressures for savings that confronted the developed countries in the late 1980s entailed a “dualization” of the prevailing synthetic or comprehensive personal income tax. The synthetic or comprehensive tax covers (integrates) all of a taxpayer’s income (the individual or the nuclear family) and taxes it according to a structure of progressive marginal rates applied to income bands. The tax follows the definition of income in the broad Haig-Simons sense: consumption plus change in assets in a given period. This dualization consisted of granting more generous treatment

12 In this case the leaders—the economies of the United States and the United Kingdom—set the amount (the income tax rate) and the other competitors react by lowering the rate further, over a period of almost 20 years. Indeed, to this day the United States has one of the world’s highest corporate tax rates, and both countries retain the mechanism of taxing distributed dividends without integrating with the corporate tax. The biggest economies, however, tend to be more attractive to investment because of the size of their markets, and less prone to constant reductions for the purposes of tax competition.

13 This reflects a kind of “prisoner’s dilemma” in which the choice is always to reduce the rate. Nonetheless, the game can become cooperative in the iteration if the other player is penalized in successive rounds and the fear of the penalty (a constant reduction in rates) induces an agreement (cooperation) that leaves the players in balance at a given rate.

14 It is interesting to note that, despite this reduction in business income tax, both the tax burden on the factors and total revenue were practically unchanged. In particular, total revenue from business income tax grew by a little more than 1 percent of GDP between the mid 1970s and the early 2000s. Some authors have explained this paradox by pointing to the increase in the number of businesses within the agents engaged in economic activities (corporatization; see Sorensen, 2006; and Piotrowska and Vanborren, 2008). Others point to the growth of business profitability, especially in the financial sector (Devereux et al., 2004). For Latin America, Barreix, Garcimartín and Velayos (2013) discount the corporatization argument but regard as valid the argument about business performance in the region, especially since the commodities boom that began in 2013. They also point to another explanatory factor: the professionalization of most Latin American tax administrations, notwithstanding the fact that much remains to be improved.

to capital income, especially dividends, capital gains and interest, treating them separately (in a schedular way).

As regards capital gains, most countries set a differential rate significantly lower than the upper marginal rate of personal income tax. The US case is typical: capital gains made in a period of more than a year were and are taxed at a single rate that has generally ranged between 15 percent and 28 percent, albeit without adjusting for inflation. With respect to interest, the developing countries began to establish a scheduler system with lower rates. In Latin America, for example, this was done in Argentina, Brazil, Costa Rica and Nicaragua.

In the Nordic countries—Denmark, Finland, Norway and Sweden—savings flight was added to the problem that their comprehensive systems had high marginal rates, far above those in other countries (as high as 73 percent in Denmark and Sweden), and narrow tax bases. The latter circumstance stemmed from special treatment and exemptions for certain kinds of capital income and the total deduction of interest—especially on mortgages—at those high marginal rates. The special treatment for capital income was part of a (disordered) effort to make their taxation more attractive and avoid the savings flight caused by a lack of cooperation among tax administrations. The comprehensive system designed in this way contained strong incentives for tax avoidance through tax planning, its capital income take was negative, and its progressivity was more theoretical than real (Picos Sánchez, 2003).

Consequently, between 1987 and 1993 the Nordic countries formalized the dual income tax. Basically, this separately taxed labor income at progressive rates and capital income at a proportional rate, whether it comprised business income or liabilities—interest, dividends, rents and capital gains. The “anchor” design in the rate on business income and capital income (about 30 percent) is in turn the lowest rate of tax on labor income, which is taxed progressively up to rates of about 50 percent.

In short, the Nordic dual system accords beneficial treatment to capital income, taking account of the nature of the factors of production: the integration of financial markets obliges countries with high income tax rates to levy a lower (and proportional) rate on the most mobile factor, finance capital, so as to discourage capital flight (Alworth and Arachi, 2008). The dual income tax system, then, can be viewed as a formal response to the capital flight associated with the synthetic system.¹⁵

In November 2005 there was a proposal in Uruguay to introduce a semi-dual tax,¹⁶ and this was later instituted in several countries: Spain and Slovenia in 2006, Germany and Peru in 2008, among others.¹⁷ The semi-dual approach takes the central idea of the Nordic dual system to tax separately labor income with progressive rates and capital income with a linear rate. Unlike the Nordic system, however, the new approach distinguishes between capital assets—business income—and passive income from capital. For example, while corporate income in Spain was taxed at 35 percent, passive income was taxed on a narrow range of 19 percent to 27 percent; in Uruguay, the respective rates are 25 percent and 12 percent.¹⁸ In other words, Uruguay’s semi-dual system was “anchored” in the capital income rate, which coincided with the lowest marginal rate on personal income.

15 Thus, business income tax is detached from its function of supporting personal income tax determined on the Haig-Simons income base—simple withholding if the personal and business income taxes are wholly integrated. That would seek to retain business savings (reinvestment) and business capacity.

16 See A. Barreix and J. Roca: Uruguay - Informe de base de la reforma tributaria (July 2005) and Informe de la Comisión de Reforma (website of the Uruguayan Ministry of the Economy and Finance, November 2005). The team that worked on Spain’s reform presented their proposal, which was drawn up independently, on the website of the Ministry of the Economy and the Treasury in January 2016.

17 Semi-dual models were later adopted by Nicaragua (2009), Honduras (2010), Panama (2010), El Salvador (2011), Guatemala (2012) and Mexico (2013).

18 In the Nordic dual system, individuals engaged in economic activities have a strong incentive to disguise their labor income (subject to marginal rates of up to 50 percent) as business income (taxed at 30 percent). The semi-dual tax in Uruguay, by contrast, constrains the prospect of arbitrage to the extent of leaving open the option for individuals who engage in economic activities to resort to the business or the personal income tax.

The lower rate on capital liability income is not only for administrative reasons but also for the purposes of efficiency.¹⁹ The former include: (a) business income is net income while capital liability income is basically gross; and (b) finance capital is even more mobile than corporate capital, and neither its location nor its yield could be known with precision in that period.²⁰

The response to the administrative complexity of the synthetic tax: the flat tax

The synthetic or comprehensive income tax has clear theoretical advantages. For example, by covering “all” income, giving equal treatment to labor and capital income, and offering reductions in the taxable base and/or exemptions to the taxable amount to be paid, it facilitates the personalization of the tax and respects horizontal equity (that is, taxpayers of equal payment capacity actually pay the same amount). At the same time, the progressive marginal rates ensure the system’s vertical equity.

In practice, however, the administrative complexity of the personal income tax calls into question its theoretical advantages. For example: i) the tangle of deductions gives rise to high administrative and/or compliance costs; ii) to avoid the unwanted incentives of classical taxation—double tax on dividends, at the corporate and personal levels—efforts have been made to devise various means of integrating corporate income and personal income taxes, leading to administrative difficulties; and iii) the correction of excessive progressivity in the event of irregular income also poses problems in determining the taxable base by period.

Given the administrative complexity of the synthetic personal income tax, and in order to correct the prospect of arbitrage spurred by the differential between the personal and corporate rates, Hall and Rabushka (1983 and 1995) proposed a combination of two taxes at the same rate:

- a tax on company cash flow—that is, on sales (including exports) less wages, national and imported inputs and investment (which can be wholly deducted at the moment they are made); and
- a tax on wages after a non-taxable minimum, which is to some extent progressive despite the flat tax.

Savings are not deducted at the moment they are made and savings yield is not taxed later. That is, there is no tax on interest, dividends or capital gains, and firms cannot deduct the interest paid.²¹ More precisely, in this arrangement the banks do not pay income tax and companies’ financial structure is almost irrelevant.²²

The flat tax was introduced in Estonia in 1994, followed by Lithuania and Latvia, but it gained importance when the Russian Federation adopted it in 2001. After 2004 it spread to Slovakia, Georgia, Romania and Ukraine. Strictly speaking, the only significant similarity between the flat tax adopted in these countries and the Hall-Rabushka scheme is that there is a single rate for wages. As regards the differences, the most important are: i) the way in which the non-taxable minimum is established;

¹⁹ See Barreix and Roca (2007) for more on these arguments and a comparison of the systems (comprehensive, flat, Nordic dual and the new duals).

²⁰ As regards the efficiency reasons: (a) with a lower rate for capital liability income, it is acknowledged that the loss of welfare associated with a tax on savings should not be measured by the reduction of its current level but by a decline in future consumption that current savings will be able to buy, and thus is significantly greater than the loss that is usually estimated (Feldstein, 2006); and (b) with a lower rate on dividends and capital gains, the aim is to avert inefficiencies in localization. For instance, a high rate on dividends causes them not to be distributed (the “lock-in” effect) and consequently: (i) causes a loss of efficiency in the choice of investments; (ii) discourages discipline among company executives, who have preferential access to financing given that the better alternative is to reinvest the profit; and (iii) can lead to a lower tax take than could be acquired by taxing the investment (or consumption) that is impeded by the “lock-in” effect (Feldstein, 2006).

²¹ Interest is a transfer that generates no value added when it moves between residents. Since it is not deductible, taxation loses importance in determining the optimal financial combination. This is probably one of the reasons why it was never implemented.

²² It is easy to demonstrate that, from a lifecycle perspective, this approach entails a tax on consumption. A tax on wages throughout a lifetime, assuming that there is no final reserve of savings, is equivalent to taxing consumption at current value. In the event of surplus savings, this observation remains valid if there is a tax on inheritances and bequests. Moreover, it works like a consumption-type VAT, based on the principle of origin and calculated using the subtraction method.

ii) some tax capital income and others do not; and iii) all have retained the traditional tax on business income, and not necessarily at the same rate as the tax on labor income.

