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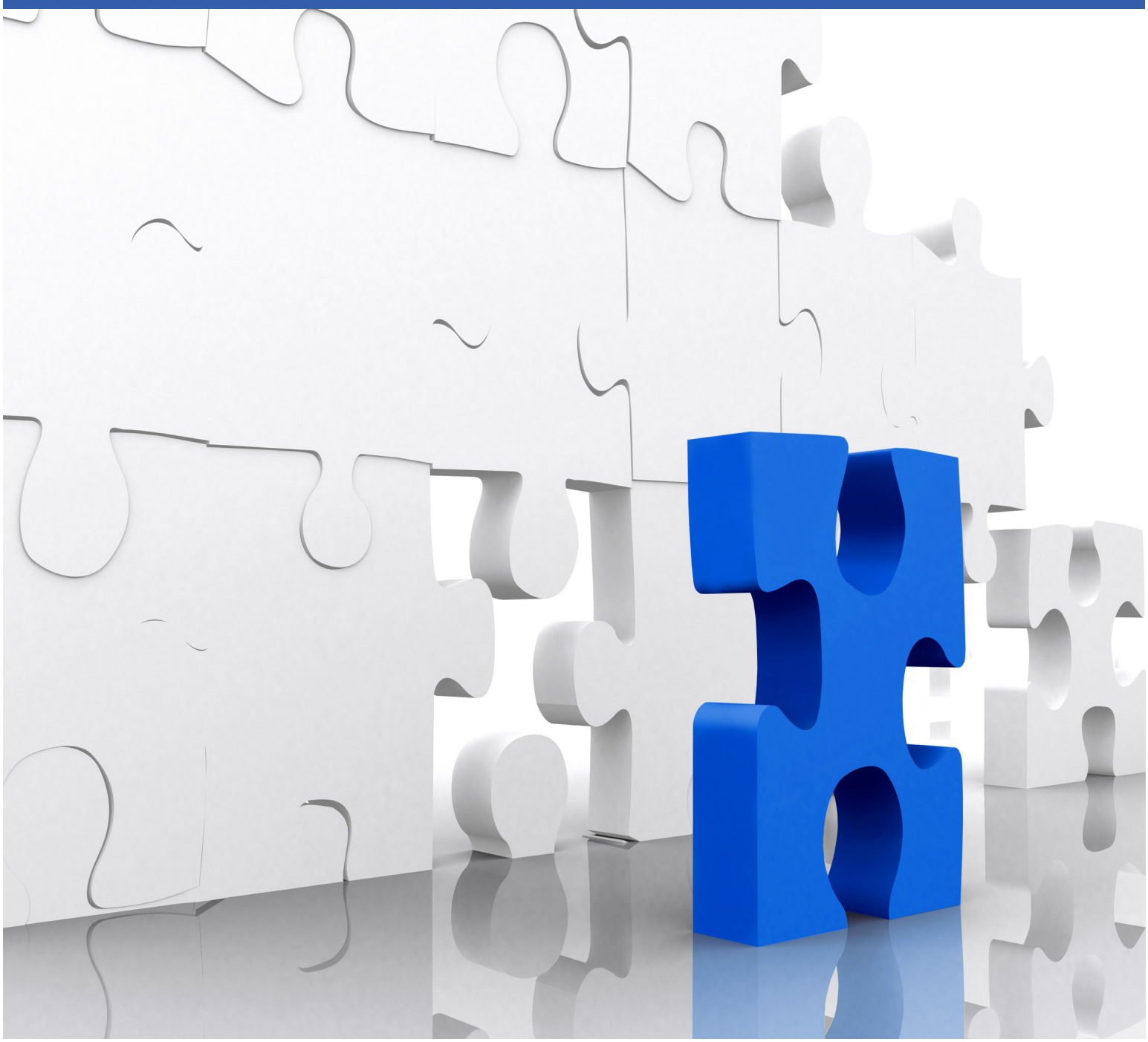

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Editorial Policy

The Technical Cooperation Agreement signed by CIAT and the State Secretariat of Finance and Budgets, the State Agency of Tax Administration (AEAT) and the Institute of Fiscal Studies (IEF) of Spain, provided for the commitment of editing a review that would serve to disseminate the different tax approaches in force in Latin America and Europe.

An Editorial Board formed by CIAT officials (The Executive Secretary, the Director of Tax Studies and Research, the Heads of the Spanish and Italian Missions) is responsible for determining the topics and select the articles for each edition of the Review.

The articles are selected by the Editorial Board, through a public announcement made by the CIAT Executive Secretariat for each edition of the review. It is open to all officials of the Tax, Customs Administrations and/or Ministries of Economy and Finance of the CIAT member countries and associate member countries. Likewise, those members of the MyCIAT Community not belonging to any of the aforementioned entities may also participate, following evaluation by the Editorial Council

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Content

Message from the Executive Secretary

Márcio Ferreira Verdi
Executive Secretary

Dear readers:

Once again, it is a great pleasure for me to present this new issue of the Tax Administration Review. At this already consolidated stage we wish to thank the authors and readers for their valuable collaborations as well as their comments and suggestions that allow us to continuously improve this periodic publication.

As in previous issues, our intention is to present to the readers, a diversity of topics covering matters of interest and current importance for our Tax Administrations.

Thus, along this line, one of the topics deals with the conflict between public interest in the collection task and the fundamental right to guarantee privacy in the electronic administration world.

There are specific countries that have endeavored to organize their integrated Administrations and in this sense, one very interesting example is the Argentine solution, whereby the administration of the Social Security resources has been entrusted to the Federal Administration of Public Revenues (AFIP).

In the area of tax figures, a paper from Peru integrally analyzes the Labor Income Tax reform, considering different reform options and proposing recommendations for their implementation. Likewise, from the Peruvian perspective and in this case in relation to Value Added and Corporate Income Taxes, the strategy for controlling these taxes in construction companies is systematically presented.

Also, as in previous issues we entered the world of international taxation; in this case, in accordance with BEPS (OECD) to analyze the transfer pricing problems in the Latin American region.

The last article compares the fiscal consolidation system with the optional system for corporate groups, which implies a challenge from the standpoint of the normative development of these systems as well as the organizational development which they demand from our Tax Administrations.

We greatly appreciate your loyalty and interest in this publication and hereby convey our best regards.

Márcio Ferreira Verdi
Executive Secretary

SOCIAL SECURITY RESOURCES AS MISSION OF THE TAX ADMINISTRATION IN ARGENTINA

Ricardo Echegaray

SYNOPSIS

The purpose of this paper is to discuss the model for managing and processing contributions intended for the different social security subsystems, hereinafter called Social Security Resources (SSR) which has been adopted by the Republic of Argentina and which task has been entrusted to the Federal Administration of Public Revenue (hereinafter AFIP).

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Content

The purpose of this paper is to discuss the model for managing and processing contributions intended for the different social security subsystems, hereinafter called Social Security Resources (SSR) which has been adopted by the Republic of Argentina and which task has been entrusted to the **Federal Administration of Public Revenue (hereinafter AFIP).**

As stated in the title of this article, the purpose is to highlight the fact that the collection of said resources is an essential mission of our tax administration.

To this end, we will provide a brief account of the historical evolution of the collection phase of Social Security management, to then continue to describe the way it is managed in AFIP, according to the single agency model adopted by the Republic of Argentina.

1. SOCIAL SECURITY RESOURCES MANAGEMENT. HISTORICAL EVOLUTION TOWARD THE SINGLE AGENCY

Social Security in our country is a contributive system, financed mainly with contributions paid by dependent workers and their employers, as well as independent workers and consists of a series of rules, institutions and procedures that tend to cover the different social contingencies; namely:

- Old age, disability and death, through the retirement system – currently Argentine Integrated Social Security System, Law N° 24.241 and its amendments;
- Illness not due to negligence during the activity, through the Health Care System – currently, the National Health Care System and National Health Insurance System, Laws N° 23.660 and 23.661 and their amendments;
- Illness not due to negligence while inactive, currently, the National Institute of Social Services for the Retired and Pensioners, Law N° 19.032;

- Occupational disease or accident, currently Occupational Hazards System, Law N° 24.557;

- Charges for dependents by means of a system of direct payment of family allowances and subsidies, –currently the National Family Allowances System, Law N° 24.714;

- Unemployment, through the respective insurance, currently National Employment Fund, Law N° 24.013, for most workers and the Agricultural Workers and Employers Registry (RENATEA) for workers of that activity, Law N° 25.191 and the amending Law N° 26.727.

Most of the aforementioned social security subsystems originated from agreements between workers and employers in the same trade or activity.

This was thus the origin of the first pension funds of the beginning of the last century. Likewise, the Health Care System that began to become widespread in the second half of the same century and family allowances and subsidies funds had that same corporate but not state origin.

Nevertheless, once these systems became widespread among most workers, dependent or autonomous, the State began to unify its regulations and control the entities –most of them non-state public entities – through laws that unified the respective subsystems and rendered obligatory the subjection as well as payment of the respective contributions for their financing.

This process of unification and submission to state jurisdiction was consolidated in the decade of the 60s of the XX century, with the concentration of the retirement funds and the centralized control of the Health Care providers and marks an important milestone with the creation, through Law N° 23.769, of the National Social Security Institute on December 28, 1989. Said Institute, whose board of directors included representatives from the workers, the retired and employers, was assigned the collection tasks of the National Social Security Collection Directorate, the payments of the three retirement funds, the role of maximum administrative instance which was previously held by the National Social Security Commission and the functions of the National Social Protection Directorate, with respect to occupational accidents.

The aforementioned process underwent another change in 1991, through the issuance of Decree N° 2284 of October 31, 1991, whereby all the different social security systems described above were integrated in a Single Social Security System (SSSS). With the issuance of this regulation it is now clear that coverage of the different social contingencies in Argentina are under a single system.

In turn, the regulation provides that said Single System will be financed with a Unified Social Security Contribution (USSC). In other words, the different contributions intended for the social security subsystems whose collection was not standard, became a combined single tax.

Said new Unified Contribution will have a common base, which is the remuneration of the dependent workers, as provided in the law that governs the Retirement System –currently Law Nº 24.241 and its amendments.

Lastly, the regulation provided that the administration of the SSSS as regards the collection of the USSC, would be entrusted to a public organization within the sphere of the Ministry of Labor, as provided in a subsequent decree, Nº 2741/91 of December 26, 1991, which created the National Social Security Administration (NSSA), as the entity in charge of providing retirment benefits, managing the SSSS and collecting the USSC.

2. SOCIAL SECURITY RESOURCES IN THE SINGLE AGENCY

The process of unification in a single entity of the administration and collection of the Single Social Security System, experienced a significant modification in 1993 when it was decided to entrust to the then General Directorate of Taxation (GDT) the application, collection, examination and judicial execution of the Social Security Resources, which at that time was the responsibility of the NSSA, which entity preserved the administration of the system.

Based on this decision, the single tax agency model began to be developed in our country. It consists of having the same State entity in charge of the collection and control of national taxes, social security contributions. Subsequently in 1996, with the merger of the then **General Directorate of Taxation and National Customs Administration, the Federal Administration of Public Revenues** was created, autarchic entity in the sphere of the then **Ministry of Economy of the Nation.**

This new organization is in charge, as we said, of the application, collection examination and judicial proceedings of the Social Security resources and currently has three General Directorates operationally in charge of tasks that comprise the single agency.

The subject matter being analyzed is currently under the responsibility of the **General Directorate of Social Security Resources**, whose functions are similar to those of the two remaining General Directorates –GCD and GDT, created in October 2011, which may operate through the GDT.

The General Directorate of Social Security Resources has two Deputy General Directorates which assist it, namely: the Deputy General Legal Technical Directorate of Social Security Resources and the Deputy General Operational Coordination Directorate of Social Security Resources, which in turn are supported by the Directorates, Departments and Divisions.

3. CONCURRENT COMPETENCIES AND INTERACTION WITH OTHER SOCIAL SECURITY ENTITIES

At this point, it must be stated that there are organizations and entities that have concurrent powers with AFIP, with respect to Social Security Resources. Thus, it is important to explain the limitations of such concurrent action, since some have original powers (granted by laws) and others are delegated.

The Ministry of Labor is the authority applying the Integral Labor Inspection and Social Security System (ILISSS).

Since the provinces have been constitutionally given the police power in labor matters, they are also part of the aforementioned System.

The **National Social Security Administration (NSSA)** is the entity in charge of the administration of **the Single Social Security System (SSSS)** and for purposes of carrying out its functions it has verification powers to ensure the actual rendering of services by those requesting their respective benefits.

Prior to the creation of the SSSS, the Health Care providers had the power to collect contributions intended for health coverage.

Nevertheless, with the creation of the SSSS, these entities lost the collection power which was then entrusted to the public entity in charge

of collecting the unified contribution; that is, AFIP.

However, since the beginning, the Ministries of Labor and Economy delegated to the Health Care providers, not the collection, but the verification and judicial execution of those resources.

The existence of current powers between AFIP, the Ministry of Labor, NSSA and the Health Care providers, forces those organizations to coordinate their efforts in order to maximize the results, bearing in mind the single nature of the SSSS.

4. PARTIAL APPLICATION OF THE TAX PROCEDURAL LAW

The regulation that provides for transferring the collection of social security resources to the tax administration, determined the partial application of the Tax Procedural Law to this subject matter.

The legislative logic of the aforementioned partial waiver had as objective to provide the collection of the Social Security Resources all those regulatory tools of tax origin that would be compatible with its particular nature and which had proven their effectiveness when collecting taxes.

On the other hand, deliberately, those instruments that did not seem advisable to be sent to social security were rejected, taking into account the greater effectiveness of those specific rules of the subject matter which, therefore, continued to be enforced.

Very briefly, we will list the main tax procedural regulations applicable to Social Security.

The principle of interpretation based on economic reality: It is known that in keeping with its specificity, tax regulations have a method of their own that allow the interpreter to deviate from the juridical forms which the parties would have attributed to a specific act, to enter into the true nature of what the business is about.

This method fits in with the eminently economic anture of the taxable events, which are those acts that allow for inferring the paying capacity of the individuals that carry them out.

The tax domicile is one of the attributes of the personality of the taxpayer or responsible person and is the physical element that allows for relating the taxpayers and responsible persons with the tax administration. It is also the place where the Treasury makes communications, notifications and announcements to said persons.

The joint responsibility, that is, the specific assumption in which an individual is responsible for someone else's debt is regulated by the Tax Procedural Law and is applicable to Social Security.

This is added to the application of the specific social security and labor regulation which also provides for joint obligations with respect to the payment of the contributions, such as in the case of buisness funds transfers and that arising from labor contracts in the case of transfer, assignment or subcontracting.

Determination of the tax: One of the most important issues in taxation is the way in which tax obligations are determined and the way they are collected by the tax administration.

The method prevailing in our country is that of self-assessment, whereby the taxpayer declares –under oath- the amount and significance of their obligation, the latter being subject to subsequent eventual review by the Treasury and it is the one currently in force with respect to Social Security.

The implementation of this principle by AFIP has given way to three systems that constitute the milestone of the Social Security assessment system, namely:

1. **SICOSS Application**:
   With the implementation of the Integrated Retirement and Pension System, currently IRPS, which was in force since July 1994, it was necessary to provide the taxpayers, as well as the tax administration with an instrument for identifying each of the social security contributors by name in order to direct the contributions made by each of them to the different social security subsystems (specifically, at the beginning, between the Public Distribution or Capitalization System, both components of the IRPS) according to the options chosen by each of them.

   To that end, it was necessary to identify each worker with a code (CUIL) and to establish a series of referential data that would allow according to the different modalities provided by the regulations, to determine the tax obligation with respect to each of them.

   This is so, given that not all workers pay the same amount nor are they obligatorily included in all the social security subsystems. Thus, there originated the need to count on a computerized application for generating sworn returns that would allow for their immediate processing and subsequent distribution of funds in real time to the different social security entities. That need was reinforced with the possibility that each worker could opt, once a year, for any of the Trade Union Health Care providers.

   This application system, which is permanently changed according to the normative modifications which the subject matter undergoes, is currently called System **For Calculating Social Security Obligations –SICOSS** and is generated and applied via WEB and it thus calculates the obligation to be paid, based on the information that must be provided by the taxpaying employer.

2. **My Register:**
   One of the main difficulties found by the employers which prevented their regularization was the number of procedures before various entities that had to be carried out in order to register a worker.

   Bearing in mind that the Social Security System is unique and the State is its guarantor, and its administrator, to a great extent, there was the need to unify the procedures in a single-window system and that the information thus obtained be shared among the different pertinent entities.

   This system is known as "**Registration Simplification**" and consists of a single source of social security data with access, in real time, to the information of the employers, the workers and their family group, through consolidated reliable data.

   The information is obtained from that produced by the employer when registering the worker before AFIP, through the Early Enrolment Code. Such enrolment as its name indicates should be made prior to beginning the labor relationship and should include the data that may allow for correctly identifying the payer. The system is completed with the withdrawals and modifications made to each worker.

   The remaining social security entities – ANSES, Superintendencies of Health Services and Occupational Risks, Ministry of Labor, etc.- obtain, on line, the aforementioned information, thereby reducing procedures to the employer.

3. **On Line Filing:**
   Notwithstanding the self-assessment principle, since AFIP has abundant information provided by or obtained from the taxpayers or third parties, in order to facilitate

the task of those obliged to pay, a system was developed for generating pro-forma sworn returns by the tax administration.

Said system is called **"On Line Filing"** and consists of the preparation by AFIP of the assessed return, based on the data registered in the **"MY REGISTRATION"** System which is validated in real time.

It allows for on-line acceptance or modifications by the taxpayers. If there are no corrections, following validation via web, the pro-forma SR is considered definitive.

Everything having to do with payment, either with money or through compensation using tax credits, as well as the ways of allocating payments to the different obligations owed, is extensively discussed in the Tax Procedural Law and applicable to Social Security.

In particular, the AFIP is empowered to establish the expiration terms. At the same time, it is empowered to collect in advance unexpired taxes. According to the taxpayer's estimated paying capacity –according to what was paid in a previous period – the Treasury may establish advances that constitute payments on account of the tax he must definitely pay at the end of the fiscal period.

In the same way, AFIP may collect taxes from the same source, by establishing withholding or collection systems. With respect to the Social Security Resources, AFIP has provided for several withholding and collection systems.

Verification and examination: Although, as we saw before there is the Social Security Resources self-assessment system; that is, that taxpayers determine the amount of their tax obligation, this system is complemented with extensive powers of verification and examination by the tax administration, in order to control the correction of such assessments or, eventually, to determine said obligation.

The aforementioned powers of the Tax Procedural Law consist of the powers of verification and comparison of data by AFIP, as well as the obligations of taxpayers and those responsible for making available to the Treasury all the documents supporting their transactions, which allows for verifying the accuracy of the assessing sworn returns, including the obligation to keep in operation the computerized systems through which the registers are prepared and are fully applicable to Social Security.

Interest: Delayed payment of social security resources is subject to the automatic application of interest. Since delinquency is automatic, it occurs upon the expiration of the general terms, without the need for previous summons by the Treasury – the unavailability of the funds, in legal terms affords the Treasury the right to be compensated for such unavailability.

As regards taxation, such interest precisely considered compensating interest, is applicable to Social Security.

On the other hand, in cases where a fiscal procedure must be filed for collecting the unpaid debt, the LPT provides, as of the filing of the claim, an increase in the applicable interest rate, which it considers punitive since it is a sanction given the debtor's reluctant behavior.

Violations and sanctions: The taxpayers and those responsible are obliged to comply with the formal as well as material duties toward the Treasury.

The formal obligations involve maintaining and making available all the support documents on its transactions and accounting entries that may allow their verification by the Treasury.

It also comprises the timely and due filing of forms, sworn returns, transactions via Internet, etc., which may be required by the legal and regulatory norms and which tend to provide all the information required by the Treasury, either from the taxpayers or third parties.

Material obligations, on the other hand, deal with the return, assessment and payment of taxes by the taxpayers.

Noncompliance with any of these duties brings with it the application of administrative sanctions, which by virtue of the principle of legality are duly classified in the laws.

From the Tax Procedural Law, most of the sanctions for formal noncompliances and some corresponding to the material ones are applied to Social Security Resources.

Fiscal execution: Whenever a debt is totally or partially unpaid following its expiration, whether it may have been self-assessed by the taxpayer or by the Treasury, AFIP has the right to attempt its enforced collection through judicial procedure.

Given the principle of speciality of tax law, the Tax Procedural Law provides a special procedure whereby AFIP may judicially claim the tax debts. It is a sort of fiscal execution which is applicable to Social Security.

Pre-judgment attachment: The Tax Procedural Law allows AFIP, in specific circumstances, to judicially safeguard its credits, to avoid the taxpayer's insolvency. This power is applicabel to the Social Security resources.

5. ISSUES OF THE TAX PROCEDURE NOT APPLICABLE TO SOCIAL SECURITY. SPECIFIC NORMS APPLICABLE TO INFRINGEMENTS, JEOPARDY ASSESSMENT OF THE DEBT AND APPEALS

Reference will now be made to Social Security procedural issues wherein the Tax Procedural Law is not applicable.

Assessment of the debt: When the taxpayer fails to comply in due time and manner with the obligation to self-declare the tax, or when that declared is insufficient or is not in keeping with reality, the tax administration is empowered to replace the person responsible and determine the real amount of tax owed.

The specific Social Security norm uses the term jeopardy assessment in a manner similar to that used in taxation, on establishing that the assessment of Social Security Contributions is made through sworn return by the employer or person responsible. Regardless of the foregoing, when such sworn returns are not filed or those filed are objected inasmuch as they do not represent the real situation, AFIP shall proceed to the jeopardy assessment of the omitted contributions, either directly due to actual knowledge of said obligations, or through estimation, if the known elements only allow for assuming their existence and magnitude.

The debt assessments may be on a true base, when the Treasury has all the elements that allow it to calculate the omitted tax obligation or through presumptions.

The preparation of the presumptions constitutes a logical process based on the verification of real data that allow for inferring other data that may be concealed. For example, through the actual verification of the manufacture of a product or a work or the rendering of a service, one may infer the use of labor.

This rule has allowed AFIP to establish Minimum Worker Indicators (MWI), for different activities, which constitutes the presumptive mínimum number of workers required for each production unit.

Infringements and sanctions: Infringements of Social Security formal and material duties that are not subject to sanctions provided in the Tax Procedural Law are sanctioned through specific social security rules.

Statute of Limitation. In the area of Social Security the loss of action for claiming a right, due to the time elapsed without the creditor having exercised it, is governed by its specific rule which provides for the ten-day statute of limitation, starting from the date of expiration of the obligation.

Since the aformentioned rule does not have specifications regarding the suspension or interruption of the statute of limitations, such principles must be taken from common law.

Administrative and judicial procedure. Appeals procedures: In this area there is a special procedure for objecting the debt assessment before AFIP.

The resolutions issued by AFIP rejecting the objections made by the taxpayers against the debt assessments may be appealed before the Social Security Federal Chamber, with the previous deposit of the assessed debt (solve et repete), as condition for admitting the appeal.

Punitive system applicable to evasion and misappropriation of social security resources: Specific noncompliances with the duties of taxpayers and others responsible persons with respect to social security resources bring with them, in addition to the already analyzed administrative sanctions, the possibility of penal persecution.

The intangibility of the social security funds is the juridical property protected by law.

In this respect, the same rule that deals with tax offenses is also applicable here. In the logic of this law there are specific tax, social security and common offenses.

It also provides for the necessary previous procedure to pursue criminal charges.

Evasion consists of the integrated maneuver through a ruse, swindle, deceitful or malicious declaration, through action or omission whereby entry of the tax owed is omitted.

The offense involves a subjective condition – the concealmente maneuver, with intention to evade – and an objective condition –that the evaded tax exceeds a specific amount determined by the law.

In turn, the evasion offense admits the aggravated form –which involves a greater sanction – according to the amount evaded or specific circumstances which the law provides as especially reproachable.

The misappropriation of contributions consists of withholding them from the worker's gross salary and not entering them.

On the other hand, as we saw, there are individuals that are appointed by AFIP as withholding or collection agents of the contributions.

Here likewise, misappropriation consists of withholding or receiving from third parties and not entering such payments in favor of AFIP.

In relation to this offense, the law imposes two objective conditions: **1)** that the misappropriated amount exceeds a specific amount and **2)** that the deposit is not made within a specific term.

Also, the rule also requires AFIP to allow the possibility that the responsible person may pay only the withheld amount, in order to avoid the penal sanction.

On the assumption of evasion, the law requires the previous assessment of the debt and, if appropriate, the issuance of the resolution rejecting the objection.

6. AN ESSENTIAL COORDINATION PROJECT BETWEEN THE SOCIAL SECURITY ORGANIZATIONS AND INSTITUTIONS: SIMPLIFYING REGISTRATION

In August 2006, the system known as "**MY REGISTRY**" was implemented. Participating therein were the Ministry of Labor, Employment and Social Security, AFIP, the National Social Security Administration, the Superintendency of Occupational Hazards and the Superintendency of Health Services, with the legal mandate of establishing the procedures for the simplification and unification of labor and Social Security registrations, in order that the employers and workers may register in a single act and by means of a single procedure.

Through the years, and with the creation of different organizations, rules were issued which resulted in an extensive universe of regulations which the employers had to comply with in order to provide the data required by the different institutions. This resulted in the composition of bases with a broad range of data that turned out to be parallel and repetitive. Thus, the transcribed article is thus based on the need to simplify the procedures of the labor and Social Security organizations.

Later on, AFIP created the so-called "Social Security Entries and Withdrawals Registry", also known as "**MY REGISTRY**". By means of a joint rule with the Ministry of Labor, the "Program for the Simplification and Unification of the labor and Social Security registration" was created and its implementation was assigned to AFIP. The objectives pursued are listed below:

- simplify the employers and workers registration obligations;
- reduce the multiplicity of procedures to be carried out by the employers for registering their labor relations;
- centralize, modernize and speed up the capture of relevant data of common use to all Social Security organizations and the Ministry of Labor, Employment and Social Security wnich, as counterpart will assume responsibilities in relation to their maintenance;
- eliminate the duplicity of data between organizations operating in the labor and Social Security sphere;
- encourage the formalization of labor relations through the facilitation of the registration processes.

Based on these premises, the organizations involved in the "**Registration Simplification**" Program determined the data that should be requested from the employers in order to set up their bases and which are collected and distributed by AFIP. Under said parameters, the system has been designed so that the taxpayer may provide the following information: a) data corresponding to their condition of employer; b) data inherent in the labor relationship with the worker and c) data related to the family relations of its employees.