Though still remote from Hall and Rabushka's proposal, especially regarding the company income tax, the flat tax introduced by these countries is easier to administer. As pointed out by Keen, Kim and Varsano (2006), the greater simplicity is not related to the fact that the structure is a flat tax, but rather to the fact that they set a high, non-taxable minimum that left a large proportion of the population unaffected by the tax and only a limited number of deductions were allowed.²³

Finally, another problem with the flat tax is that the single rate that makes it possible to sustain revenue at the level it was before the tax's introduction might be too high for capital income, especially in developing countries. Hence the flat tax, like the synthetic tax, can displace savings (capital flight).

c. Personal Income Tax-Comprehensive and Accrual (PIT-CA): a Proposal for a Constantly Evolving Tax

Historical context

As we have seen, on the one hand globalization fostered free trade and thus tariffs disappeared as a tax pillar. On the other hand economic integration, in offering less freedom for countries to distinguish themselves through trade, exchange-rate and monetary policies (the European Union is the extreme example), exerted pressure on income tax as a factor of competitiveness that a country could offer. Hence freedom of capital movements, economic integration (at the regional level), and the need to attract investment are three key factors affecting taxation on companies and their relocation—besides the emergence of the corporation that is nationless, or unlinked to a country with which it is identified.

This has been expressed in various mixes of business and capital income taxation, including sundry incentives that give rise to arbitrage options that are very significant for final profitability. At the corporate level we can mention tax inversion,²⁴ abusive reductions in the payment of corporate income tax by means of administrative decisions,²⁵ or legislative loopholes.²⁶ In the case of personal taxation the situation is worse because savings flight could be linked to money laundering and terrorism.

In numbers, therefore, Chart 3 shows the clear stagnation of personal income tax revenue as a percentage of GDP in the developed countries, at about 10 percent, despite the increase in income concentration (Alvaredo et al., 2013). We will discuss this below.

23 Additionally, it should be acknowledged that administrative withholdings are simpler; the above-noted problem of excess progressivity when income is irregular is eliminated; there's also lower incentives to transfer income between related taxpayers (spouses), though such incentives do not disappear completely because of the non-taxable minimum; and finally, if the business income tax rate is equal to that levied on labor income (as in the Slovak Republic and Romania), there is no incentive for people to form companies in order to lower the tax burden on their economic activities.

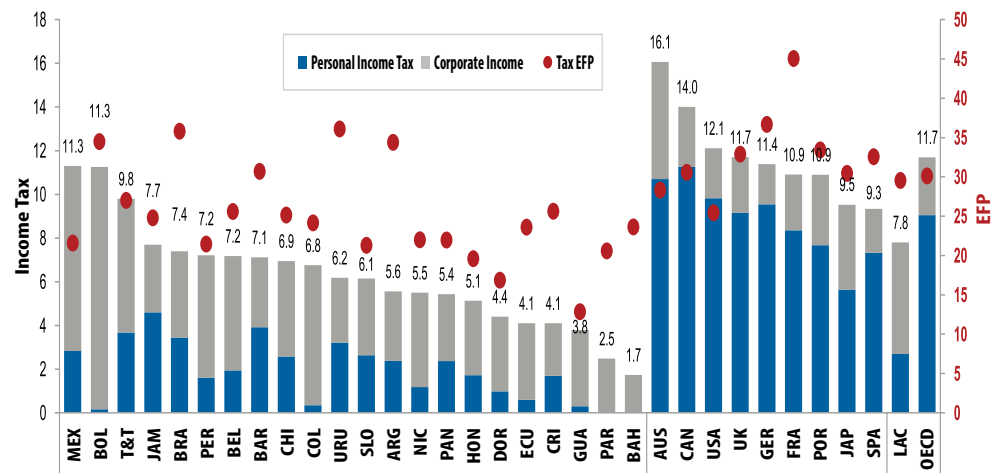
24 Tax inversion consists of relocating a company's legal domicile to a jurisdiction with lower income tax, or to a tax haven, while keeping the most important operations in the (original) country that has higher tax. In general the companies are originally US firms and they make purchases from pertinent businesses in the overseas market, albeit smaller, using unrepatriated profits and international debt.

25 For example, the European Union's (EU) Directorate for Competition condemned administrative rulings made by several countries as illegal and contrary to European regulations on permissible state aid. Moreover, it ordered them to recover the unpaid taxes of US and European companies that had benefited. (This situation originated in the investigative reporting known as LuxLeaks in 2014.)

26 One of the mechanisms most frequently used to exploit legal loopholes or inconsistencies between countries consists of hybrid instruments between parent companies and subsidiaries: for example, capital transfer contracts that, by law, can be classified as a loan to or a share in the business. Loans in favor of the assignor of the capital can therefore have the same nature as interest or dividends. The former are deductible from the taxable amount of the assignee's income tax as an expenditure, while the return on capital—in countries with participation exemption, since it comes from an overseas subsidiary—are not taxed in the parent company's country. Thus we have an income that has resulted in a lower tax in the source country (where the payment is considered as interest) without commensurate taxation in the country of residence (where it is considered as a dividend).

In LAC the situation is much worse²⁷ because the richest 10 percent, who account for about 40 percent of income, paid on average an unseemly effective rate of 2.3 percent in 2013 (Barreix, Benitez and Pecho, 2016). Meanwhile, revenue from the corporate income tax is meager in almost all the countries considered here, and it is striking that it is lower in the developed countries, where it barely surpasses 3 percent of GDP and accounts for less than a tenth of the total tax burden.²⁸

Chart 3: Corporate and Personal Income Tax and Equivalent Fiscal Pressure (EFP), LAC and OECD Countries* (2013, % GDP)



* OECD excludes Chile, Mexico, Czech Republic, Estonia, Hungary, Israel, Poland, Slovak Republic and Slovenia.

Source: IDB-CIAT (2015), OECD (2015), WEO..

Government authorities have been reacting to all this, not always judiciously or uniformly. For example, the penalties applied by various tax authorities in the world's most sophisticated and controlled financial markets to some of the global institutions of personal banking are well known. Thus political and legal disputes have arisen between jurisdictions, several of them global financial centers, thereby bringing about changes (against much resistance) to banking secrecy on five continents. This is in addition to the tragicomedies in the more advanced countries related to the purchase of databases or plea bargain deals that are unworthy of finance and taxation in the twenty-first century.

But the outlook has been changing markedly in recent times (Barreix, Roca and Velayos, 2016).²⁹ The new circumstances allow us to aspire to implement a system for the automatic exchange of financial information—a fundamental premise of our proposal—in tandem with a more precise determination of the profits from business income by country. There would be, therefore, an interesting paradox: though capital today is more mobile than ever for financial purposes, its “trajectory” for tax purposes would be known (traceability). In short, capital, and income in general, can run but can't hide. This is a basic difference from the situation in the past, in which capital mobility was so certain and its trajectory so unknown in both financial and tax terms that other, simpler and less precise approaches to taxation were justified.

27 LAC, moreover, has other structural problems: its per capita financial personal income is, as a simple average, six times less than that of the OECD countries, and the LAC countries have weak institutional frameworks for tax administration in the broad sense, which also includes judicial authority, property registers and so on. Furthermore, in their study of the political economy in 50 countries between 1990 and 2007, Ardanaz and Scartascini (2013) find that: i) the countries that historically have had an unequal distribution of income and wealth systematically tend to have high levels of “poor legislative proportionality” (the discrepancy between the proportion of legislative seats and the proportion of the population included in the electoral districts); and ii) high levels of “poor legislative proportionality” are related to low ratios of personal income tax to GDP.

28 Note that it is difficult to be precise about the distinction between revenue raised from personal and from corporate income tax. Additionally, and related to the foregoing, some LAC countries include income from natural resources that commanded high prices in 2013, while the OECD countries continued to emerge from the “Great Recession” brought about by the 2008 international financial crisis.

29 Recent efforts, analyzed below, have managed to alter and indeed subdue (in the medium term) various criminal activities related to the “offshore industry” in the broad sense, such as the disguises of trusts, shell companies and false residences.

Considering these new and promising circumstances, therefore, and the poor outcomes of income tax, we are proposing a personal income tax (PIT-CA) that covers an individual's entire world income, including capital and business income, on an accrual basis and in complete integration with corporate income tax. In other words, this is the effective and refined application of the Haig (1921)–Simons (1938) definition of income as the sum of (i) the market value of the goods and services consumed; and (ii) the change in the value of the assets (property rights) of the individual or household (nuclear family). The final tax treatment of the individual's world income will be that of the country of residence. In other words, taxpayers can decide to change the location of their investments and those investments can, moreover, be subject to very variable at-source taxation, but at the end of the tax period all income must be included in the taxable amount and taxed at the rates applicable in a taxpayer's country of residence. With this design, movements for the purposes of lower at-source taxation would be of little avail (there could only be a slight financial benefit).³⁰

Recent technical precedents

The two design developments considered here are the concept of “attributed income” from the Chilean reform of 2014 (Jorrat, 2015) and the integration of personal income tax with the wealth tax to obtain a single basis for all of the taxpayer's income (Díaz de Sarralde and Garcimartín, 2015). In Chile it was stipulated that taxation was based on “attributed income”: company owners, partners or shareholders must declare as annual income their share in the profits (returns) accrued in the businesses, and not only the dividends or withdrawals received. This reform aimed to solve the domestic problem arising from the gap between the corporate income tax rate (20 percent) and the upper marginal rate of personal income tax, which created opportunities for arbitrage (sheltering income in companies), and provided an incentive for avoidance and evasion.³¹

In the second precedent, the authors integrate the current personal income tax and the wealth tax into a single base. In operational terms, they add to the traditional income from labor and capital a differential income from net worth,³² thereby ensuring the uniform treatment of all sources of income and avoiding double taxation.

The structure we propose takes the concept of “attributed income” and generalizes it to all the income from the company and from other vehicles for passive capital allocation,³³ applying it without exception, whether the income has a domestic or foreign source. Moreover, we adopt Díaz de Sarralde and Garcimartín's (op. cit.) concept of global income with a unified base and we propose a single base—of business, labor and capital income—that does not consider notional (net) asset yields but

30 It should be noted that we have changed our proposal for the tax's design, considering that we have proposed the semi-dual model (Barreix and Roca, 2007), with the participation of Velayos, in various previous articles and reforms. The reason for the change is the same as the idea behind our previous proposals: to combine pragmatically the theoretical virtues of the design with the real possibilities of its implementation. Specifically, what sense did it make to propose a world income criterion when the close-to-zero exchange of information ensured it would fail in practice? Hence, at one time, we proposed the criterion of “strengthened territorial” income (see Barreix and Velayos, 2013). On the other hand, what sense did it make to propose the complete integration of business and personal income in times of banking secrecy for tax purposes and the “non-traceability” of savings yields, which caused most capital income to be exempted or given differential treatment? Thus in the past we proposed the semi-dual tax (schedular, but on all income). Note, finally, that the proposal to tax on an accrual basis goes beyond the comprehensive personal income tax, which opts to tax realized and received earnings. In all, we regard as valid the concept that is arguably attributable to Keynes: “... when my information changes, I alter my conclusions. What do you do, sir?” Moreover we comply rigorously with Montaigne's dictum: ... “I may indeed contradict myself ... but I never contradict the truth.”