In sum, AFIP fully complies with the collection of specific taxes for Social Security financing and the distribution to each of the organizations and institutions responsible for administering the various subsystems and, as of the enforcementof the aforementioned System it has also assumed the primary responsibility of obtaining all the information generated by the employers for Social Security management, even with respect to the benefits.

7. THE SINGLE AGENCY AS MODEL ADOPTED BY AFIP

The experience at the national level shows the implementation of parallel collection systems evolving, in recent years, toward the integrated collection system, according to the characteristics listed by Stanford Ross[1].

This is the collection model which we call Single Agency, adopted by AFIP, which we could define as that in which the Tax Administration concentrates all fiscal collection (taxes, social contributions and customs duties) since it has the greatest possibilities of using the information, optimizing assistance to the taxpayer, the administration of subjective risk and saving resources through the centralization of administrative processes in a single entity devoted to such purpose.

As strength of the Single Agency we may point out that it allows greater control on compliance with taxpayer obligations, since the necessary information for making data crosschecks regarding taxes and Social Security is available in order to detect evasion or avoidance.

Another relevant characteristic is based on the availability of integrated and easily accessible information, the complementarity of skills and competencies of specialists on the subject matters that are included in the Single Agency concept (taxation, Social Securty and customs) and the best negotiating capacity for interacting with other control entities.

Likewise, it recognizes a concentration in examination and efficiency in enforced collection, by unifying in a single entity the fiscal proceedings involving taxes and Social Security contributions, thereby avoiding excessive administrative and judicial spending.

The Single Agency takes advantage of the synergy among the different concepts which allows the State to prepare integral collection plans, promoting the capabilities of control and identification of the administered subjetcs, either in their capacity of taxpayers of national taxes and customs duties or those subject to the Social Security system.

In sum, the Single Agency model has evident advantages over the parallel collection scheme and demands -likewise- harmonious action, with permanent coordination between the collecting entity and those in charge of managing Social Security benefits, as well as the common use of technological tools that may facilitate the relationship with citizens, in their capacity of taxpayers as well as affiliates or direct or indirect Social Security beneficiaries.

In this line of thought, during the years elapsed since the DGI took over the collection of taxes based on the payroll, there has been a permanent increase in the use of the best functionalities of the model, sustained collaboration and operational integration with those in charge of managing benefits and the decision to relate with the administered subjects thorugh on-line computerized tools (web).

This has greatly contributed to the success of the model, moving toward an electronic government scheme, where AFIP optimizes all resources available for better compliance with its functions at the service of the citizens.

As corollary to what has been stated, it must be pointed out that AFIP's acceptance of the Single Agency model and the advantages this implies, are necessarily conditioned to the permanent maintenance of the public service paradigm.

1. *Ross, Stanford G.; "Institutional and administrative issues"; en "Social Security un 21°century"; Kingson-Schulz", Oxford; 1997*

To persist in said attitude will allow not only for sustaining adequate levels of collection, but also consolidating the bases of a new relationship with the citizens, where inclusion and the Social Security benefits would encourage compliance with tax obligations.

8. MANAGEMENT MODERNIZATION

AFIP, through the General Directorate of Social Security Resources, in its capacity of articulator of information Exchange between organizations and entities linked to Social Security has achieved a leadership position in information management.

The significant increase in the number of persons that contribute to social security has been sustained through the intensive application of modern information and communication technologies.

The volume of transactions, the installed processing capacity and the computerized network currently administered by AFIP, make the organization one of the main innovators on the subject. Since the National Government has promoted the application of modern technologies as regard electronic government and the digital signature, in practice AFIP has assumed a position of excellence in that sense.

The General Directorate of Social Security Resources has developed, jointly with the specialists of the Systems and Telecommunications area, a series of systems and applications that have significantly modified the relationship between the administration and the contributors, the employers and the community involved in the Social Security system.

All the computerized tools are operated via Internet, which greatly facilitates the users the transactions that require consulting the registration files.

The daily distribution of collection and the automatic control of compliance with the obligations, in relation to the Social Security resources is another of the important steps taken with the use of the installed capacity as regards information technology and communication at the service of Social Security.

The inclusion of citizens in the formality process through the regulatory reforms, and friendly mechanisms for providing assistance and carrying out procedures, inquiries and exchange of information through the Web, allows them on-line access to information regarding their contributions, which in turn, helps to facilitate control.

In that sense, the tasks of the General Directorate of Social Security Resources are framed within the concept in force in AFIP and which consists of permanent improvement, innovation and attention to the taxpayers' needs.

The intensive use of Internet –as virtual assistance counter – covers most of the interactions between the citizen and AFIP. The technological advances that have been implemented contribute evident facilities for achieving controlled management and services of excellence. The computerized and technological platform available at AFIP is a true fact and its intensive use, a reality.

The massive and systematic use of the fiscal code allows contributors to verify their contributions that are quite up to date, while employers may as well verify their staff payrolls and use them as a master file.

Recently substantive processes have been improved through technological innovation and measures have been taken for standardizing the use of the digital signature in telematic transactions that require assurace of authorship and juridical authenticity, as well as the standardization of the electronic window.

9. ORGANIZATIONAL INSERTION AT THE REGIONAL AND WORLD LEVEL

Actions regarding Social Security resources have been only recently incorporated in the discussion groups in the international sphere. To date, actions have been undertaken in different spheres, such as the exchange of information and the inclusion of collection of social security contributions in internatonal organizations.

In this context, worth noting are the activities being carried out in specialized organizations with respect to related topics, such as the International Labor Organization (ILO), the Ibero-American Social Security Organization (ISSO) and the International Social Security Association (ISSA), as well as representative institutions of supranational political units such as Mercosur or the Eurosocial Project promoted by the European Union.

With respect to social security agreements ratified by our country, worth mentioning in particular are those signed within the framework of the ILO as well as the Mercosur agreements.

One of the aspects of greatest concern in the international sphere is the reduction in the generation of the so-called “decent labor” and registered employment. Thus the aforementioned agreements are focused on the search for changing this situation.

In order to improve the current collection and registration procedures and adapt them to the new socio-economic realities, it is convenient to follow up the new trends that may allow for increasing the collection of contributions of the different subsystems that are part of Social Security.

It is for this reason that AFIP has decided to involve itself in relation to international organizations that analyze and examine the aforementioned problems in such topics as:

- Investigation of collection systems within the framework of the agreement signed with the Ibero-American Social Security Organization (ISSO).

- Development of technical assistance and human resources training projects that may allow for knowing the objectives pursued by the so-called “Regional Observatory of Social Security Resources”:

- Analysis of the international agreements dealing with benefits ratified by Argentina and their projection in relation to collection (ILO).

- Insertion and development of the collection issue in other international organizations.

- Formalization of new agreements with the tax administrations of other countries aimed at the exchange of information regarding applicable collection procedures and computerized systems.

Finally, it is worth adding that in social security there is an international trend toward analyzing collection and benefits as aspects that complement each other in the analysis and feasibility of financing the Social Security systems.

10. CONCLUSION

From all that has been stated it is clear that the challenge to be faced is focused on considering in depth and intensifying the struggle against unregistered employment and labor informality with its resulting lack of protection and social exclusion, unfair competition and the subsequent non-financing of the system.

Although in recent years there has been a significant reduction of this scourge, it is no less true that the current level of informality is incompatible with a social security system that is inclusive, shows solidarity and has universal coverage.

Things being thus, it is evident that every proposal aimed at labor formalization must cover the following substantive aspects, namely:

Fiscal incentives

Different fiscal incentives have been applied in order that employers, when hiring a worker may comply with all registration requisites imposed by the regulations in force. Likewise, mechanisms have also been anticipated for inducing the generation of employment through the hiring of new workers or registration of those labor relations that were infringing the law, which consist of the reduction of employer contributions.

It is obvious that the objective pursued is not only the collection of contributions, but rather that the worker may have an appropriate job and may enjoy the benefits provided by the Single Social Security System.

In this regard, there is currently in force a sensitive reduction of employer contributions intended for the Single Social Security System for a period of 24 months, as of the month of initiation of a new labor relationship or the regularization of a pre-existing one.

Another mechanism for encouraging regularization is the conclusion of the already mentioned Agreements of Union Co-responsibility established through Law N° 26.377, with respect to the primary activity where there is high seasonality and turnover of temporary workers.

These agreements involve a new collection modality of contributions intended for Social Security, through the payment of a fee or percentage of the sales value of the pertinent production, in substitution of the aforementioned obligations.

This practice is an effective instrument that will allow for reducing informal labor in the rural activity. Therefore, it is appropriate to promote the entering into these agreements, which in addition to the collection effect will allow workers to enjoy the benefits afforded by the different Social Security subsystems.

At this stage, particularly important is a bill recently sent to the Congress of the Nation, promoted by AFIP, which is intended to grant new fiscal incentives for contributing to labor registration, as well as increasing the sanctions to those who fail to regulate their situation.

The Project consists of three substantial Titles:

Title I: Public Registry of Employers with Labor Sanctions.
Title II: Special Systems for Promoting Registered Work.
Title III: Administration of the Work.

- The Public Registry of Employers with Labor Sanctions (REPSAL) endeavors to register employers with sanctions for infringements specified by the Project. In addition, said employers, because they are included in the Register, may be subject to the restrictions/ sanctions determined by the project.

- The Special Systems for Promoting Registered Labor consist of: a) a mechanism for promoting the registration of workers by the so-called micro-employers; and b) a system that promotes the hiring of new workers. In both cases, the inductive mechanism is based on the reduction of contributions;

- In the area of Administration of the Work, the project provides for new competencies in favor of the Ministry of Labor, Employment and Social Security for the application of sanctions concurrently with those held by the governments of the provinces and of the Autonomous City of Buenos Aires. In addition a Unit is established in the sphere of the MTESS devoted to sectors that are complex to be verified.

Simplification of administrative procedures

As already stated, the implementation of the "REGISTRATION SIMPLIFICATION" System endeavors to reduce and simplify the procedures to be carried out by the employers when hiring a new worker, in order to fully comply with the obligations imposed by the different entities involved in Social Security.

This system –which receives information corresponding to employers and workers – allows for determining new developments for expanding the scope of application, designing procedures that will be beneficial to those obliged and to the different social security entities.

On the other hand, the composition of the data bases and exchange of information will result in the reduction of the levels of evasion, thus becoming an effective tool in the struggle against unregistered employment.

Under these premises, AFIP implemented the "Certification via WEB" system which, through Internet, allows employers to issue in an automated fashion the certification of the services rendered and remunerations received, when the labor relationship expires or when the workers thus request it.

It is worth noting that the briefly described simplification procedures comprise an information network that allows employers and the organizations that use the registered data, savings in costs as well as speeding up the procedures and obligations imposed by the Social Security regulations.

As we said at the beginning, we endeavored and hope to have achieved it, to stress that for the Argentine tax administration the management of specific Social Security resources is a fundamental mission.

This is so, not only because of its importance from the collection standpoint, but because of its purpose of social inclusion and of facilitating the existence of dignified and decent labor, with the possibility that the Argentine working class may enjoy the benefits granted by the labor law and Social Security.

Therefore, it has been necessary to accept the challenge of dealing not only with the taxpayers and those responsible, but also with the mass of payers (workers paying their contributions) and with the different fund receiving organizations and entities that administer the Social Security subsystems and act before AFIP as users-providers of a public service, such as the collection and distribution of the contributions in a timely manner.

For achieving said purposes, the Social Security has been pioneer with the Tax Administration of electronic government, of which AFIP is currently proud of being a leader in the country at the same level of the main administrations of the world.

Also important are the normative tools that have been obtained for implementing those policies.

Even though there are still new challenges to be faced and issues to improve, we believe our Tax Administration has kept up pace with those who had the idea, as state policy, to entrust this task to us.

A REVIEW OF TRANSFER PRICING ISSUES IN LATIN AMERICA IN THE FRAMEWORK OF THE ACTIONS PROPOSED BY THE OECD IN ITS BEPS ACTION PLAN

José Luis Galíndez Narvaéz and Alfredo Julio Sosa

SYNOPSIS

This article addresses the main actions on transfer pricing of the **Action Plan on Base Erosion and Profit Shifting** prepared by the OECD, and its impact on the tax control of commercial transactions between related parties in the countries of Latin America, where the importance of the issue has raised the tax administrations attention.

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Content

The **Action Plan on Base Erosion and Profit Shifting**[1] (or BEPS[2] Action Plan) is a work completed by the OECD[3] with the purpose of improving the gaps that currently exist in the mechanisms to combat international tax evasion. The OECD has expressed its concern for the use of aggressive tax planning schemes by various multinational enterprises.

In this context, certain business structures have made use of agreements to avoid double taxation in order to reduce their tax obligations and in some cases circumvent them. While it is true that tax treaties were created to avoid double taxation and to fight international tax evasion, on certain occasions they are instruments to generate double exemption.

It is hoped that the BEPS Action Plan allow to establish common bases in the tax control of commercial transactions between related parties, and in particular, in the countries of Latin America[4], where the importance of the issue has called the tax administrations' attention.[5]

1. THE TRANSFER PRICING NORMATIVE

The question of the tax jurisdiction is closely related to the calculation of benefits: after determining that a part of a company's profits come from a particular country, which should be entitled to tax them, it is necessary to establish rules to allocate the proportion of the benefits that will be taxed. The OECD has developed transfer pricing guidelines[6] to address this problem.

The transfer pricing calculation is based on the internationally accepted Arm's Length Principle[7], under which, for tax purposes, income between related parties must be distributed as

1. *Action Plan on Base Erosion and Profit Shifting. OECD 2013*
2. *In English, "Base erosion and profit shifting'.*
3. *OECD Organization for economic development and cooperation link http://www.oecd.org*
4. *The report of the Inter-American Center of tax administration (CIAT) called Control of the manipulation of the transfer pricing in Latin America and the Caribbean (2013) will be taken as documentary baseLink: http://webdms.ciat.org/action.php?kt_path_info=ktcore.actions.document.view & fDocumentId = 8068*
5. *70% of the countries of Latin America include general rules, 10% of these countries include basic principles, 78% have offices or specialized equipment and 73% perform field inspections. Source: The Control of transfer pricing manipulation, CIAT .*
6. *These rules were known as Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The last edition was in 2010. OECD. (Paris, 2010).*
7. *The criterion of OECD countries continues to be the arm's length principle as the one who should govern the determination of the transfer pricing between associated companies. This principle has a solid theoretical basis, offering the position closest to the operation of the free market in cases where properties (property or other tangible or intangible assets) are transmitted or services between associated companies are provided. Although it is not always easy to put into practice, it tends to determine appropriate levels of income among members of multinational, acceptable groups for tax administrations.*

if they were independent in identical or similar circumstances[8].

The Arm's Length principle has been, for most Latin American legislations, the international standard to regulate transactions between related parties. This principle is based on comparing a transaction between related parties as if it had been made between independent parties in similar conditions.

When independent companies do business together, the market forces normally determine the conditions of their trade and financial relations (for example, the traded goods or services prices and the terms of the transaction or of the provision)[9].

When operations take place between related companies, the market forces may not directly determine their relationships as it should be.

The Arm's Length principle establishes that the agreed price and the conditions under which transactions between related entities are developed are consistent with those that independent companies would agree in similar operations and comparable circumstances.

In transactions between independent companies, payments usually reflect the duties performed by each one of the entities, taking into account the assets used and the risks assumed. To determine if it is possible to compare operations with market transactions, an analysis is therefore necessary to ensure, from an economic point of view, that the relevant characteristics of the situation under study are reasonably comparable.

A functional analysis to determine and compare the economically significant elements of the operation is a key of this analysis: the activities carried out, the assets involved, the responsibilities and the risks assumed by the parties.[10]

This principle, initially formulated by the League of Nations[11], is included in the legislation of most countries, and is enshrined in the Articles 7 and 9 of the Model Tax Conventions of the OECD and the United Nations, as well as practically all of the Double Taxation Conventions.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and the report entitled "The attribution of profits to permanent establishments"[12] provide guidelines on the articles 7 and 9 application of conventions which are inspired by the OECD Model Tax Convention.

These guidelines have raised awareness of the need for an explicit legislation on transfer pricing involving documentary obligations[13] and as a result, more and more countries have enacted legislation on transfer pricing and the related documentary requirements.

Although the vast majority of national transfer pricing regimes are based on the Arm's Length principle, each national scheme has its own characteristics and reflects the positions of each country in that area.[14]

8. *Addressing Base Erosion and Profit Shifting. OECD. (Paris, 2013).*
9. *Comment 1.2 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. OECD. (Paris, 2010).*
10. *Addressing Base Erosion and Profit Shifting. OECD. (Paris, 2013).*
11. *International body created by the Treaty of Versailles, 28 June of 1919. Dissolved the April 18 of 1946, being succeeded by the United Nations (UN)*
12. *The attribution of profits to permanent establishments (Link http://www.ief.es/documentos/recursos/publicaciones/libros/OCDE/14_Beneficios.pdf.) OECD (Paris, 2008)*
13. *E. LLianares, Sébastien Gonnet et Yohann Bénard, management stratégique des prix de transfert, says in his work 'a good transfer price policy must be supported by proper documentation and currently no taxpayer has such documentation'. EFE. (Paris, 2006).*
14. *Addressing Base Erosion and Profit Shifting. OECD. (Paris, 2013).*

One of the main premises of the Arm's Length principle is the functions, assets and risks of one of the parties to the transaction are more important, the greater the expected compensation will be, and vice versa. Therefore, this creates an incentive to move the functions, assets and risks where the taxation is more favorable.

It is sometimes difficult to move specific fundamental functions; however risks and ownership of tangible and intangible assets are, by their nature, easier to move.

Many business tax planning structures mainly focus on transferring the most important risks and intangible assets, difficult to assess, to countries of lower taxation, where they can benefit from a more favorable tax regime. These mechanisms may contribute or lead to the Tax Base Erosion and Profit Shifting.

It is to note that the contemporary economical context is characterized by a shift of global wealth towards emerging economies. This transition has its origins in the economic opening of China and India, a process that took shape during the decade of the nineties, and has increased with the beginning of the 21st century. The combination of the size of these economies with their intense and sustained growth, and their strong demand for natural resources, has provided support for growth in a number of emerging and developing economies. As a result, the emerging world is gaining more representativeness in the global economy[15]. Compared with Asia, Latin America contributes marginally to this wealth shift toward emerging countries[16].

1.1. The control of operations with related parties in Latin America and the Caribbean

In the countries of Latin America and the Caribbean, developments in the control of transfer pricing has been uneven. If we classify countries, taking into consideration a series of indicators, such as the time when they were issued and implemented legislation, the control/ audit progress and aspects related to human resources; five groups could be described[17].

A **first group**, consisting of those countries which have implemented rules for more than one decade, includes Argentina, Brazil and Mexico; a **second group** of countries, which has implemented legislation later, but which have achieved substantial progress would include Chile, Ecuador, Dominican Republic and Venezuela.

In all the countries of these two first groups, regulations cover all or most of the aspects that allow the control of transfer pricing and have units dedicated exclusively to control them, documentation requirements, audits, as well as cases in courts.

A **third group** is made up of countries that have strengthened the transfer pricing laws and have created or are in a process of creating specialized units, as it is the case of Colombia, Peru and Uruguay.

A **fourth group** of countries are in more premature phase of development of the

15. *Economic Outlook for Latin America 2014. Logistics and competitiveness for development. The report says: "If in 2000 the relative weight of the non-OECD economies was 40% of world GDP, this proportion has increased to 49% in 2010 hoping to rise to 57 per cent in 2030". OECD/ECLAC/ CAF (Paris, 2013). p. 68*
16. *The report says: "despite the period of growth which is registered in the region since the beginning of this century, we cannot say that Latin America has become a new pole of global growth."*
17. *Classification performed on data in 2012 from the report called Control of the transfer pricing manipulation in Latin America and the Caribbean. CIAT. (Panama, 2012)*

regulations, given that even though their laws have already been enacted, they have just been recently implemented or have not entered into force yet. Similarly, their units of transfer pricing are in formation process. This group includes El Salvador, Guatemala, Honduras and Panama.

The rest of the analyzed countries, which make up the **fifth group**, are those that to date have introduced no regulations. Here we find to Bolivia, Costa Rica, Jamaica, Nicaragua, Paraguay and Trinidad and Tobago. However, all countries mentioned, with the exception of Jamaica and Bolivia, are in process of developing regimes for the control of transfer pricing.

The majority of the regional countries tax administrations have carried out audits for the control of transfer pricing, although in some cases, as a result of the standards adopted, without considering the international framework of the Organization for Cooperation and Economic Development (OECD) guidelines.

Heterodoxy in the region can be seen in:

- The use of the method described in the Argentine legislation.
- Methods for the market prices determination of hotel operations in the Dominican Republic.
- "Protection regimes" or "safe harbors" for maquiladoras in Mexico.
- The Brazilian methods of fixed margins that have generated great discussions in international tax forums.

All of them have developed international guidelines and answers to the countries that have adopted them in order to counter abusive transfer pricing planning.

It has certainly developed a school of learning and replication of best practices and experience in the countries of the region. For example, five countries (Brazil, Ecuador, Guatemala, Peru and Uruguay) have collected the experience of Argentina and implemented measures similar to the sixth paragraph[18] of its rules for valuation of goods traded on transparent markets or "commodities"[19], when an intermediary located abroad is part of the transaction.

Consequently, the distribution of taxable bases of international groups between tax jurisdictions in Latin America is based on the Arm's Length principle; in particular from the principles described in the OECD transfer pricing guidelines, however some countries in the region have implemented alternatives for the control of transactions between related parties which are different from the Arm's Length principle.

On this topic in particular, it can be said that in Latin America transfer pricing problems are based on:

- How legislation is redacted.
- The training of inspectors.
- Knowledge of global chains of value (CGV)[20], the structure and functioning of business or economic sectors.

18. *The Argentinean law incorporated six paragraphs to article 15 of the tax law, giving a legal framework to the implementation of the sixth method. The sixth paragraph stipulates the implementation of a "best method" in the case of exports relating to cereals, oilseeds, other products of the land, hydrocarbons and their derivatives, and, in general, known in transparent markets traded goods, which involved an international intermediary which is not the effective recipient of the goods. The best method sorts consider transparent market price for the day of loading of the goods. Countries such as Uruguay and Brazil have extended the regulation, to the import operations by incorporating some criteria in their application.*
19. *Commodities are characterized by being marketed with a reference value in markets defined geographically with immediate or future delivery, they are interchangeable with others of the same type; their quality tends to differ very little, being essentially uniform without distinctions between producers.*

- Access to information in order to make the comparison of a transaction related to an independent transaction.
- The lack of effectiveness in the mechanisms for the exchange of tax information between tax administrations.

Now, the adaptation of legislation and the development of administrative capacities to strategic needs and fiscal resources of each country may constitute one of the success factors for the implementation of the Action plan on Tax Base Erosion and Profit Shifting.

In general, this means:

- Prioritize the compliance and control activities in respect of transfer pricing depending on the circumstances of each economy and particularly the type of international trade, its complexity and the number of large taxpayers affected
- Set realistic goals of enforcement and control, taking into account the capacities of the administration.
- Establish compliance goals that are reasonable for taxpayers according to the importance of international trade.

While it is true that the Arm's Length principle has worked effectively in the majority of the countries of the region, and constitute some of the safest methods to reduce the double taxation risks and the risks of double exemption, "the limits of the Arm's Length principle raise questions about the possibility of an alternative basis for the assignment of groups of taxable bases between tax jurisdiction".[21]

The OECD admits that national rules governing international taxation and standards are characterized by a low level of integration while today's worldwide taxpayers' environment is characterized by a constant evolution, widely supported by information and communication technologies.

For this reason, the concerns raised by the transfer of benefits were echoed by formulating an action plan, which we will discuss directly and indirectly regarding the transfer pricing treatment.

20. *"These networks allow countries specialize in specific activities of the production process, without having to take all the necessary steps for the final production of the good. Additionally, in Latin America the services appear to be, in the case of some industries manufactures and primary products, as another potential source of added value". Economic Outlook for Latin America 2014. Logistics and competitiveness for development. OECD/ECLAC/CAF 2013. (Paris, 2013) p. 21*
21. *Bernard Castagnede. Précis de Fiscalité Internationale. (Paris, 2010) p. 100.*

2. THE OECD ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING [22]

In the changing environment of international taxation, a number of countries have expressed concern about the way international standards in bilateral treaties distribute the taxing powers between source countries and residence countries.

This Action Plan focuses on addressing the Tax Base Erosion and Profit Shifting, and although actions proposed to combat Tax Base Erosion and Profit Shifting will restore enforcement both at the source or at the residence in a series of cases in which, otherwise, cross-border revenues would remain without tax or with very low taxation, those actions are not directly aimed at changing the current international standards regarding cross-border income tax powers distribution[23].

The OECD proposals on the Tax Base Erosion and Profit Shifting include works on:

1. **Intangible assets,** whose purpose is to clarify the rules on transfer prices relating to the use and transfer of intangible assets and clarify the economic obligations which must be respected in the agreements of the taxpayers,

2. **Documentary obligations,** which aims to simplify tax compliance while, at the same time, they provide States more useful information to evaluate the risks associated with transfer pricing, and

3. **Disclaimer rules ("safe harbors"),** which purpose is to articulate mechanisms to effectively resolve the less controversial issues in relation to transfer pricing, so more attention would be given to the delicate issue of the Tax Base Erosion and Profit Shifting.

On the other hand there are works on:

1. **The reorganization of companies,** discussing aspects of transfer pricing relating to the reorganization of companies and, in particular, issues related to the risk allocation are examined for the first time.

2. **Methods based on benefits,** which have resulted in new guidelines on the choice of the most appropriate transfer pricing method for each situation, and the practical application of transactional profit methods.

3. **The attribution of profits to permanent establishments,** in which the issues relating to the attribution of revenues to the branch operations in accordance with the Arm's Length principle are discussed.

In summary this Action Plan seeks to optimize national and international instruments against the Tax Base Erosion and profits shifting. In that sense, the OECD proposes some provisions to improve the existing rules, establishes a two years period to implement the actions, as well as the resources and methodology to implement the plan.

2.1. The Action Plan and the Latin-American context

Recognizing that the transfer of benefits is a global problem that clearly affects the mobilization of resources in developing countries, the OECD has so far organized two regional events.

22. *Action Plan on Base Erosion and Profit Shifting. (BEPS) OECD. (Paris, 2013).*
23. *Action Plan on Base Erosion and Profit Shifting OECD. (Paris, 2013).*

The first one was held in Seoul and the second, which we will present in the present work, was held in Bogotá on February 27 and 28, 2014[24]. It gathered countries and organizations of Latin America and the Caribbean.[25]

At the meeting held in the city of Bogotá, the implications that base erosion practices have for the countries of the region of Latin America and the Caribbean were discussed, as well as the specific challenges faced by countries to deal with the problems of profit shifting and the challenges for the administrations of the region to implement the new standards resulting from the BEPS Action Plan, among other issues.