31 In fact, several studies show that half of the retained earnings pending taxation are not invested in productive businesses but accumulate in investment companies—that is, saved in financial instruments. At the same time, there is evidence of vast evasion in withdrawals and dividends. Moreover, aside from the complexity of enforcement and oversight of the income distributed, earnings from business capital faced a much lower effective rate than the tax on labor income (Jorrat, op. cit.).

32 The authors distinguish imputed profitability for: 1) productive assets (goods assigned to economic activities); real estate and other leased assets; shareholder equity; and so on; and 2) non-productive assets (all capital in economically inactive holding companies, excluding main residence). They also subtract debts—to obtain net assets—and then a non-taxable minimum.

33 Hence we include income from other capital allocations, such as mutual funds and investment companies engaged in real estate and investments. This is perfectly possible; it would suffice to apply the “allocation” system to income from collective investment vehicles and even certain “insurance” models (that is, that the investment vehicles in each tax period calculate and impute for their shareholders the gains derived from the professional placement of the contributions—dividends, interest, and net capital gains).

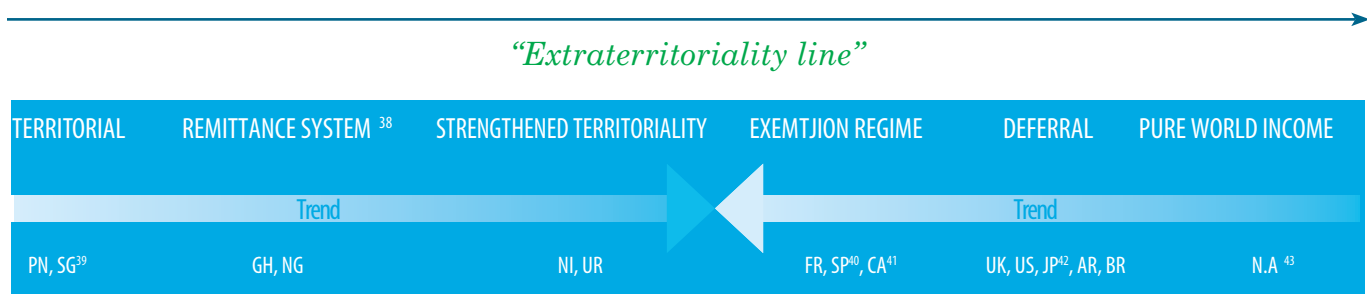
rather real income. In effect, we believe that taxing all income there is no need to tax net worth, which conceptually is the net flow of future income discounted by the time value of money and its corresponding risk.

Although the matter is not part of this study, it is important to acknowledge that a fitting complement to the tax design proposed herein is an appropriate tax on inheritance and bequests in order to offset, at least partially, the intergenerational injustice inherent in hereditary wealth.³⁴

Finally, as mentioned, the crucial development for the proposed design is progress on administration of the tax, giving it an international focus that is adapted to the circumstances of globalized (and worldwide) income. This originated in the resurgence of tax transparency, especially the (automatic) exchange of tax information and its basic requirements: the lifting of banking secrecy and identification of the beneficial owner, driven by growing international cooperation and its enforcement mechanisms.³⁵

While the theory is clear as regards the superiority of world income,³⁶ we have shown in previous studies³⁷ that world income is not applied in practice. Indeed, the concepts of territorial income and world income are still technically imprecise, in the sense that in reality two forms or models of taxation are not directly at odds with each other. Rather, we can say that the countries choose an à la carte menu of extraterritorial taxation in line with three key factors: (i) the type of income (from an economic activity or an equity investment—known as passive income) and the person obtaining it (a company or an individual); (ii) factors such as the tradition of taxation, the country’s economic model, the progress made by its tax administration; and, especially, (iii) the above-mentioned level of effective tax transparency at the world level. Hence, as can be seen below on the “spectrum” (Diagram 1, which deals only with business income), almost no model is strictly territorial and, most particularly, none to date has applied a pure and absolute tax on its residents’ total world income.

Diagram 1: Spectrum of Territoriality and World Income



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

Source: prepared by the authors on the basis of data from the IBFD Tax Research Platform.

³⁴ Of course we also regard property tax as valid (real estate and vehicles); it has a significant element of user charges and, in our judgment, it belongs to the municipal level.

³⁵ We should also mention other progress in the field of information technology, such as electronic invoicing, which has now been implemented in seven Latin American countries; and electronic receipt of payroll, which is in the process of being implemented in three jurisdictions. These are fundamental steps forward in tax control of domestic economic activity. It will also be very useful when there is international electronic invoicing, a control instrument with several applications such as review of transfer pricing and combating “missing trader” fraud in the VAT on exports between EU countries.

³⁶ There are several advantages to using world (or universal) income as a basis for taxation. First, it is a better reflection of the taxpayer’s economic capacity than is territorial income. Second, it makes it easier to calculate the taxable amount since it allows consideration of all deductible expenses and taxable earnings, irrespective of the jurisdiction in which these were generated. Finally, it automatically curbs the “race to the bottom” among jurisdictions, since any reduction in tax in the country where the income originated would entail a transfer of fiscal resources to the beneficial owners’ country of residence.

³⁷ See Barreix and Velayos, 2013.

In conclusion, if tax transparency were managed effectively, as has been agreed upon by a (significant) majority of the world's jurisdictions, there would be no administrative arguments to hamper the widespread application of the principles of world and global income.³⁸

Structure of the Personal Income Tax-Comprehensive and Accrual (PIT-CA)

The design of the proposed PIT-CA, which is presented in Diagram 2, is based on the following premises:

- The taxable person is the individual or nuclear family if national legislation so allows.³⁹ Company fiscal results⁴⁰ and capital income are included in the taxable base. With regard to non-resident taxpayers, there is no significant difference from the models currently in effect, in which the tax on income from companies owned by the taxpayer is definitive. A similar treatment will be applied to non-residents' other capital income (withheld payments).
- Given that all income, without exception, is included in the taxable amount, there is full integration—that is, the taxable base will cover labor, business and capital income, and tax payments made for such purposes will be credited, since they are regarded as advance payments on PIT-CA.
- The world income criterion is used, and thus an individual's taxable base includes all overseas income (a treatment similar to that mentioned in paragraphs 1 and 2 above), and all the taxes paid on such income are credited, including payments made to repatriate it.^{41, 42}
- In all cases the accrual accounting principle is used to determine income in the tax period, except for unrealized gains attendant on the increase in the value of real estate or other assets, stocks, patents and so on.^{43, 44}

38 With world income, taxpayers are taxed according to their residence and not according to the place where the income source is located. Global income proposes taxing all income, with no exemptions.

39 In relevant cases, the estate will be a taxable person until the heirs are determined.

40 We do not discriminate in the treatment of business activity—that is, all businesses are taxed independently of their legal nature, be they sole traders, partnerships or limited liability companies, or corporations. With regard to the latter, following Avi Yonah (2014), there are three views of the corporation: a) that deemed to be an artificial entity created by the State and its legal system; b) that regarded as a real entity, such as the individual, comprising persons (its human resources), and thus distinct from the State and its own shareholders; and c) the aggregate view that the only legitimate function of the corporation is to maximize its shareholders' profits. The latter of these is what we judge to be appropriate for tax purposes.

41 In this regard, the international tax framework could condition the proposal if the country had signed double taxation agreements (DTAs) with a very broad exemption method, or absolutely for certain incomes. In these cases, to tax this income it might be necessary to renegotiate the DTA. Nonetheless, BEPS action 6 (see item 5) makes provision for a quasi-definitive solution (in the future) by proposing a new paragraph in article 1 of the Model DTA, as follows: "3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under ..." and then lists a series of paragraphs and articles that should be safeguarded for technical reasons but that do not call into question the essence of the new addition—that is, that a State has full freedom to tax its residents' incomes (OECD, 2015).

42 Additionally, for a multilevel corporate structure, and given that in the tax period all income must be attributed to the individual shareholder, the problem of determining and acquiring information on this final income might be significant when companies use (accepted) methods of calculating income on a consolidated basis, thereby hampering assessment of the final value attributable to a shareholder of each company in the group. Nonetheless, the problem might be resolved: a) when the country-by-country reporting system has been refined; or b) simply because taxpayers are entitled to ask the companies in which they hold shares to provide the amount attributable to them. Finally, it bears repeating that the more refined and transparent the mechanisms used to present company information at the international level (not just for tax purposes), the simpler it will be to apply the PIT-CA. In this regard, initiatives such as the International Legal Entity Identifier System (<http://www.leiroc.org/>) is a step in the right direction, and could be complemented with other corporate information in the future. See also Section 5.5.

43 There is the possibility of considering separate baskets for domestic and foreign income. Similarly, pure capital income could also be divided between domestic and foreign earnings. In both cases, different arguments can be advanced, such as that of no compensation given the different nature or origin. These reasons might be legitimate in different cases, but they are not the purpose of this analysis.

44 In the case of investment vehicles that use the allocation method, certain income (such as the higher value of listed shares at the end of a tax period or the higher value of real estate, as long as they have not been realized) are not calculated at the moment of allocation, and this system should be retained. The same holds for an individual's direct investment. Moreover, there might be certain nuances in assessing the value of collective investment vehicles at the end of the period and, furthermore, some systems might not make provision for "allocation" in their tax regulations. Nonetheless, apart from the fact that it would be advisable to harmonize the means of calculating the taxable bases in order to avoid overtaxing or detaxing, the financial regulations governing collective investment vehicles establish the need to break down clearly the income sources during the period, such that it is not too hard for a shareholder to know what corresponds to "allocation" (interest, dividends or realized gains) and what does not.