In this view, two messages stand out from the meeting, which the authors understand as central to Latin American issues:

- The relative disparity in the level of development of the tax systems of the region, with special attention to international taxation, indicates that there is no unique approach, and that therefore the solutions must attend all situations.
- For developing countries, it is crucial that the resulting tax policy measures are capable of practical application, taking into account the current existing limitations regarding capacity of administrations and access to information

In addition, various issues in the context of the treatment of transfer pricing were discussed, such as:

1. The erosion of the base through the interest deduction and other financial charges (in accordance with Action 4 of the BEPS Action Plan).
2. Prevention of harmful tax competition between countries in the region (Action 5 of the BEPS Action Plan).
3. The prevention of abuse in the taxation of income derived from the extraction of natural resources, and the analysis of legislative measures adopted by countries of the region, including the so-called "sixth method"[26]
4. The clarification of the tax treatment of intangibles, especially in relation to royalties (Actions 8-10 of the BEPS Action Plan).
5. The bases erosion through payments for services received from the central office (Action 10 of the BEPS Action Plan).
6. The convenience of a more effective and harmonized transfer pricing documentation, including the report country-by-country, without imposing a too heavy burden to businesses and tax administrations (Action 13 of the BEPS Action Plan).

We will now address the most important points of the referred actions that were featured at the meeting in Bogota and that the OECD aims to develop.

24. *Regional consultation on Erosion of foundations and transfer of benefits Bogotá - Colombia February 2014, Link http://www.oecd.org/ctp/resumen-LAC-consulta-regional-BEPS.pdf*
25. *The event has attracted 78 participants from 15 countries of the Region of Latin America and the Caribbean, as well as representatives of 10 regional and international organizations, including the OECD, the OECD's Korea Central, the Global Forum on transparency and exchange of tax information in the OECD, IMF, CIAT, G20, USAID, ITC, IDBCOSEFIN, GIZ and the Commonwealth of Nations. Organizations representative of the business sector were also present (BIAC, through allies such as Repsol, Unilever and the Asociación Nacional de Industriales-ANDI Colombian and regional) and civil society (including TJN, TUAC, BEPS Monitoring Group, Global Alliance for Tax Justice and Latindadd).*
26. *The so-called sixth method, aims to avoid tax harmful triangulation in operations that involve primary products with known price quote. Strictly speaking, it is not a method in the context of the methods described by the OECD, but it improves an instrument anti-abuse, applicable to situations in which there is suspicion of harmful planning in the international operation, which refers to movable assets that are operated in large volumes, as it is the case with commodities.*

2.1.1. Limitation of the Tax Base Erosion by way of deductions on interest and other financial charges[27]

The reduction of the tax base through the deduction of financial costs is certainly a prominent issue on the transfer pricing agenda for any country that require the inflow of large amount of funds from abroad via parent companies or financial institutions from economic groups for the development of the productive and commercial ventures.

Facing this issue, the OECD Plan aims to:

- Develop recommendations on best practices in the design of standards to avoid the Tax Base Erosion a through the use of deductions for interest, for example, through the use of debt between related entities and with third parties to achieve the excessive deduction of interests or to finance the production of exempted or deferred income and other financial income which are economically equivalent to interest payments. The work will assess the effectiveness of different types of limitations.
- Establish guidelines on transfer pricing with respect to pricing of related financial transactions, including the financial guarantees and performance, derivatives (including internal derivatives used in interbank relations), and captive insurances and other kinds of insurance.

2.1.2. Fight against harmful tax practices, taking into account transparency and substance

Before the 2010 revision, the applicable OECD guidelines in the field of transfer pricing did not provide a general definition of "economic substance", nor clarified, in general terms, how to deal with the economic substance of a related operation when it differs from its appearance[28].

The 2010 guidelines[29] provide for the possibility of a tax administration to question the contractual terms when they are not consistent with the economic substance of the transaction, or when are not adjusted to the behavior of the parties, however, the meaning of such process is open to many interpretations. In this sense, we regret to say that it lacks an orientation. The fact that the draft of the OECD TP Corporate Restructuring (2008), did not consider the economic treatment of economic substance, focusing only on the commercial rationality, is also regrettable.

It is true that the new chapter IX of the OECD guidelines include a section in which a definition of this concept is drafted[30]. However, this quasi definition is inaccurate and seems to create more problems than it solves.

Several commentators have used the principle of "substance over form" to describe the situations in which a different treatment is applied. However, what is meant by "substance over form", doesn't

27. *Action 4. Action Plan on Base Erosion and Profit Shifting. OECD. (Paris, 2013).*
28. *Andreas Bullen. Arm's Length Transaction Structures - Recognizing and Restructuring controlled transactions in transfer pricing. IBFD*
29. *Paragraph 1.48 to 1.54, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations . OCDE. (Paris, 2010).*
30. *Section C.2 determination of the economic substance of a transaction or an agreement*

seem to have any precise meaning and therefore provides only a modest guidance.

Action 5 of the BEPS Action Plan drafted by the OECD could generate the basis for a more precise and pragmatic definition of the principle of economic substance that would identify, classify and deal with those practices or maneuvers, from their real nature of tax abuse.

This Action 5 deals with the following points:

- To update the work on harmful tax practices with the improvement of transparency as a priority, including the spontaneous exchange required in individual resolutions regarding preferential regimes, and the existence of an substantial economic activity as a basic requirement to apply any preferential treatment.
- Taking a holistic approach for assessing preferential tax regimes in the context of the Tax Base Erosion and Profit Shifting.
- Work with countries that are not members of the OECD on the basis of the existing framework and modifications or additions to the existing framework will be considered.

On this last point the OECD understands that the current rules work well in many cases, but need to be adjusted to prevent the transfer of benefits resulting from the interactions between more than two countries, and to be fully useful in the context of global value chains.

In order to preserve the expected effects on the bilateral relations, rules need to be modified to address the use of multiple layers of legal entities between the country of residence and the source country. [31]

2.1.3. Prevent the artificial avoidance of the permanent establishment status.[32]

The OECD consider convenient to review the definition of permanent establishment for the purposes of:

- Prevent artificial avoidance of the status of permanent establishment, including through the use of mechanisms of broker and exemptions for specific activity.
- Dealing with situations related to the allocation of profits.

The OECD recognizes that the multinationals have been able to use and abuse the regulations to separate incomes from the economic activities that produce them and move them to areas of low taxation.

This is almost always produced by transfers of intangibles and other mobile assets for less than their real value, by the overcapitalization of those entities that are taxed at reduced rates and contractual assignments of risks to territories of low taxation, in transactions that would rarely occur between independent parties.

The OECD understands that some special measures, either inside or outside of Arm's Length, may be necessary with respect to intangible assets, risk and excess of capitalization to deal with these shortcomings.

2.1.4. Intangibles[33]

The OECD understands the importance of developing rules that prevent the Tax Base Erosion and Profit Shifting through the movement of intangible assets between the members of a group.

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31. The interposition of third countries in the bilateral framework established by the signatories of a Convention has led to the development of structures such as establishments of foreign companies of low taxation, instrumental societies, and the artificial movement of income through transfer pricing.

32. Action 7. Action Plan on Base Erosion and Profit Shifting. OECD. (Paris, 2013).

33. Action 8. Action Plan on Base Erosion and Profit Shifting. OECD. (Paris, 2013).

This will involve, according to the OECD criteria:

1. The adoption of a wide and clearly delineated definition of intangible;
2. Ensure that the benefits associated with the transfer and use of intangible assets are properly assigned in accordance with (rather than separate from) the creation of value;
3. Develop rules of cost of transfer or special measures for the transfer of intangibles of difficult valuation; and
4. Update the regulation on cost-sharing mechanisms[34].

2.1.5. Risk and capital[35]

The OECD considers that rules should be developed that prevent the Tax Base Erosion and Profit Shifting through the transfer of risks or excessive allocation of capital to members of the same group.

This will include the adoption of rules on transfer prices or special measures that will ensure that an entity will not obtain any inadequate results only by contractual assumption of risk or for having provided capital.

The norms to be developed will also require the alignment of results with the creation of value and their coordination with the work on deductions for interest expenses and other financial payments.

2.1.6. Other high risk transactions[36]

Other sensitive issues that have raised concerns among the tax administrations are those transactions that would not occur, or would occur only rarely, between third parties and that allow the Tax Base Erosion and Profit Shifting.

The OECD considers that its treatment will involve the adoption of norms on transfer pricing or special measures to allow:

1. Establish the circumstances in which transactions can be re-qualified
2. Clarify the application of transfer pricing methods, in particular, the division of benefits, in the context of global value chains; and
3. Provide protection against the most common types of base erosion through payments such as management expenses and head office expenses.

2.1.7. Review the transfer pricing documentation[37]

A key issue in the application of transfer pricing is the asymmetry of information between taxpayers and tax administrations.

In many countries, tax administrations have little capacity to develop a “General overview” of the global taxpayer value chain. In addition, the differences in approach to transfer pricing documentation requirements lead to significant administrative costs for companies.

In this regard, it is important that tax administrations have at their disposal adequate information about the relevant functions performed by other members of the multinational group regarding intra-group services and other transactions.

For this reason, the OECD finds important to develop rules relating to transfer pricing documentation to increase transparency towards the tax administration, taking into account the costs of compliance for businesses.

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34. For more information on the mechanisms of distribution please read Chapter VIII, agreement on sharing costs of the guidelines applicable to transfer pricing in terms of prices for transfer to multinational enterprises and tax administrations. OECD. (Paris, 2010)
35. Action 9. Action Plan on Base Erosion and Profit Shifting .OECD. (Paris, 2013).
36. Action 10. Action Plan on Base Erosion and Profit Shifting. OECD. (Paris, 2013).
37. Action 13. Action Plan on Base Erosion and Profit Shifting .OECD (Paris, 2013).

The norms to be developed include the requirement that MNEs provide to all relevant Governments the necessary information about the global allocation of their revenues, economic activity and the taxes paid between countries, using a common model.

Actions to fight against Tax Base Erosion and Profit Shifting must be complemented with actions that guarantee the certainty and predictability. An important complement to the work on issues of Tax Base Erosion and Profit Shifting will be working to improve the effectiveness of the friendly procedures.

The interpretation and application of the new rules resulting from the work described above could introduce elements of uncertainty that should be minimized as possible.

As a consequence, efforts will be aimed at examining and combating obstacles preventing countries from resolving controversies arising from the application of the Convention through friendly procedures. Similarly the possibility of completing the existing provisions on friendly procedures in tax conventions with a mandatory and binding arbitration clause should be taken into account.

3. FROM POLITICAL AGREEMENT TO TAX LEGISLATION: THE NEED FOR PROMPT IMPLEMENTATION OF THE MEASURES

It is the understanding of the OECD that the fulfillment of the actions included in the action plan on the Tax Base Erosion and Profit Shifting will give rise to a series of results.

Some actions will result probably in recommendations related to domestic legal provisions, as well as changes in the comments to the Model Tax Convention of the OECD and the OECD transfer pricing guidelines. Probably, other actions will result in changes to the Model Tax Convention of the OECD.

This is the case for example of the introduction of a provision anti-abuse of Convention, changes in the definition of permanent establishment, changes in the provisions on transfer pricing and the introduction of new provisions in the Convention relating to the imbalances by hybrid mechanisms.

Changes to the Model Tax Convention of the OECD will not be directly effective without the corresponding amendments in the bilateral tax conventions. If these are processed on a convention by convention basis, the large number of conventions in force can make this process very long, and more even when countries embark upon general renegotiation of their bilateral tax conventions. A multilateral instrument amending the bilateral agreements is a promising way forward in this regard.

4. CONCLUSIONS

As we have seen, the actions on transfer pricing of the BEPS Action Plan seek to identify those practical issues that limit the registration and control of operations that foster the artificial shifting of benefits through companies belonging to the same economic group.

To summarize, we can describe the following actions highlighted from the document on the challenges we face in the control of transfer pricing:

a. The use and transfer of intangible assets and the economic obligations which must be respected in agreements between related parties;
b. The simplification of documentary obligations to assess risks in transactions between related parties and better analysis in the global value chain of the taxpayer;
c. Aspects relating to the reorganization of companies and, in particular, issues concerning the distribution of risks between related parties;
d. The attribution of profits to permanent establishments, where the issues relating to the attribution of revenues to branch operations in accordance with the Arm's Length principle are examined;
e. Guidelines with respect to the pricing of the related financial transactions, including the financial guarantees and performance, derivatives, captives insurances and other kinds of insurance, and loans between entities of the same group;
f. The proposal to insert in double taxation conventions the rules of compulsory and binding arbitration on issues of transactions between related parties.

Effective enforcement actions in Latin America will depend on the possibilities and needs of each country, according to the development of their economies and of the technical and human capacity of their tax administrations.

It is also noteworthy that the OECD promotes the discussion of some special measures, either inside or outside the Arm's Length, in order to avoid the harmful transfer of benefits. The base principles from the OECD transfer pricing guidelines seem to be a common denominator in the region, however, individual cases as protection and anti-elusion rules, implemented by some countries, are presently created as a practical solution to certain situations in which the Arm's Length principle is not seen by the tax administrations as a realistic tool that allows to avoid the transfer of profits and correct abusive maneuvers.

Without a doubt, the role of international cooperation has been and will be a key in the development on the control of the transfer of benefits for the region. The organization and promotion of training and technical assistance by multilateral agencies such as the IDB, World Bank, CIAT, IMF, the European Union, OECD and UN present encouraging results in the fight against tax avoidance and tax evasion.

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REDUCING THE TAX GAP ON WORK REVENUE IN PERU

Carlos Gallardo Torres and Yazan Al-Karablieh

SYNOPSIS

This paper tackles the earned income tax gap, a loss of potential revenue that, if generated, can target development objectives by mobilizing government expenditure. The current design results in (1) large jumps in the marginal tax rates, (2) a high threshold to paying taxes, and (3) lower tax burden on the higher-income taxpayers. The paper proposes a design showing an immediate response of increasing income tax revenue by up to 5.7% only in the first year, with higher potential in the following years. In addition, this paper recommends a massive and innovative usage of electronic invoicing.

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Content

In an attempt to raise additional revenue, Peru has achieved progress in the areas of indirect and corporate taxation, but is yet to achieve similar progress in raising revenue from the earned income tax, prompting the Tax Administration and the Ministry of Economy and Finance to seek reform recommendations. This paper tackles the earned income tax gap, a loss of potential revenue that, if generated, can target development objectives by mobilizing vital government expenditure and transfer spending. Earned income refers to wage and self-employed labor income, but this paper focuses on the self-employed professionals and labor workers, since sole proprietorship businesses are not subject to the earned income tax, but are instead subject to a simplified corporate tax regime.

In the Peruvian case, the main potential constraints to earned income tax reform are tax design, Tax Administration performance, and tax culture. The paper proposes a design showing an immediate response of increasing income tax revenue by 5.7% only in the first year, with higher potential in the following years. Tax design, however, cannot raise substantial revenue without an active effort to continue to improve Tax Administration practices, tax culture, and target the self-employed. The self-employed remain the largest obstacle to raising taxable income. Therefore, any tax table design attempting to reduce distortions must be accompanied by measures to encourage compliance.

In addition to redesigning the tax table, the paper points to an electronic invoicing policy option that can respond to tax collection limitations. Because invoices can be deductible from taxable income, up to a limit, electronic invoicing creates incentives for customers to demand receipts, especially from the higher-income professionals. To achieve an effective implementation, the paper also recommends Tax Administration to release information about rising audits to create credible threats for evasion, especially targeting the self-employed. Authorities should additionally focus on expanding effective programs attempting to increase public service provision awareness and engage voluntary taxpayer compliance.

The analysis then considers the Tax Administration's ability to administratively implement the recommended policy option and the political system's ability to pass the tax reform law. Administrative capacity requires attention, yet there is rising confidence in current efforts to handle the tax reform. The largest implementation constraint will be political support. For this purpose the paper suggests efforts to build a political coalition in Congress by engaging stakeholders according to their interests, such as highlighting the progressivity benefits embodied in the proposal to groups representing the lower-income workers.

This paper proceeds as follows: **(1)** highlighting the problem and the need for reform, **(2)** a description of the tax structure and recent trends in Peru, **(3)** a review of tax reform lessons from theory and global trends, **(4)** a diagnosis of the constraints to increasing revenue from the earned income tax in Peru, **(5)** a consideration of policy and reform options, and **(6)** recommendations of policy options, an implementation plan, and administrative and political analysis.

1. THE NEED FOR REFORM

Peru, like many Latin American and other developing countries, faces high informality, tax evasion and avoidance, and suboptimal collection practices. Yet Peru's loss of potential revenue from the earned income tax is also characterized by an inefficient tax design. This paper will break down the tax design constraint and recommend changes to its current shape. Additionally, realizing that changing design must be enforced by higher compliance and improved practices in collection, the analysis will also focus on tackling other factors constraining earned income tax collection.

The importance of increasing revenue from the earned income tax is reflected in the need for additional expenditure by the government. Much of development economics has centered on the government's delivery of goods and services, such as education, because of the contribution of these goods to economic growth. Peru also uses transfer spending as a development tool to reduce poverty and inequality. Despite a moderate increase in expenditure since 1990, Peru's social expenditure remains among the lowest in Latin America. Additionally, Lustig[1] et al. find Peruvian transfer programs effective at poverty and inequality reduction achieved per percent of GDP spent. Thus, closing the earned income tax gap serves as an essential step towards achieving these development goals.

Additionally, the Ministry of Economy and Finance is pushing the earned income tax problem on the agenda as a result of Peru's potential to raise more revenue, and the tax's revenue performance relative to the corporate tax and indirect taxation. Despite achieving some progress with raising revenue as a percentage of GDP, Peru (15.7% of GDP in 2012) lags the Latin American average of 17%.[2] Interesting enough, Peru's 2012 indirect tax revenue is on par with Latin America (10.3%) at about 9.6% of GDP.[3] Peru's 2012 corporate tax revenue is also at 5.3% of GDP compared to the Latin American average of 3% of GDP.[4] Having achieved progress in other tax domains, closing the earned income tax gap is now a priority.

The problem diagnosis begins with Peru's personal and earned income tax revenue relative to Latin America. Peru's personal income tax performance is higher at 1.8% of GDP, though the earned income tax revenue generated is only 1.5% of GDP in 2012.[5] Despite not falling below the Latin American average, the low revenue to GDP ratio from the earned income tax clearly lags the improving performance of other sources of tax collection. The overall tax burden gap, defined as the deficit in tax collection with respect to international standards, is about 3.5% of GDP and the income tax gap is about 1.5% of GDP.[6] The figures reflect that less revenue is collected in Peru relative to other countries with similar levels of GDP, size of the labor force, percentage of the self-employed, trade openness and rents from natural resources, indicating room for increased collection.

1. *Lustig, N., Pessino, C., & Scott, J. (2013). The Impact of Taxes and Social Spending on Inequality and Poverty in Argentina, Bolivia, Brazil, Mexico, Peru, and Uruguay: Introduction to the Special Issue. Public Finance Review No. 1313.*
2. *Corbacho, A., Cibils, V. F., & Lora, E. (Eds.). (2013). More than Revenue: Taxation as a Development Tool. Palgrave Macmillan.*
3. *Calculation based on the 2012 CEPALSTAT and Central Bank of Peru databases.*
4. *Ibid*
5. *Author's calculations based on 2012 Tax Administration data*
6. *Ibid. 2*

Table 1
Peru in a nutshell

Social expenditure	**: Ranks 18th in LAC**
Tax revenue (%GDP)	**: 15.7, below LAC average**
Earned income tax revenue (%GDP)	**: 1.5, lags performance of other sources**
Income tax gap	**: 1.5 %GDP less revenue collected**
To start paying taxes	**: More than 1.7 times GDP per capita. Higher than LAC and middle income countries**
Tax evasion	**: 32% earned income tax, 51% self-employed**
Labor informality	**: 64% in urban areas**

Source: CEPAL, Tax Administration, Central Bank of Peru

Tax design and non-design issues contribute to the earned income gap. On one hand, the tax design component shows large jumps before the first marginal tax rate (15%) that might constitute a signal of individuals misreporting their income not to pay taxes. It also shows a high threshold for taxpayers to pay taxes on earned income, at 1.7 times GDP per capita, above the Latin American and OECD averages (1.4 and 0.24).[7] In addition, two aspects that should also be considered when evaluating the current design are: (i) the different opportunities for tax avoidance that it allows, and (ii) its progressivity or the size of the redistribution effect through taxes.

On the other hand, the non-design constraints exacerbate the problem and cast doubt on whether redesign alone can increase revenue. Symptoms of these constraints are the existence of significant tax evasion and labor force informality. Other relevant symptoms include the constrained tax enforcement and monitoring with low, yet improving, field audit rates, while administrative symptoms include a higher cost to collection as a proportion of tax revenues in Peru relative to the Latin American average. It is clear that Peru faces at least some of the typical developing country limitations to collecting the earned income tax. These limitations form, to a large extent, part of the larger problem of the earned income tax gap, and therefore require attention during diagnosis and a role in policy interventions.

The policy question is the following: how can we generate revenue by reducing the earned income tax gap, without increasing the burden on the poor or introducing large economic distortions, and while aiming to pass an administratively and politically feasible reform? We also seek to answer two sub-questions. First, what main components of the tax schedule can be redesigned to achieve the objective of the policy question? Second, what are the main constraints to earned income tax collection in Peru, and what feasible interventions can we recommend to supplement the tax design reform, especially those targeting the self-employed?

7. *Ibid. 2*

2. CURRENT INCOME TAX STRUCTURE AND RECENT TRENDS IN PERU

Since 1980 there have been two significant reform events. The first, in 1993, is the reduction of the number of brackets and tax rates from 5 to 2, in addition to the elimination of almost all itemized tax deductions and allowances. The second, in 2009, is the implementation of the individual dual income tax system developed in 2007, leading to a different tax treatment of capital income on one side and earned income on the other. Additionally, political instability caused many changes in individual taxation, given the modification of the tax schedule ten times since 1980. Interestingly enough, six of them were done by the President using legislative powers granted by the Congress.

Prior to 2009, Peru had a comprehensive tax system where earned and capital income less deductions and allowances were taxed according to the same progressive tax schedule. The 1982 tax schedule included 14 brackets, with marginal tax rates going up to 65%. However, tax reform simplified and flattened the tax schedule: by 1990, the tax schedule included 9 tax brackets, with tax rates going from 8% to 45%; and by 1993, tax reform reduced the number of tax brackets to 5, with marginal tax rates ranging between 6% and 37%. These brackets were determined by a certain number of Peruvian Tax Units, a method of indexation used in legislation whose value is updated almost every year. [9]

Previous tax regulations included many deductions and allowances, most too distortionary. The deductions and allowances were of general application, while some were exclusive to self-employed individuals or payroll employees. In addition, the tax system had some income excluded from taxation up to a threshold amount. This amount was modified between one and seven Tax Units throughout this period and was applicable to both, self-employed and payroll employees. In addition, self-employed individuals could choose between a deduction of 20% of their gross income (with a limit of 24 Tax Units) or to apply to the itemized deductions.[9]

However, the deep Peruvian recession by the end of 1980s and the subsequent reform of a collapsed Tax Administration led to an over-simplification of the tax regulations. The reform reduced the number of brackets and rates to only two, 15% and 30%, effective since 1994. The 2001 change in the tax schedule reduced the top marginal rate to 20% with the aim of overcoming the economic crisis of the late 1990s. Subsequently, policymakers increased the number of brackets to 3, making up the marginal tax rates of 15%, 21% and 27%, effective since 2002. Finally, to equalize the tax burden between individuals earning dividends and individuals earning other kinds of income, the top marginal rate was increased to 30% for the tax schedule to take its current form.[10] In its current form, the taxable earned income is equal to the gross earned income (plus worldwide income) minus the threshold amount (seven Tax Units) in general and the 20% of gross income deduction (with a limit of 24 Tax Units) in the case of the self-employed. To place this in perspective, the present-day individual dual income tax system has the following additional components: capital gains, interest, royalties and property income

8. *The value of a Peruvian Tax Unit for 2014 is 3800 Soles (the local currency), or approximately US$ 1360.*
9. *The deduction was 15% of gross income between 1982 and 1984.*
10. *The report done by Congress cites that people receiving dividends from companies were taxed at a tax rate of 27% applied to the company's income and of 4.1% applied to the dividends itself, leading to an effective rate of 30%.*

are subject to a tax rate of 6.25% applicable to 80% of the income, while dividends are subject to a final tax rate of 4.1%.[11]

Previous tax reforms provide several lessons. First, many of the previous reforms were a response to the Peruvian economic crises or high inflation rates. This fact means reforms were driven out of practical considerations, rather than optimal tax theory or motivation to raise revenue in an efficient manner. Second, too many reforms in the 1980s and 1990s created regulatory instability. Increased stability in the 2000s decade shows the potential for higher revenue collection. Third, and more technical, the previous tax reforms show that too few marginal tax brackets are not optimal, while too many tax brackets are highly distortionary. Fourth, an increase in deductions and allowances creates distortions, but a few deductions can be useful given considerations for specific groups of taxpayers.

Table 2
The evolution of the tax system

Fiscal periods	1982-1984	1985	1986	1987-1989	1991	1992-1993	1994-2000	2001	2002	Since 2003
Number of brackets	14	12	10	9	8	5	2	2	3	3
Tax rates (%)	0 - 65	0 - 50	0 - 48	8 - 45	8 - 37	6 - 37	15 - 30	15 - 20	15 - 27	15 - 30
Deductions/allowances	Flat and Itemized						Flat			

Source: Tax Administration

3. LESSONS FROM THEORY AND GLOBAL TRENDS

3.1. Equality, efficiency, and complexity considerations

In reforming the income tax, policymakers must balance efficiency objectives with distributional objectives. The classic tradeoff between efficiency and distributional objectives comes from the following: social welfare tends to be larger with more equal distribution, yet redistributive taxes and transfers can create different work and income incentives.[12] Efficiency objectives tend to be grouped with growth-enhancement, revenue-increases, and less distortion of agents' behavior. These characteristics of efficiency go hand-in-hand since distortionary behavior reduces the taxable income of taxpayers, and thus, all else equal, an increase in efficiency results in an increase in taxable income, revenue, and tends to be correlated with higher growth rates. Yet achieving distributional objectives tends to undermine efficiency objectives and vice versa. A decrease in the marginal tax rates of lower tax brackets, for example, can increase labor-force participation and taxable income at the lower end of the income distribution, but with the price of discouraging taxpayers in the above brackets of the distribution. This is because higher-bracket workers will reduce hours worked, or distort

11. *In the case of dividends, they are already considered out of the progressive tax schedule and taxed at 4.1% since 2003.*
12. *Diamond, P., & Saez, E. (2011). The case for a progressive tax: from basic research to policy recommendations. The Journal of Economic Perspectives,25(4), 165-190.*

other behaviors, in order to avoid the higher spreads in the marginal tax rates. This response reduces taxable income at the higher end of the distribution and risks producing efficiency losses in the form of behavioral distortions.