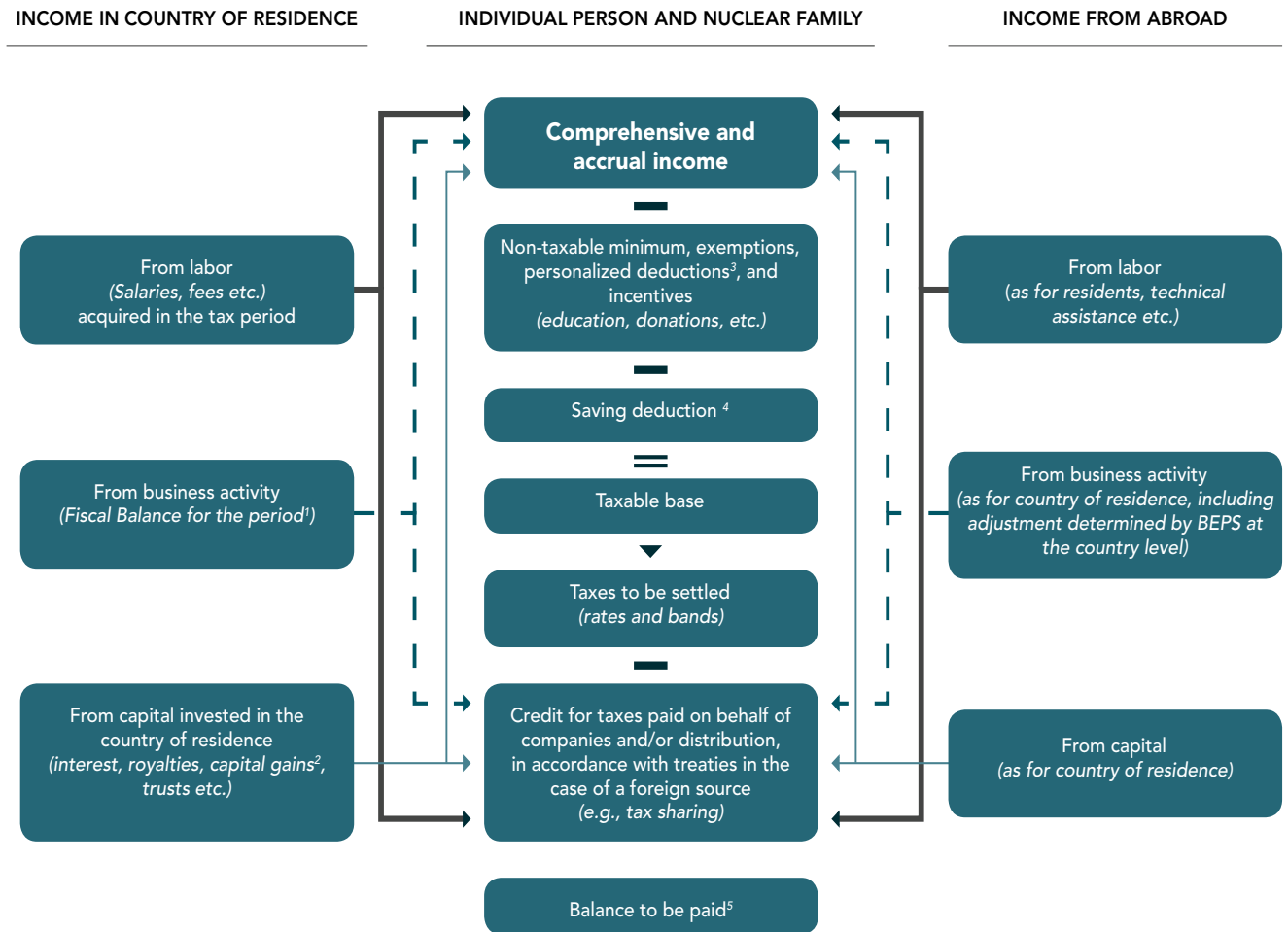
- In the case of companies, and as applicable, the criteria applied will be those contemplated in the recommendations of the Action Plan of the global project drawn up by the OECD with the support of the G20 and known as Base Erosion and Profit Shifting (BEPS). The goal of BEPS is to combat tax avoidance and curb the aggressive tax planning in which large multinationals currently engage; the outcome of such planning is a very significant saving on the companies' tax burden, to the detriment of emerging countries and, of course, developed countries as well. To this end it is crucial to ensure the continuous development of mechanisms for assessing income (development of the 15 actions, OECD 2015b) using country-by-country reporting.⁴⁵
- A deduction can be considered, or a credit for the purposes of progressivity, based on the taxpayer's domestic and/or international savings, with certain conditions and/or restrictions in light of the possible effects of income tax on decisions to postpone consumption. This deduction will be applied as a percentage of the taxable person's assessed savings, including retained earnings during the tax period. This can be taken into account in general and, especially, in the transition period, or considering the phases of the economic cycle, or under certain conditions that are particular to the regional and international context. Additionally, with certain limits and conditions, thought could be given to channeling savings to activities, sectors or regions (we will discuss the possibility of applying it in the section on efficiency).
- Thought could also be given to granting a facility for payment of the tax balance with a guarantee, with installment amounts and timeframes to be determined, for part of the domestic savings and, optionally, and that generated overseas. Again, this option is based on considerations of the implementation period but, above all, as a function of other conditions such as the stage of the economic cycle and/or personal or national economic circumstances.⁴⁶

The next section offers a comparative analysis of the PIT-CA and the models now in effect in terms of the characteristics that a tax system must have: sufficiency, neutrality, efficiency, horizontal and vertical equity, administrative and institutional viability, and the capacity to be coordinated with other jurisdictions.

⁴⁵ For a more detailed analysis of the substance of BEPS, see Barreix, Roca and Velayos (2016).

⁴⁶ Additionally, this mechanism mitigates one of the tax's main problems, the "minority shareholder problem": if a company decides not to allocate dividends in a given year, a minority shareholder (that is, one who cannot influence that decision) with little income apart from that dividend could face cash-flow difficulties in paying the tax derived from the company profits, which he or she has not yet received.

Diagram 2: Personal income tax-comprehensive and accrual, PIT-CA⁴⁷



47 1. Includes the corresponding adjustments—for example, company tax incentives, losses from previous periods, tax adjustments and so on. 2. Economic capital gains from the sale of assets (for example, businesses or shares, securities, personal and real property), taking account of the cost of acquisition and later investments, and as necessary the fiscal balances on which taxes were paid in previous tax periods, adjusted for inflation. 3. Deductions in line with national legislation. It is advisable to use the exemption from the bottom up method and/or zero-rated bands, including for the non-taxable minimum. 4. Possible deduction of savings (see the discussion in subsections 4.3 and 5.3). 5. Possible fiscal financing (see the discussion in subsections 4.3 and 5.3).

d. Main technical features of the PIT-CA

Sufficiency

In the years of the “Great Recession,” indebtedness grew very significantly in the more developed economies (Chart 4); five of every six countries has a fiscal deficit.⁴⁸ Hence there is a very clear need for more public resources in the world’s biggest economies. Every single LAC country had a fiscal deficit in 2015. Economic and fiscal conditions, which were in marked decline, have deteriorated sharply in many countries, especially in South America, with the end of the commodities “supercycle.” Moreover, most of the developed countries and a large number of the developing countries will experience a gradual ageing of their populations in the coming decades. Thus there will be pressure on public finances given the mounting expenditure on health care and pensions.

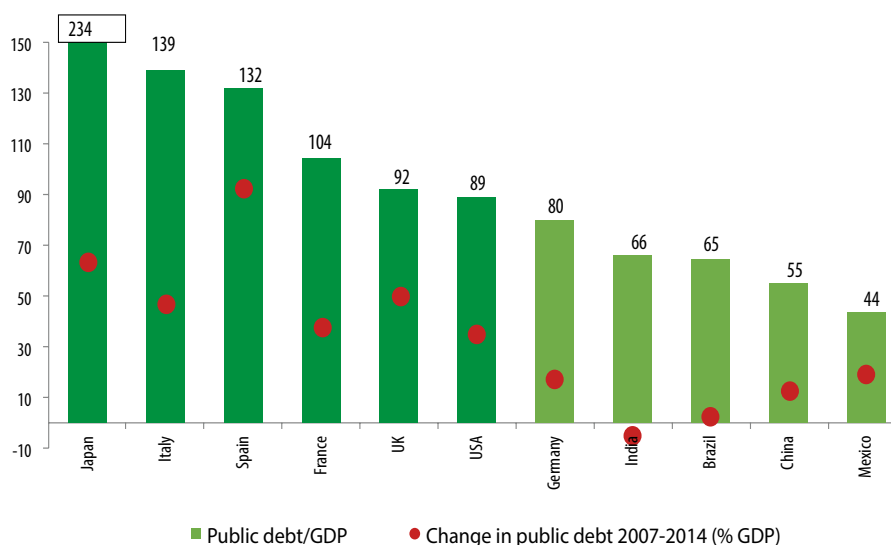
As a corollary, there is a need for a tax system that makes it possible to address these requirements in the future. In turn, the tax burden on salaries is very high, taking account of income tax and social security contributions: in the OECD countries it stood at an average of 36 percent of total wage costs in 2013–2014, and in LAC is stood at 21.7 percent in 2013.⁴⁹ In light of the above, an increase in fiscal pressure on other bases will be needed, especially taxes on business and capital income.

In this scenario the PIT-CA, by taxing all income on a single base, and for the accrual amount, has the greatest prospect of expanding the taxable base. The PIT-CA, moreover, does not grant rate reductions, as are almost universally conceded to pure capital income. Neither does it allow deferrals or exemptions conceded to income earned abroad through legal entities or investment vehicles.

Neutrality

Without question, the PIT-CA offers the greatest degree of neutrality among the models used to determine the tax. Indeed, its single taxable base applies to all income, irrespective of origin (domestic or foreign), type (capital, labor and even land rent), or originator (individuals or family units, legal entities or other “vehicles” of whatever kind).

Chart 4: Public debt (2014) and changes in public debt (2007–2014)



Source: McKinsey Global Institute (2015).

⁴⁸ OECD (2016). <https://data.oecd.org/gga/general-government-deficit.htm>.