It is important to note that while the traditional tradeoff between efficiency and equality remains intact, the argument for lower marginal tax rates at the top of the distribution is not immune to increasing dissent. In fact, after reaching a consensus on the distortionary effects of very high top marginal tax rates following the work of Feldstein[13], the literature has recently rejected many of the earlier arguments.

3.2. Behavioral responses, kink points, and tax design

To understand how the design of the earned income tax can influence revenue collected, the review of the optimal design for progressive taxation with a focus on changes in marginal tax rates is essential. The evidence from the existing literature provides a reference point for analyzing the Peruvian taxable income data, especially at the first jump in marginal tax rates, the initial tax payment threshold, and finally for higher marginal tax rates.

To design a progressive tax, any tax authority must balance efficiency and equity, acknowledging the tradeoff between a large taxable income and high marginal tax rates. The review of the effect of marginal tax rates on taxable income is therefore central to understanding how redesigning a tax table can influence tax revenue and the behavior of agents. Feldstein[14] demonstrated the taxable income approach that has since become conventional in addressing taxation's effect on behavior, since it allows for a wider range of responses than the traditional view of hours supplied. It is important to note that behavioral responses from tax shifts is not limited to shifts in the same form of taxable income, but can also include responses in other taxable income forms. The elasticity of taxable income with respect to the marginal tax rates became central in this debate on lowering or raising the marginal tax rates. With the increasing importance of these elasticities in policy debates, the literature developed additional ways to measure them. For example, behavioral responses around kink points present at marginal tax rate jumps allows for the use of the bunching approach to estimate elasticities or behavioral responses around these points.

Providing key evidence relating kink sizes and behavior, Chetty et al.[15] find that taxable income elasticities, and thus behavior responses, are higher for larger kinks and for larger groups of workers. The authors explain the size of the behavior responses in micro studies through search costs and finding new jobs, in which larger tax changes through larger kinks tempt taxpayers to pay search costs to find jobs that place them at the kink. Intuitively, larger benefits from moving towards the kink point or the previous income bracket as implied by larger kinks induces taxpayers to tolerate higher search costs for a new job. One can extend this intuition to include all behavior responses: larger benefits from moving towards the lower income bracket or bunching at the kink point. Regardless of whether this comes from legal responses or from tax evasion, it can induce larger responses from taxpayers, making larger kinks more

13. *Feldstein, M. (1995). The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act. The Journal of Political Economy,103(3), 551-572.*
14. *Ibid. 13*
15. *Chetty, R., Friedman, J. N., Olsen, T., & Pistaferri, L. (2011). Adjustment costs, firm responses, and micro vs. macro labor supply elasticities: Evidence from Danish tax records. The quarterly journal of economics, 126(2), 749-804.*

distortionary. The self-employed, however, do not face the same adjustments costs or hours constrained, and thus self-employed taxpayers do not show significantly different bunching behavior based on the size of the kink, the size of deductions, or aggregate bunching.

While the previous evidence suggests that bunching may be clearer for the lower marginal tax rate brackets, the higher marginal tax rate brackets cannot be neglected. First, this is due to the potentially large tax revenue increase that higher income tax payers could provide. Second and possibly more important, raising revenue at the bottom of the distribution may be limited due to the aim of maintaining progressivity in the tax schedule, and the limited ability of the lower-income and middle-income households to provide a greater portion of their income. In the top end of the income distribution, however, where the marginal tax rates are higher, there is some consensus on the existence of a highly sensitive taxable income. The sensitivity of taxable income at high marginal tax rates is partly due to tax evasion and avoidance. This is particularly relevant for Latin America and Peru where evasion is unquestionably high.

Piketty et al.[16] also argue that optimal labor income taxation for the top income brackets may not be as distortionary with the presence of a large compensation bargaining effect.[17] Assuming thicker tails in the distribution of ability or income, other studies have also shown that rising marginal tax rates between the middle-and high-income taxpayers are justified, with optimal high income marginal tax rates above 30%. These insights are useful in the Peruvian case, where only at 2% of those paying taxes belong to the highest income bracket with 92% belonging to the lowest marginal tax rate bracket.[18]

Studies on elasticities and behavioral responses have also confirmed that other non-tax rate components influence the amount of tax collected. In their account of three elasticities that influence the link between tax rates and higher income taxpayers, Picketty et al.[19]provide lessons for optimal taxation and revenue generation, and consolidate some of the mixed evidence on the optimal top marginal tax rates. The authors argue for the existence of avoidance and bargaining elasticities in addition to the real supply elasticity. A poorly designed tax system that allows for tax avoidance, by offering many opportunities for avoidance, can face high avoidance elasticity at the top rates. In this case, very high top marginal rates can be counter-productive. First, this shows that lower top marginal tax rates need not produce large behavioral responses. Second, and crucial for this analysis, this shows that the tax table should not be the only component in reform considerations. If complexity of the tax regulations can increase these avoidance opportunities, then a simplified tax regulations is more efficient and can be revenue generating. Yet complexity is only the tip of the problem, meaning avoidance opportunities are better reduced via other interventions, such as tax enforcement and encouraging voluntary compliance, especially in the case of the self-employed.

3.3. Trends in income tax policy

Advanced and developing countries show several common trends and practices in income tax policy. In general, the expanding size of governments and their ability to tax without “destroying economic

16. *Piketty, T., Saez, E., & Stantcheva, S. (2011). Optimal taxation of top labor incomes: a tale of three elasticities (No. w17616). National Bureau of Economic Research.*
17. *Piketty et al. show that when top marginal tax rates are very high, the net reward to a highly paid executive for bargaining for more compensation is modest, but when top tax rates fall, high earners start bargaining more aggressively to increase their compensation.*
18. *Calculations based on 2010 Tax Administration data.*
19. *Ibid. 16*

growth" are notable changes in the 20th century for both advanced and developing countries. Additionally, where tax collection is done with the assistance of third-parties, the evasion rates are negligible regardless of the category of the country – advanced or developing. What sets advanced and developing countries apart is the high rate of third party reporting, especially by firms, in advanced countries, where third-party reporting forms a significantly larger portion of taxable income.[20]

Other common trends have followed many of the theoretical prescriptions. The trends show that, adjusted for changes in the ranges of incomes over which top marginal tax rates apply, top marginal tax rates have tended to fall over time in 11 out of 14 OECD countries. However, it is important to note that, despite falling, these marginal tax rates remain significantly higher than Peruvian marginal tax rates. Not only did top marginal tax rates fall, but 9 of 14 countries flattened the marginal tax schedule measured by a decline in the spreads between taxable income brackets.[21] Flatter tax rates mean smaller kink points and lower distortions from income responses to differences in marginal tax rates. Finally, Mankiw et al.[22] show that OECD countries tend to increase redistribution in years of higher earnings inequality. Redistribution policies have increasingly targeted vulnerable groups to poverty in these OECD countries. To the extent that these policies represent a move towards theory, OECD countries have progressed towards a reduction in inefficiencies and a movement towards optimal taxation.

4. DECONSTRUCTING THE PROBLEM AND IDENTIFYING CONSTRAINTS

4.1. Identifying drivers of revenue loss using the tax cycle

In formulating a response to the earned income tax gap, it is useful to diagnose the constraints that explain the source of this gap. To identify these constraints, one can observe the three main tax cycle processes that taxpayers undergo: registration, declaration, and payment. In many developing countries, the problems of tax collection can be attributed to large registration gap, where potential taxpayers are not registered to pay the income tax. Likewise, the declaration gap involves those who have been registered but do not declare income. Finally, the payment gap refers to registered taxpayers declaring income but not making payments. By breaking down each of these three gaps into potential constraints on the tax system, one can develop a list of factors that restrict raising additional revenue.

Constraints on tax collection are either due to the lack of optimal policies, in tax design or in addressing complementary constraints, or the lack of administrative or implementation capacities to allow these policies to take effect. The registration gap can be constrained by a lack of policies to address the informal economy and a lack of administrative capacity or high costs to registration. The declaration gap can be constrained by tax design, tax culture, or low

20. *Kleven, H. J., Kreiner, C. T., & Saez, E. (2009). Why can modern governments tax so much? An agency model of firms as fiscal intermediaries (No. w15218). National Bureau of Economic Research.*
21. *Mankiw, N. G., Weinzierl, M., & Yagan, D. (2009). Optimal Taxation in Theory and Practice. The Journal of Economic Perspectives, 147-174.*
22. *Ibid. 21*

administrative capacity or high costs to monitor, audit, and enforce compliance. Similarly, the payment gap can be due to tax culture or some form of low administrative capacity, or complexity.

The leading constraints to tax collection are the following: (1) Tax Administration performance, monitoring, and enforcement, (2) tax culture and intrinsic motivation, and (3) marginal tax rates schedule and the taxable income distribution. This section also addresses the implications of informality on tax collection.

4.2. Tax administration monitoring and enforcement

This section is motivated by the deterrence theory of tax evasion, where taxpayers decide how much to evade based on legal penalties and the probability of getting caught. We follow the tax administration evaluation structure proposed in Vázquez-Caro and Bird[23] The first common approach is benchmarking by descriptive statistics or the quantitative approach, and the second is benchmarking by sound institutional practices or the qualitative approach. Finally, they advocate for and use a systemic approach.

4.2.1. Quantitative benchmarking

Diaz et al.[24] systematically compare tax administrations in Latin America by developing quantitative indicators. From an efficiency perspective, the cost of collecting revenue[25] in Peru in the period 2006-2010 is about 1.54 monetary units per 100 units collected. This is higher than the Latin America Average in the same period (1.37) and the OECD average (0.96) in 2009. At first sight, this seems alarming. Yet we calculated similar ratios for the period 2008-2012, observing a decreasing trend in relative costs between 2009 (1.99) and 2012 (1.62).[26] These numbers need to be taken with precaution because, while a low cost could be due to an increase in efficiency, it can also be a result of a cut in investment expenditure. The fact that the Tax Administration invested around 2.4% of its executed budget in 2012, very similar to other countries in the region, shows that the lower cost is due to increased efficiency.[27] However, investment itself is below potential: 2012 investment was only 30% of the estimated potential investment in that year[28] and only half of the investment in 2011.

Another measure of tax administration performance is outstanding collection efficacy. The first measure is registration. Diaz et al. show that the 2010 participation of registered individuals in the labor force (32.5%) was above the Latin American average (22.8%). This ratio has increased from 24.2% in 2006 to 35.5% in 2012.[29] This increase suggests an improvement in complete, accurate and constantly updated information, allowing the analysis of taxpayer behavior and facilitating compliance control. A second measure is the facilitation of filing and payment of obligations. One important improvement in this regard is the offering of pre-made declarations and returns. This is available only in 5 countries in Latin America, including Peru.[30]

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23. *Vázquez-Caro, J., & Bird, R. M. (2011). Benchmarking Tax Administrations in Developing Countries: A Systemic Approach. eJournal of Tax Research, 9(1).*
24. *Diaz Yubero, F., Pecho, M., Cremades, L., Vásquez, O., Velayos, F., & Barreix, A. D. (2013). Estado de la administración tributaria en América Latina: 2006-2010. Inter-American Development Bank.*
25. *A result of comparing a tax administration's total spending with the revenue it generates in a given period of time.*
26. *Calculation based on Ministry of Economy and Finance budget database.*
27. *Diaz et al. 2013 report a level of investment in Peru of 4.1% of the executed budget in 2010, slightly above the Latin America average (3.9%) without considering Colombia (39.1%).*
28. *In the report elaborated by the Tax Administration that supported Law No 29816 issued in 2011, the Tax Administration presented an investment plan for the period 2011-2015, where roughly 50% of the investment was to develop offices.*
29. *Author's calculations based on Diaz et al. 2013 questionnaire and World Bank database.*
30. *Ibid. 24*

Finally, a third measure is auditing. Unlike the previous tax administration indicators, auditing evidence in Peru is worrisome. Diaz et al. show that the number of field auditing taxpayers as a proportion of active taxpayers in Peru was practically zero percent in 2010, similar to almost all countries in Latin America.[31] This raises concerns over the capabilities of the tax administration in enforcing compliance, and results in taxpayer perceiving that willful omissions go unpunished. However, the positive is that, the number of audits has increased since then. Considering only individuals, the value of this ratio increased from 0.63% in 2011 to 0.84% in 2012.[32] In line with this upsurge, the amount of tax collected directly related to auditing actions, both to individuals and corporations, increased from 7% to 10.7% of tax collected in the same period.[33]

In general Tax Administration performance seems to be on par with Latin American in certain measures, shows better performance in registration, and is certainly improving with respect to auditing. Yet a comparison of the previous indicators has certain limitations, since these indicators depend on a number of factors that have no clear direct correlation with overall efficacy or efficiency; for instance, the different tax rates and structures that exist in each country.[34] Therefore, when drawing any conclusion in the case of Latin America and Peru one needs to consider, for instance, that only three tax administrations (Brazil, Argentina and Peru) collect through three sources of revenue (taxes, tariffs and social contributions).[35] Furthermore, some administrations, such as the one in Peru, are appointed with some additional responsibilities.[37] In other cases, as in Chile for example, the Tax Administration is not authorized to prosecute tax debtors similar to the Tax Administration in Peru; Chile has another institution to such purpose.