⁴⁹ Taxing Wages 2014–2013 OECD (2015a) and Taxing Wages and Informality in Latin America and the Caribbean (2016). In the OECD the average personal income tax burden is 13.4 percent, while in LAC it is just 0.3 percent. This gap explains more than 90 percent of the difference between the two groups of countries.

Moreover, it uses the accrual method to determine both personal and corporate income, harmonizing the time unit of the income's creation and making it the same as the moment in which the economic benefit is realized.

Finally, all of a taxpayer's income is taxed with no exception and at the same rate because, as discussed earlier, income can run but it cannot hide (and without double taxation, because all domestic and international credits are recognized).⁵⁰

Efficiency

Although efficiency is a different concept and one that is more complex than neutrality,⁵¹ PIT-CA's almost complete neutrality establishes an a priori advantage over previous models in efficiency terms. The most contentious effect of personal income tax is its impact on savings, regarded as the quandary of whether to consume now or in the future. Since PIT-CA uses the concept of "attributed income," we also consider the effect on corporate savings.

The income tax models currently in effect are not neutral in their treatment of savings, neither over time nor for the different asset classes. It is also accepted that all income tax can affect savings decisions; this proposal is no exception.

PIT-CA, however, has some features which allow that effect to be attenuated. First, by including retained earnings, the expansion of the base can have a positive impact if it is matched by a rate reduction for the tax's global base. It could be argued, however, that the rates on capital returns rise, affecting savings. Nonetheless, questions have been raised about this in recent studies of the issue. For example, Yagan (2015) analyzed the significant dividend tax cut in the United States in 2003, using corporate tax returns from 1996 to 2008. He found no effect on investment or salaries. This implies that the cut in the rate would not have such a significant effect on the cost of capital and/or that the cost of capital would have less of an investment impact than expected. Therefore, taxing pure capital income at higher rates than the favorable rates prevailing in almost all countries—and assuming that those in the richest deciles receive dividends and capital earnings, which will be covered by the higher PIT-CA rates—will not have a substantial effect on investment, and therefore neither on corporate savings.

Additionally, the final rate to emerge from the combined application of the corporate income tax rate and the upper marginal rate of personal tax in the distribution of domestic profits to a resident reached a simple average of 49.1 percent in 2000 and 41 percent in 2011 for the countries of the OECD (2011). In the United States, Germany, France and the United Kingdom the rates surpassed 50 percent in 2011.⁵² This indicates that there is a possibility of expanding PIT-CA's base to include retained corporate earnings and, at the same time, reduce the tax's marginal rate without a loss in revenue. This is especially true given that the rates for capital income are significantly lower at about 19 percent (OECD, 2011), and that there is the substantial effect of foreign earnings that are untaxed, either because of the exemptions (territoriality) prevailing in the European Union or because of earnings that are not repatriated to the United States in order to avoid their being taxed. It is foreseeable, moreover (as discussed in the section on equity), that this situation will be positive for middle-class taxpayers, whose final effective taxation will be reduced with the lowering of the

50 Nonetheless, provision should be made for a preferential treatment for pension savings (see the EET system below). This is not only because it is an established tradition, but also because of the advantages of sufficiency (it would allow the subsequent taxing of income with greater generational precision), efficiency (it fosters savings and avoids "economic myopia"), and equity (labor income, or unfunded income would be the prime beneficiaries of this deferred treatment). Moreover, these people would be taxed less because it would be when their income declines as they retire, such that their "lifecycle" taxation would be balanced.

51 It is very difficult to measure all its effects, both with comparative statics and general equilibrium models.

52 Just for the purposes of comparison with the labor factor, in 2010 the average upper marginal rate of personal income tax on the salaries of single people in the OECD was similar at 41.5 percent.

marginal rate, to the detriment of those with large fortunes who inevitably will bear this tax that they can currently defer.

A second factor that makes it possible to moderate PIT-CA's effect is to grant a deduction, or a credit for greater progressivity, incentive for savings⁵³ (see Diagram 2) for business reinvestment and for deferral of personal consumption—for an increase in savings, including voluntary pensions savings.⁵⁴ This deduction could take various forms.⁵⁵ First, thought could be given to limits and restrictions that determine its basis as a percentage of net income or by type of income, whether capital or corporate earnings. Second, different conditions might be considered depending on whether the deduction for savings affects only those generated by domestic activities (incomes) or those from abroad.⁵⁶ Finally, specific benefits could be contemplated for priority sectors or regions in the country's development strategy.⁵⁷ It is important to note that this measure, a deduction for savings, is a possibility that requires more detailed study and, in particular, the characteristics of each jurisdiction must be kept in mind.

With regard to corporate savings, the key to avoiding a differential effect with prevailing models is to maintain the corporate income tax rate and PIT-CA's upper marginal rate within a relatively narrow range. If the upper marginal rate of personal income tax is significantly higher, application of the "attributed income," without the earnings for the period having been distributed, could cause a financial problem for the taxpayer (see footnote 53 in this regard).

Finally, as mentioned, the new form of settlement does not change the treatment of pensions or equivalent life insurance, whose special treatment⁵⁸ can continue. The tax also remains neutral of the taxpayer's occupation and payment arrangements, since this structure can be applied using backward (past) and forward (future) annual income averaging for an extraordinary income period.

Horizontal and vertical equity

With regard to horizontal equity, the PIT-CA has advantages over all of the previous structures because it taxes all forms of income—effectively applying the Haig-Simons definition—and treats them in the same way, especially as regards timing, using the accrual accounting method. Since the sum of all income is settled on a single basis, at the same time and without the privileges of differential rates for some kinds of income such as capital earnings, or of certain juridical or discriminatory practices arising from territoriality, taxpayers with the same incomes are effectively subject to the same tax treatment.⁵⁹

53 In some way an effort made to attenuate the double taxation imputed by Fischer (1942), which drove consumption and leisure at the cost of savings, work, and business initiative.

54 This credit could bring the PIT-CA close to Kaldor's (1955) progressive tax on spending (consumption); Kaldor argued that this tax better reflected taxpaying capacity than did income tax. Nonetheless, it is clear that consumption, whether the taxpayer is a saver or a spendthrift, does not reflect capacity to pay. Kaldor's contention that society prefers those who contribute wealth over those who withdraw it does not change the argument. More important is that a tax on spending is regressive because the exemption of savings favors the rich, who are better placed to save. The author's argument in favor of using very progressive taxes on spending does not resolve this criticism. The tax has merit, however, inasmuch as it is a very effective means of controlling inflation. Similarly, it is evident that it does not have the automatic stabilizing power of income tax, a feature that is strengthened in the PIT-CA with the management of credit for saving in the different phases of the cycle.

55 There could even be a credit instead of a deduction to foster progressivity.

56 Careful in this case that the configuration of the deduction does not cause the kind of discrimination that might contravene the country's international commitments, such as World Trade Organization (WTO) agreements, or most especially in an economic union or other agreements on free capital movements.

57 See previous footnote.

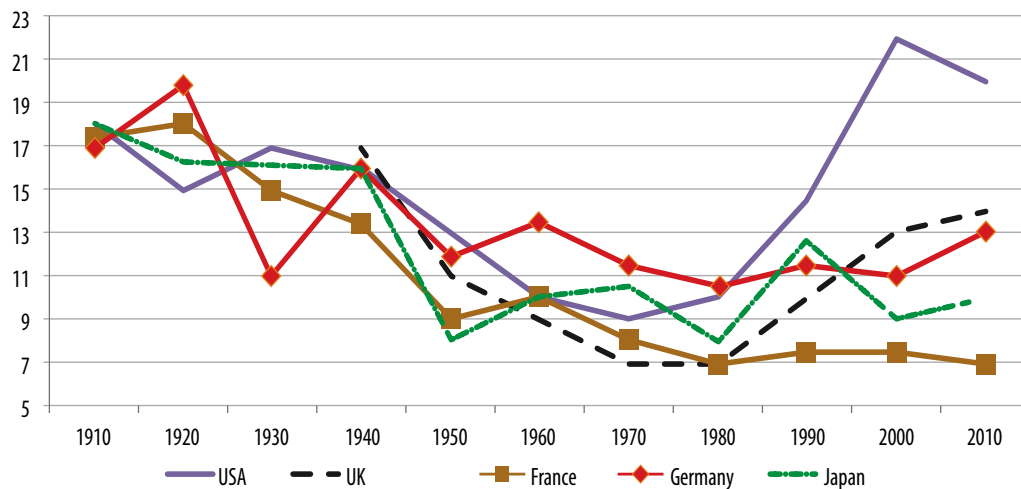
58 In general the treatment is EET: i) exempted through the income tax deduction for pension fund contributions, with certain limits; ii) exempted the yield on those funds' investments; and iii) taxed when the payments become effective in the withdrawal period.

59 It is worth recalling that, in light of the increase in marginal rates during the first 20 years in which income tax became widespread, in the 1940s, the tax became replete with exemptions and deductions in an effort to avoid possible negative effects on savings, labor supply and venture capital. The constant use and abuse of personal income tax exemptions—for social "externalities" (education, donations and so on), and to "foster savings" (from the use of housing to investments that were of strategic priority), plus "investment incentives" in corporate income tax (from tax holidays to various deductions)—distorted the broad Haig-Simons definition of income. Consequently, the tax's horizontal and vertical equity, and especially its simplicity, were also tainted (Barreix and Roca, 2010). This situation persists to this day, albeit tempered by flat and dual designs, though it cannot be attributed to the structures of the tax but rather to its non-adaptation to reality.

With regard to vertical equity, it is complicated to compare a not fully defined proposal with the alternatives in, at least, four different schemes: comprehensive, flat, dual and semi-dual. It is valid, however, to consider the need to encourage taxes that help improve income distribution, especially given the trend towards and future outlook of an increase in inequality.

Recent studies have identified a trend, especially in the past 35 years, towards the concentration of income, as shown in Chart 5. This has been accompanied by a tendency towards the concentration of ownership, except for the period between the First World War and the 1980s. Indeed, in his seminal historical and statistical analysis of two and a half centuries of wealth concentration and its geographic distribution, Piketty (2014) argues that when capital's average rate of yield grows faster than the economy, inequality increases. To obviate this tendency inherent in the capitalist process, which brings with it a social rupture, he proposes very progressive taxes on income and also on property, though the latter is technically more controversial and complex.

Chart 5: Income share of the 1% richest - Selected countries (% of GDP)



Source: Alvaredo, Atkinson, Piketty and Saez (2013).

* United States includes capital gains. Germany includes capital gains since 1950, and Japan since 1947.

the growth of the middle classes in various developing countries, it has also affected them in developed countries because of the overseas outsourcing of some activities, especially low-technology undertakings. Indeed, recent policies to mitigate the effects of the Great Recession that began with the 2008 financial crisis⁶⁰ have concentrated income yet further in the developed countries. The bailout of the financial sector entailed lending at unusually low long-term rates (quantitative easing), which drove stock market growth (global asset bubble) and favored a deleveraging of companies' debt burden, thereby doubling their owners' wealth.⁶¹ In the United States, for example,

Additionally, governments' reaction to globalization has been to grant generous tax incentives to attract and retain (fear of flight) investments, especially by multinational or multiregional enterprises, which are crucial economic agents in corporate capital mobility (Tanzi, 2000). These policies amplify the concentrating potential of income and wealth to the international level.

Although globalization has favored

60 Forty years after the collapse of the Bretton Woods system (1968–1971), which entailed the abandonment of fixed exchange rates and the conversion of monetary authorities as fiduciary ones, with the potential to print money without backing.

61 Additionally, the Great Recession followed the 2008 financial crisis with its weak and parsimonious level of activity, which had little effect on the recovery of jobs and incomes. Hence extended periods of unemployment, or the very low wages of temporary jobs, are driving consideration of a minimum income (or a negative income tax).

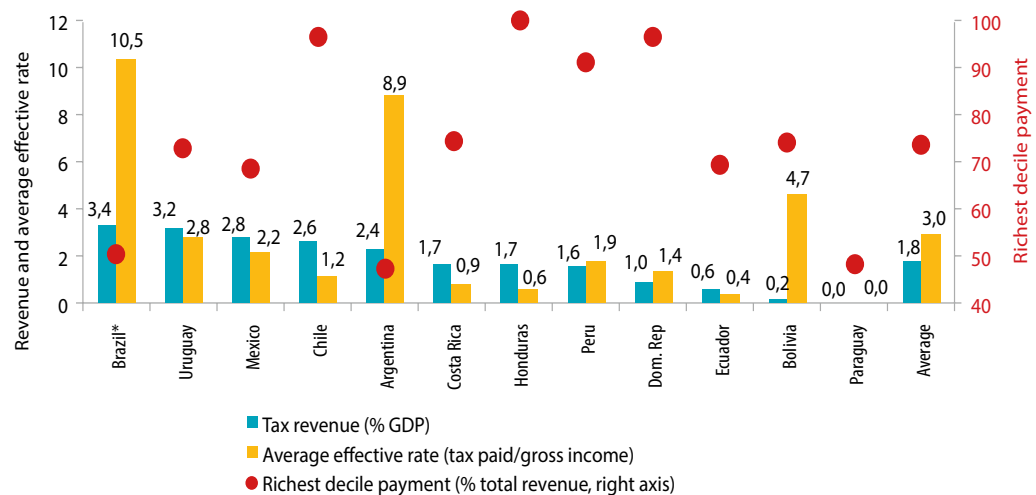
the wealth of the three richest percentiles (total) increased from 51.8 percent in 2007 (before the financial crisis) to 54.4 percent in 2013, while the average family's income fell by 5 percent and its wealth by 2 percent.^{62, 63}

Additionally, the synergy between technology and globalization is changing the way in which work is done and poses the risk of increasing job insecurity, especially for those with a modest level of education, thereby contributing to the increase in inequality. In LAC the situation is even more complicated: the combination of low productivity and informality is conducive to keeping workers in poverty. As a corollary, the structural inequality in LAC societies is consolidated. To help counteract this trend, LAC countries must strengthen personal income tax, whose revenue levels and effective burdens are distressingly low at the moment (see Chart 6), so as to increase the resources available for social infrastructure and enhance the redistributive impact.

That said, obviously it should be stressed that the phenomenon of inequality is extremely complex, and efforts to address it cannot be confined to tax policy, nor even to fiscal policy,⁶⁴ without taking account of income, labor, competitiveness, social and other policies. Moreover, political economy constraints must be kept in mind, and it is worth pausing here to consider them.

The influence of capital mobility is evident in political economy models. A pertinent example is its consideration as an additional condition to the median voter theorem, which posits that the vote of the majority will coincide, under certain premises, with that of the median voter. This additional condition argues that the richest sectors of a society avoid taxes⁶⁵ and confiscation by means of capital flight, and thus the democratic process avoids opposition from a powerful pressure group while at the same time achieving the coexistence of formal democracy with tax regressiveness (Mahon, 2016). This process is clear in developing countries, which have very limited revenue-raising capacity. In the developed countries, for their part, efforts have been made

Chart 6: Personal Income Tax: Revenue, effective rate and share of revenue from the richest decile, selected LAC countries, 2013



Source: Barreix, Benítez and Pecho (2016).

* Brazil's income distribution was determined on the basis of minimum wages and not ordered by deciles.

62 The 20 percent richest owned 45 percent of the total wealth in 1989 (Board of Governors of the Federal Reserve System, 2013 Survey of Consumer Finances. <http://www.federalreserve.gov/econresdata/scf/scfindex.htm>).

63 It should also be recorded that while the richest percentile's share of personal income tax revenue grew from 19 percent of the total take in 1980 to 38 percent in 2012, its share of income grew by significantly more, from 8.5 percent in 1980 to 22 percent in 2012, indicating lower average effective rates (<https://www.irs.gov/pub/irs-soi/soi-a-ints-id1506.pdf>).

64 Several empirical studies have underlined the redistributive superiority of public spending, especially social spending, but it is a mistake to underestimate the redistributive potential of taxes given their double impact: direct—taxing those with greater payment capacity proportionally more; and indirect—as a source of financing for progressive and redistributive public spending. In this regard, see the IDB's series of tax equity studies: Barreix, A., Roca, J. and Villela, L. (2006); Barreix, A., Bès, M. and Roca, J. (2009); and IDB (2010); and more recently, Lustig (2015).

65 They also avoid progressive taxes on their income and wealth, pressing for their replacement by taxes on consumption or the labor factor, urging incentives to savings and investment, using avoidance mechanisms and, in the absence of a good tax administration, opting for direct evasion.

to strengthen their institutional advantage in acquiring resources and maintaining levels of welfare spending by means of the tax transparency process that began in 2008.

In parallel, a cultural perception takes hold that the informational asymmetry stemming from international tax opacity leads to inequality of treatment among citizens. Lower-income taxpayers—who in the advanced economies are bearing the brunt of austerity policies in the wake of the 2008 financial crisis, and in the developing countries are suffering the demand adjustments attendant on the recent fall in commodity prices—are affected by personal income tax, social security contributions, and all indirect taxes. Hence the wealthiest, with professional advisers and access to opaque jurisdictions, can reduce or hide their assets and income—which, it is even suspected, were not acquired licitly. The lack of fiscal transparency, therefore, raises questions about the justness of the open market economy, and about the competence of democracy itself to address structural inequality.

Let us now consider the other prime feature of the political economy, which simultaneously complements and competes with the median voter theorem: the fiscal covenant (ECLAC, 2015). The Social Contract approach (fiscal covenant) argues that governments can levy taxes if taxpayers trust that they will be compensated with the provision of a public good (in the broad sense). This compensation for taxation, which operates in a similar way to the benefit principle, may be direct (from a subsidy to a specific good or service) or indirect (such as the security of property rights, or the national satisfaction of eliminating illiteracy). This agreement with or consent to taxation on the part of the citizenry and power groups poses two important problems. The first is to arrive at a common perception of how “compensatory” public goods are defined; and the second is the country’s administrative (institutional) capacity to provide them adequately and to raise revenue effectively. That said, it is likely that globalization has diluted or blurred the national objectives that define a mix of public goods on which there is consensus, in view of social or foreign-policy crises, and thus there has been a break in the links (common interests) between the groups that craft the covenants (social contract) forming a core of political-cultural values which normally involve a fiscal component.⁶⁶

In this complex scenario, the PIT-CA is better placed than current income tax models to tackle the problem of growing inequality. In fact, PIT-CA’s taxable base will be broader since it will tax all income: not only labor income but also capital income (now traceable because of interjurisdictional agreements and technological advances), and not only domestic earnings but also those from abroad (which will also be known). These changes will surely have an impact on the higher-income sectors, which are those that account for most capital income and overseas earnings. Additionally, the PIT-CA will tax accrued income, which similarly can be surmised to affect the higher-income sectors: those that can most easily defer the realization of gains because of their economic power and their capacity to arrange avoidance or evasion strategies.

Simplicity, administrative-institutional viability, and “coordinability” in the PIT-CA

Given that it is almost impossible to assess objectively a tax system’s desirable property of simplicity, especially for income tax, we will discuss its viability and “coordinability.”

The Chile reform was harshly criticized for making provision for the application of “attributed income” at the national level, which is one of the pillars of the PIT-CA. It was argued that it was administratively difficult (impossible, according to its detractors) to settle the tax because of the complexity of assessing income in interrelated companies and/or because it is hard to trace the income and, moreover, because of its expression in fiscal values. This argument is easily rebutted. Given that

66 Examples of this range from the Constitution of the United States, the first modern representative democracy, which agreed in the fiscal arena that there would be no taxation without representation, to Spain’s Moncloa Pacts for the consolidation of democracy and accession to the European Union, in which it was agreed to increase the tax burden (and improve tax administration), among other measures.

tax laws in almost all jurisdictions tend to be virtually identical to international accounting standards, an inability to settle the tax in a reasonable time would suggest that taxpayers are incapable of determining their income—that is, how much was earned or lost, in what and where. In essence, such taxpayers are incapable of managing their assets.

It is truly hard to credit, well into the twenty-first century, that a tax cannot be settled, not only because of the arsenal of information technology within everybody's reach, but also the available army of accounting, tax and financial advisers. Moreover, in that case how do we justify the huge development of global personal banking and financial consultancy firms, including via the web? Or the success of private equity funds and family offices, which have existed for more than 100 years since the first was created for the Rockefeller family? The weakness of the argument is inversely proportional to the resistance that such entities mount to income tax, especially to a global tax.

A similar response applies to the purported complexity of implementing BEPS at the company level. The argument is the same, with the aggravating factor that the means of settling corporate income tax has not altered substantially in more than a century. If multinational companies and global funds cannot settle their taxes and report that to their owners, how can they grow, and do so without appraising their returns and assets, without assessing their performance and future outlook in each country? Similarly, the worldwide expansion of accounting consultancy and portfolio management firms would be a nonsense. This explains their resistance to BEPS. It seems unreasonable to believe that a tax that worked when the world barely had electricity cannot be administered when the submission of electronic tax returns is becoming mandatory.

Nonetheless, it is clear that neither BEPS nor the PIT-CA will be easy to implement, and that there will be mistakes and approximate solutions. Indeed, the very proposal of BEPS has spurred discussions because of the new income-allocation alternatives that are consequent on its future implementation.⁶⁷ Transparency levels the playing field for tax administrations in dealing with multinational companies (their advisers and owners), in terms of the informational asymmetry advantages that globalization confers on the latter. Moreover, this is a goal of the social sciences, especially accounting, which seek to reflect and understand reality with the greatest possible precision.

In all, replacing the models currently in force with the proposed arrangement could save **i)** the huge costs of (non-)compliance attendant on tax gimmicks, including the armies of advisers; **ii)** the tax administrations' oversight costs; and **iii)** perhaps the biggest cost, which stems from political economy: the perception of an unfair tax system in a modern economy.

A second matter in an analysis of the proposal's viability is the (international) institutional arrangements needed to apply it. There are successful, albeit imperfect, experiences of international cooperation in this field, such as the institutional framework for trade liberalization with the support of multilateral agreements. In practice, those agreements were also tax accords inasmuch as they involved replacing tariffs with VAT, for the most part, and excise taxes. The various negotiating "rounds," from the first General Agreement on Tariffs and Trade (GATT) round in Geneva in 1947 to the current WTO round, comprise the institutional framework for the enforcement of the agreements,

⁶⁷ As an example, we can cite the important discussion that has been prompted by the future implementation of BEPS, which will make it possible for the authorities to better assess global income and better approximate the income that corresponds to each jurisdiction. This has spurred a discussion about the allocation formulas used to divide income among the countries in which the multinational operates—specifically, the discussion about the use of formulary apportionment for the multinational's unitary taxation, as against the arm's length principle. This discussion involves academics (Picciotto, 2012), professionals (Spencer, 2014), multilaterals (IMF, 2014) and social organizations (Tax Justice Network, 2013), among others.

which govern matters ranging from complaints to the imposition of sanctions for non-compliance, and which have proven legal certainty.⁶⁸

In short, countries pledge to enforce trade rules that have caused (and cause) friction, not only among the countries themselves but also among companies and civil society groups. There has been compliance with these rules because of a large dose of cooperation, expressed in negotiations that take a long-term view. Moreover, the regulations in these international fora affect areas such as income tax in export processing zones, environmental legislation, and customs administration, involving the use of instruments and the enforcement of practices in constant flux.

In the case of tax transparency, the exchange of information and now BEPS, the G20 and OECD countries are clearly the pioneers. Nonetheless, experience seems to show that success in this first group can further the democratization of the process so as to catalyze and consolidate future developments more deeply and in more jurisdictions. We also believe that multilateral, bilateral and non-governmental organizations should support this process, led today by the OECD. All these stakeholders necessarily will have to cooperate in order to confront the aforementioned powerful interests, and resolve the formidable technical complexities of implementing tax clarity.

In that respect, we consider it vital to support the Global Forum on Transparency and Exchange of Information for Tax Purposes, so as to: i) foster effective automatic exchange among all jurisdictions, giving impetus to a participative process that ranges from regulations to technical assistance for enforcing such regulations with the greatest legal certainty; ii) ensure that the automatic exchange of information covers all income, be it corporate, capital or labor income; and iii) make ownership transparent up to the ultimate beneficial owner (UBO).

There are various means of meeting this basic objective. Our preference is that national registries demand that all registered entities, on pain of severe penalties, report on the entire ownership chain up to the ultimate beneficial owners. This would enable each jurisdiction, in consultation with a second jurisdiction (or more if deemed necessary), to verify the real ownership sequence in much shorter timeframes. This procedure was adopted by the Global Forum (Tax Transparency, 2015) in October 2015 and is similar to that recommended by the Financial Action Task Force (FATF) to foster the implementation and continuous enhancement of policies to combat money laundering and the financing of terrorism. As a complement, a global public registry could be created, building on the achievements of LEIROC (www.leiroc.org) and viewing its mandatory updating as part of the standard of transparency.⁶⁹

Moreover, and particularly important, the worldwide drive to accord primacy to transparency through the traceability of income and assets flows will have crucial positive externalities in other areas of the rule of law. It will be easier, for example, to reveal and avoid commercial fraud, or corruption in public procurement, among other matters. Thus, for example, it will be increasingly easy to uncover criminal activities (drugs trafficking, people smuggling, and so on), commercial and personal fraud, or corruption in public procurement, among other illicit activities. There is evidence of success in this respect: thousands of cases as a result of the disclosure of bank accounts in tax havens, financial centers and opaque jurisdictions, and the pursuit of those involved in unjustified enrichment and/or the use of dummy companies or strawman; such efforts will be strengthened when the ultimate

68 According to the WTO, this first negotiating round gave rise to a series of trade rules and 45,000 tariff concessions that affected about a fifth of world trade (totaling US\$10 billion). When the agreement was signed on October 30, 1947, the group had expanded to 23 members. The tariff concessions came into effect on June 30, 1948 through the Protocol of Provisional Application. The new General Agreement on Tariffs and Trade was thereby born, with 23 contracting parties (founding members). Today the WTO, which was institutionalized in 1995, has 162 members that account for 99 percent of world trade.

69 Garcia Andres (2016) quotes the following: "...Zucman proposes the creation of a world financial register in which, initially, all company shareholders would appear, so as to be able to determine where profits are generated and where taxes should be paid ... To be effective, such a project must also impose an obligation to inform companies and other legal entities of the identity of the beneficial owners."

beneficial owner is known. It should not be forgotten, however, that tax transparency and the other instruments mentioned do not replace but complement the indispensable factors: competent police forces and effective judicial systems.

Finally, to foster a country's competitive insertion, the desirable characteristics of its tax system—sufficiency, efficiency, equity and simplicity—should be complemented by coordinating capacity (“coordinability”) with the country's trade partners (Barreix and Villela, 2005). The PIT-CA doubtless has a huge head start on any of the traditional income tax structures (synthetic, flat, dual or semi-dual): it not only avoids double taxation, but also prevents non-taxation. To go a little further, the PIT-CA's clear advantage lies in its “coordinability”: its design makes it a tax with universal application, which facilitates convergence towards a determination of the common taxable base, and makes it easier to acquire information that is increasingly broad and standardized.

e. The Role of Corporate Income Tax in the PIT-CA Scheme

Abolish or uphold corporate income tax?

There have been discussion since the 1990s as to whether corporate income tax would survive as a tax or as a mere advance on personal taxation. Today, there are diametrically opposed positions on the existence of corporate income tax. On the one hand, the main arguments for eliminating it in the United States have been summarized by Gordon (2014). He argues that the poor structure of double taxation (corporate income tax and dividends in personal income tax) has meant: i) that senior management pays more attention to after-tax profits than to productivity (the stock market perspective); and ii) that certain industries receive privileged treatment (crony capitalism), making the tax highly complex. This structure, which raises the cost of repatriating profits, has led to the retention of almost US\$2.5 trillion abroad, avoiding tax by means of aggressive tax planning that is tolerated, and sometimes favored, by the jurisdictions themselves.⁷⁰ According to Spencer (2014), abolition would entail a short-term impetus to investment and a company's value because of the perception of future gains that would be generated in the United States and in other countries, which would be obliged to reduce or eliminate their corporate income tax. Many of these problems, however, are specific to the design of the (high) US tax on income bears double taxation at corporate and personal level with no relief.

On the other hand, the Tax Justice Network (TJN, 2013a) gives 10 reasons to strengthen corporate income tax. A central part of its arguments refers to sufficiency and the difficulties of replacing it, especially in developing countries. Moreover, the TJN maintains that the cuts to corporate income tax will not end with a zero tax, but rather will continue until they are subsidies provoked by tax wars. It is also true that revenue from corporate income tax has been losing importance for more than half a century relative to other taxes, but its share is by no means negligible and the PIT-CA design can restore its potential. Most of the opponents of corporate income tax suggest replacing it with general sales taxes, which would completely change its outlook in terms of efficiency, equity and administration; that debate is beyond the scope of this article.

70 For more information, see Barreix, Roca and Velayos (2016). As examples, see the following files on state aid available on the European Commission website: Apple case, state aid SA.38373 (2014/C); or Starbucks case, state aid SA.38374 (2014/C). Finally, those interested can also visit the following site to analyze the “LuxLeaks” affair in greater depth: http://www.icij.org/project/luxembourg-leaks?utm_campaign=lux_release&utm_source=email&utm_medium=button_middle&mc_cid=28019c7941&mc_eid=80ffe22bbd or <https://es.noticias.yahoo.com/la-ue-estima-ilegal-el-r%C3%A9gimen-exoneraci%C3%B3n-fiscal-111512708.html>.

Additionally, corporate income tax acts as an offset for public services received, especially in the case of foreign-owned businesses, and for residents it serves as an advance on the PIT-CA.

Finally, as the TJN states, corporate income tax cuts and special regimes have global effects. This is very clear in light of the well-known negative impact of tax havens—for both tax evasion and other criminal purposes—and outdated incentives such as the recent push for new “resident-non-domiciled” regimes, especially in Europe. This is an incentive for new (or repatriate) residents that allows them, for a given number of years, not to pay tax on labor and capital income acquired and retained abroad.⁷¹

According to the TJN, corporate income tax fosters transparency in corporate governance, recording the sequence of returns as well as the economic and financial circumstances of companies and their owners. Furthermore, Avi-Yonah (2004) argues that corporate income tax in the United States, since it was introduced in 1909, has served to regulate large companies, monopolistic or with extensive market power, engaged in the fuels, steel and railway sectors, a regulating function that persists to this day.

As regards equity, the TJN argues that the corporate income tax favors redistribution since it falls on higher-income residents and, moreover, the revenue from it can finance pro-poor public services such as health care and education. The TJN maintains, moreover, that democracy is thereby protected. Above all, it should be noted that the argument about public expenditure is valid, as long as such spending is well designed and sufficiently provisioned, which is not always the case (see footnote 70). But the problem is much more complicated in terms of the incidence of corporate income tax and, therefore, of the tax's equity.

Harberger's (1962) erstwhile dominant incidence model established that in an open economy a local tax cannot affect the return on capital if there is perfect international capital mobility. Neither can it change the prices of tradable goods, because prices are set by international markets if there is free trade. In principle, income tax tends to reduce capital's rate of return, but since this is set at the international level, the adjustment variable is the capital stock. Because of the lower capital stock, its marginal productivity increases but that of labor falls, and, consequently, wages fall. As a corollary, labor bears most of the burden, although this also depends on elasticities (the elasticities of substitution between capital and labor in production, and elasticities of consumption between the goods produced).

Nonetheless, Harris (2009) shows that for the United States, under almost any reasonable assumption of incidence, its impact on income distribution is progressive because capital income is basically received by higher-income groups. Additionally, Gravelle and Smetters (2006) show that when substitution in consumption between national and imported products is imperfect (because of product differentiation or for technological reasons, for example) corporate income tax does not fall entirely on the local labor force but is largely transferred to the rest of the world. In all, a conclusion on the incidence of corporate income tax is beyond the scope of this study, and it should be acknowledged that changing world conditions call for continuous research efforts.

71 In England there have been regimes for people with non-domiciled status (“non-doms”) since the Napoleonic era, to protect exiles with property abroad during times of war, but in this century the schemes have been expanded to cover other high net worth residents under certain conditions. There have been similar schemes in Switzerland (“forfait”) for more than a century and a half, in Monaco, and in France (“impatriation”), whereby those returning to the country are allowed to keep their global income beyond the scope of the tax during the first five years. Hong Kong also offers an inducement to very wealthy individuals by allowing them to bring in their overseas income at a reduced rate (15 percent).

Finally, as regards simplicity, since its nineteenth-century inception, corporate income tax's structure of difference between income and spending has not changed substantially. While there have been occasional changes, such as thin capitalization rules, transfer pricing or adjustments for inflation, there have been no significant changes to the structure of the tax.⁷² Indeed, BEPS will be the most important change in the tax's history, given the chain of possible adjustments entailed, but this too is unlikely to affect its structure.⁷³ A world that has made great progress on economic integration and information technologies must and can tackle greater complexities in taxation and deal with new tax designs, such as the one proposed herein. Indeed, all countries, to a greater or lesser extent, have provisions geared to encouraging companies to engage in new undertakings that favor certain actions of benefit to society,⁷⁴ from employment through investment and research to local development. This leads us to consider the role of incentives in corporate income tax from the perspective of the PIT-CA.

Incentives in corporate income tax with a design under review

Differences in terms of infrastructural endowments and/or particular historical factors bring about a concentration of production, and therefore create agglomeration economies that benefit companies located in certain countries or regions. They also induce heterogeneity in the structure and production dynamics of countries and regions (Laurent et al., 2010). Hence the most recent literature recognizes three types of motives for subsidizing investment. The first two are obvious: compensation for market failures in access to financing, and regional disparities in the endowment of resources not subject to free movement. As a third factor justifying investment subsidies, other studies emphasize the need to compensate those regions beset by institutional weaknesses (Porto and Vallarino, 2014).⁷⁵

The effectiveness of corporate income tax incentives to attract investments, foster innovation or promote other social goals (employment, local development and so on) is not wholly proven (Artana and Templado, 2012; Bolnick, 2004; Clark, 2007; and James, 2009). It has been shown, however, that they lead to a reduction in the effective tax rate and in the revenue raised. As seen above, trade and financial integration⁷⁶ among developed countries imposed competition in the form of corporate income tax rates, which have fallen by almost half in a quarter of a century.⁷⁷ In the developing countries, for their part, incentives have operated mostly on the taxable base of the corporate income tax, from tax holidays to free zones, and including sectoral, regional or cross-cutting incentives (research and development, the environment and so on). Again, there have been few assessments of their effectiveness, but inevitably they have favored evasion in Latin America by up to 52 percent (Barreix, Garcimartín and Velayos, 2013).

Besides this discussion of cost-effectiveness, it is hard for the political economy to encourage the elimination of incentives in corporate income tax. Additionally, current legislation gives primacy to exemption of repatriated business income (territorial regime) and deferral that shelters profits abroad, or payment of the tax is obviated by means of various avoidance techniques (tax inversion, hybrid instruments between parent and subsidiary companies, the complicity of local authorities and

72 There are also what are termed "minimum income taxes," which require payment in line with assets, gross income or cash flow (Mexico's IETU) but that, apart from few exceptions such as Guatemala and Belize, do not seek to replace corporate income tax but rather to mitigate the oversight failings of the administrations that have to manage them. Indeed, in the two countries mentioned, they are actually converted into other kinds of taxes: those on gross income.

73 It is possible that the major one consists of possible settlement on operating profitability and not on traditional net profitability, much like the system used for supplementary taxes on natural resources (in Chile and Peru, for example).

74 There are far fewer disincentives to activity (for example, not accepting deductions for purchases from informal sources) or limits on certain forms of spending (such as capitalization rules or overseas spending, especially in jurisdictions with low or no taxation).

75 A fourth factor may be added: meeting strategic objectives, a consideration that is not purely economic.

76 Including more open legislation in the area of international mergers and acquisitions.

77 There are exceptions such as the United States, where the rates (federal and state level together) have not fallen since the reforms of the 1980s and early 1990s, although there have been reductions in capital gains.

so on). All of this points to an ominous future for the neutrality and horizontal equity of corporate income tax, as well as its yield, if transparency is not made to prevail.

The PIT-CA's design has significant implications for incentives:

- Since the PIT-CA taxes the investor's global income, tax relief directly benefits the investor's country of residence. For non-residents the corporate income tax is a definitive tax in the source country, which will be determined more precisely through BEPS by jurisdiction. It should be recalled that current legislation gives beneficial treatment to income earned abroad.
- With the loss of the tax advantage for the foreign investor to the benefit of his jurisdiction of residence, the corporate income tax's incentives are simply a transfer between tax jurisdictions, thus giving the source country a reason to offer tax relief only when warranted—for example, if there is a tax sparing clause in a treaty.⁷⁸
- By encouraging countries to collect corporate income tax and to cease the “race to the bottom” in the form of rate reductions or base exemptions, the PIT-CA promotes international cooperation, including the revitalization of tax sparing. In effect, the authorities in the resident's jurisdiction will now know clearly which country is its partner in the creation of resources through the tax, and the host country of the investment will be able to identify the beneficial owner of the investment and where that owner pays tax.

Additionally, it is worth offering some thoughts on abusive practices and aggressive tax planning by multinational firms and their relationship with the PIT-CA. In a world with reasonable sources of financing but scant business capacity, multinational firms are to be welcomed. They operate with cutting-edge technical know-how and skilled personnel from various cultures, and in the future they will probably be unassociated with a particular country. While it is logical that they will seek market power and profits, including a reduction in their tax obligations, they are not justified in engaging in abusive practices of avoidance and evasion, in settings marked by the administrative incapacity of some jurisdictions and/or the complicity—by means of opaque gimmicks—of others. In this context the PIT-CA, with its generalized application and effectiveness of oversight, has the advantage of rendering moot a company's aggressive tax practices or avoidance schemes, given that any greater pre-tax profit would be transferred to a higher PIT-CA to be paid that year in the location of the individual shareholder.

The multinational company, moreover, would not be able to conceal profits (what we can term avoidance-oriented accounting practices). In effect, if this is done at the local level, the misalignment between the country-by-country report and consolidated corporate analysis would disclose such practices. If it is done at the consolidated level, it would clash with the ultimate goal of the shareholder and the board: to be profitable.

Finally, though it could be argued that the PIT-CA would transfer tax competition (in a kind of race to the bottom) from corporate taxation to personal taxation, it must be said that well assessed corporate income tax in the source country protects the latter's tax revenues. This tax model, moreover, makes it possible to determine clearly who benefits from the tax relief and by how much, at the level of the individual (resident) beneficial owner of the income and the level of the company's taxable earnings (in the host country), and of the two tax jurisdictions involved. Furthermore, this new design makes it possible to identify the contribution made to activity, investment and national savings by every taxpayer, company and individual—resident and non-resident—in the jurisdiction. Hence, the country can determine the tax treatment to be afforded to every one of these actors in line with its

⁷⁸ Tax treaties can include “tax sparing,” whereby the benefits granted in the source country are recognized for tax purposes in the investor's country of residence. If we add to this the application of BEPS by jurisdiction, there is a better allocation of resources, through lower rates of evasion and avoidance that ensure more transparent tax competition.

economic policy priorities relative to its national goals, the advantages and services that the country offers in a competitive environment, and the political economy process that determines every fiscal incentive.

f: Conclusion

The income tax system has endured for more than 200 years and has been marked by its adaptation to cultural, economic, political and social changes. Since its modern inception a century ago, it has become the leading source of revenue in history. The consolidation of worldwide economic liberalization in the past three decades has spurred new income tax designs that now coexist. With the onset of the twenty-first century, however, significant advances in information technology have conjoined with the drive for tax transparency, the result of the 2008 financial crisis and the Great Recession that came in its wake in the developed economies, thereby spawning a new international context. Income tax cannot stand apart from these circumstances, which are now being changed by the automatic exchange of information and the implementation of BEPS. For that reason we propose a personal income tax that covers all of a taxpayer's worldwide income on an accrual basis, with the corporate income tax that complements it in its functions as a policy instrument, a means of tax control, and a revenue advance on the PIT-CA itself. In our view, this architecture will make it possible to boost the tax's revenue, efficiency, equity, simplicity and "coordinability" relative to current models. Without question, the tax's structure has to be modernized in view of the new horizons in prospect, and this study seeks to make a contribution to that process.



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