4.2.2. Institutional practices

From an institutional perspective, Vázquez-Caro et al.[37] uses the 2007 European Commission fiscal blueprint for tax administrations to indicate 14 different desired aspects in a tax administration. These include an adequate level of autonomy, administration tax legislation framed according to key principles, and comprehensive and integrated revenue collection strategies, among others. In this regard, the Peruvian Tax Administration has made progress by working on annual management and operating plans since 2002, establishing objectives, indicators and conducting performance evaluations, all according to five-year institutional plans.

Furthermore, a 2011 law aims to improve the performance of the Tax Administration against tax avoidance and evasion, and increase the tax base and the tax collection. The main improvements involved an increase in autonomy by assigning a 5 years appointment for the head of the Tax Administration,[38] and changes in the organizational structure of the Tax Administration. In addition, the law provides the

31. *Diaz et al. report a ratio of 0.2% as the average ratio for Latin America. All 13 countries that provided numbers on this subject, including Peru, have ratios lower than 0.8% (Guatemala).*
32. *Calculations based on Tax Administration data. The number of audits to individuals went from 32,924 in 2011 to 48,440 in 2012. Furthermore, the number of overall audits (individuals and corporations) rose from 117,751 in 2011 to 247,424 in 2012.*
33. *This includes all actions of collection by the Tax Administration of tax debts declared by Taxpayers as well as payments induced because of auditing.*
34. *Among these limitations, and in particular referring to the cost of collection, OECD 2011 mentions not only (i) tax rates and structures but also (ii) scope and nature of the taxes overseen by national tax administrations; (iii) collection of social security contributions; (iv) range of functions carried out by the entities being examined; (v) measurement methodology and accounting criteria employed; and (vi) stage of institutional development of the agency at issue.*
35. *In 2002, aiming to take advantage of different synergies, the Tax Administration absorbed the Customs Authority.*
36. *For instance, since 2012 it is responsible of the control of imports, exports and transportation within the country of chemical inputs used to produce illegal drugs and used in the illegal mining sector.*
37. *Ibid. 23*
38. *The Head of the Tax Administration is appointed by the President of Peru. Before this law was issued, the average term duration of the Head of the Tax Administration in the last 20 years was 1.4 years, much lower than in Chile for example (6 years).*

Tax Administration with more financial autonomy, and improves its salary structure and other labor conditions. Thus, in general, recent reforms have led to an improvement in institutional practices as measured by international guidelines.

4.2.3. Systemic evaluation

However, international guidelines may not fit the context in Peru. Vázquez-Caro et al. posit that most of the aspects listed by the European Commission depend entirely on subjective judgment, and criticize benchmarking (quantitative or qualitative) in the cases a country blindly adopts the practices of other countries. The authors advocate for a systemic approach to assessing tax administrations, that gives full consideration to an entire set of factors,[39] listing underlying values found in good tax administrations,[40] and highlighting the shift in the definition of the relationship between taxpayers and the tax administration from an adversarial legal approach to a new model of cooperative compliance. A successful transition to this new model, they add, includes at least six critical factors: (i) structured risk management; (ii) viewing the taxpayer as a customer; (iii) the quality of the tax laws; (iv) appropriate international networking; (v) a wide range of consultative arrangements; and, (vi) a generalized use of internet-based technology. In each of these factors, the Peruvian Tax Administration has improved remarkably by setting a vision of becoming an ally of the taxpayers, assessing its service performance annually against explicit service standards, implementing electronic invoicing,[41] and recently increasing the number of tax treaties and prioritizing the implementation of new software that will allow the integration of all programs used by the Tax Administration, improving risk management.

The different features reviewed in this section provide strong evidence for improving performance. However, some aspects in the performance of the Peruvian Tax Administration remain a concern. For instance, if the low level of investment, or the lack of involvement of regional and local governments in income tax collection, risks the institutional improvements or the long-term objective of reaching a 5% field auditing ratio to individual taxpayers, then the perception of willful omissions going unpunished could not effectively be reduced. Thus, the performance of the Tax Administration is improving, but remains an area where there is potential for further improvements, especially in terms of field audits and taxpayer perceptions of increasing tax collection enforcement.

4.3. Tax culture and intrinsic motivation

The conventional argument that tax culture affects tax evasion rests on the notion of "intrinsic motivation." Frey[42] formally argues that "intrinsic motivation," where "civic virtue" compels taxpayers to comply with their tax liabilities, has a separate effect on the amount of tax evasion and misreporting of earned income. While "extrinsic motivation" involves a taxpayer's cost-benefit analysis of evading or paying taxes, intrinsic motivation involves a sense of volunteering

39. *These factors are (i) agencies' operational and institutional characteristics, (ii) their contribution to the tax systems' efficiency and equity, (iii) the relationship of the taxpayers to the State, the influence exerted by political and economic forces and, above all, (iv) the link between these various factors which, in combination, determine the results obtained.*
40. *These values are (i) A high level of commitment to protect the tax base; (ii) A cooperative (or collaborative) compliance model; (iii) Concern for equity above maximization of collection; (iv) Rationalization of transaction costs related to tax compliance; (v) Strategic management development within the changing role of tax administration as the country changes; (vi) The internationalization of tax administration as a response to limitations in the coverage of national tax systems; (vii) Standardization of tax processes based on automation and the formalization of processes and deeper use of the internet; and (viii) Major focus on the development and satisfaction of human resources.*
41. *Although electronic invoicing is not compulsory in Peru, its use has experienced a humongous increase from 3,582 invoices issued in 2008 to 1.2 million issued in 2012.*
42. *Frey, B. S. (1997). A constitution for knaves crowds out civicπ. The Economic Journal, 107(443), 1043-1053.*

to paying taxes regardless of punishment, enforcement, and audits. Taxpayers in this case include bad conscience or bad reputation in their cost-benefit analysis of evasion.

"Civic virtue" to pay taxes can arise due to higher perceptions of fairness in the tax system, where equitable systems could enforce norms against evasion. Perceptions of fairness can either be on the revenue side or expenditure side of government. For example, on the revenue side, extremely unequal tax systems can produce dissent against paying taxes for those perceiving inequality in contribution. On the expenditure side, taxpayers are more likely to cooperate in paying taxes if they perceive that the government repays the taxes in public services, good governance, and fairness. The results of the Latino Barometro survey show distrust in public management and dissatisfaction with the level of public spending. Nearly 85% of respondents in 2005 do not have faith that money spend by the government will be spent wisely. A popular citizen perception is that taxes are ill-spent or channeled to the corrupt, where responders rated these categories as the second and third ranking reasons to not pay taxes. Similarly, satisfaction with public services is clearly a problem, showing general dissatisfaction with public infrastructure investment in roads, public areas, and public transport at rates above 60%. The survey shows greater disapproval with healthcare, education, and rule of law investments at 74%, 66%, and 85% respectively.

There is no doubt that such levels of dissatisfaction are alarming, showing signs of distrust in government. Yet such evidence is inconclusive about whether this distrust translates into a binding constraint on tax compliance. Peruvian responders in 2010 showed a general aversion towards tax evasion relative to the Latin American average (2.3 versus 2.5 where a 1 indicates very averse and a 10 indicates justifiable).[43] While this could be due to the fact that responders do not want to disclose such preferences in fear of being identified, for example, the fact is that establishing a link between distrust with the government and non-compliance remains somewhat elusive.

Despite the unclear relationship, the fact that studies show evidence for a correlation between perceptions of public service quality and compliance demonstrates the need to further examine the potential for improving tax culture. It is very likely that those who evade taxation in Peru also show more distrust in government, yet the data that correctly breaks down responders into evaders and non-evaders remains elusive. While tax culture is not likely to be a binding constraint on tax collection, the available evidence points to the direction of large dissatisfaction in public sector management, and this begs attention during tax reform.

In addition to tax compliance as a response to public service provision, the interaction between tax culture and informality and legality creates constraints for the Tax Administration. Attitudes towards tax evasion and informality come into play in a worker's decision to join the informal economy. Thus, in an environment of high labor informality, such as Peru, the attitude towards taxation is likely to be weak, demanding the attention of the Tax Administration.

The tax culture question is on the agenda of the Tax Administration, prompting the adoption of "compliance management" approaches from other Latin American countries, and the reinforcement of tax education and cultural

43. *The 2012 Survey on Corruption by Proetica shows 32% of respondents have no tolerance (strong disagreement) towards evading taxes if they know they won't be caught. 66% of respondents also express regular tolerance (disagreement and indifferent) to the statement.*

programs. Given the disapproval in government and public services, in addition to the linkages between tax culture and the informal economy, the 2009 Tax Awareness Survey and baseline study performed in Peru could continue to shed light on the factors that could promote a greater disposition to pay taxes, especially among those prone to defaulting on their tax obligations.

4.4. Marginal tax rates and the taxable income distribution

This constraint derives from optimal income taxation theory discussed in section 3. The marginal tax rate schedule can be either too distortionary, creating large deadweight losses, or simply not covering a large portion of the population by design. In the latter case, large increases in the tax base could be possible without creating large distortionary effects.

4.4.1. Bunching

Using histograms, we have three main findings. First, there is no clear evidence of bunching in the form of spikes around jumps in the marginal tax rates using only histogram evidence. Second, the histogram density around the second jump in the marginal tax rates is almost entirely flat, showing no significant difference between the number of taxpayers around the kink and those in areas below and above the jump. The third jump in marginal tax rates shows small spikes around the kink, indicating the possibility of a small amount of bunching. Third, the bulk of taxpayers fall below 7 tax units, or below the first and largest increase in marginal tax rates from zero to 15%.

Our estimates also show that the proportion of the number of earners around the jumps is about one third for the top two jumps in the marginal tax rates, indicating a flat distribution around those jumps. This casts doubt over the possibility of bunching from the small histogram spikes around the third jump in marginal tax rates.

We confirm the graphical evidence of 2010 tax filers using 2011 tax filer data. Due to 2011 data limitations, these graphs shows more gaps in the density of taxable income. Thus, a spike in the number of taxpayers just below the third rise in marginal tax rates is inconclusive. Our break down of the sample of earners into a group with only self-employed income shows no significant difference between the findings of the self-employed and those with zero self-employment. Yet this is in no way conclusive due to the limitations of the 2011 tax data.

However, using kernel density estimates, we find a spike in density around the first marginal tax rate jump, as opposed to the household survey density. We interpret this evidence as a difference between the taxable income distribution reported to the Tax Administration, and the taxable income that is closer to un-tampered reporting, shown in the household survey. The fact that household surveys are representative for lower incomes is consistent with this interpretation. The most plausible reason for this difference, between the 2010 tax data and the household survey data, is the high jump in marginal tax rates (15%) relative to the lower jumps in the marginal tax rates from the first to second, and second to third, income brackets.

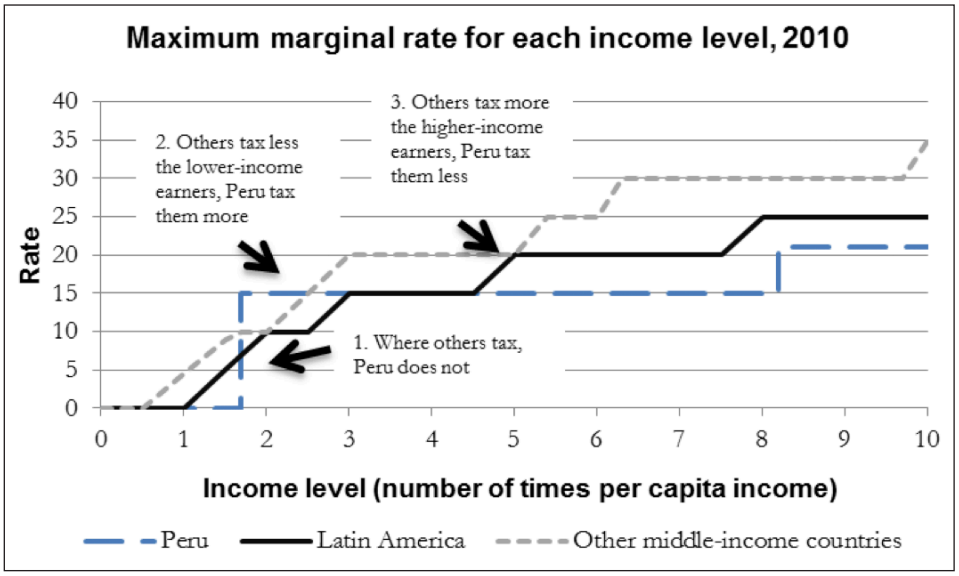
We suspect that clearer evidence of bunching, albeit a lower amount, could be found for higher incomes if more individuals reported their incomes at that level. Yet the data shows that the largest portion of the population remains below the first jump in marginal tax rate. Coupled with the high jump in marginal tax rates, the high threshold for paying taxes indicates a high potential to reduce behavioral distortions using a lower spread in marginal tax rates, and a slightly lower threshold. The evidence shows that we

cannot find clear evidence of bunching for the higher income brackets, presenting strong evidence for missing taxpayers, specifically the self-employed. Bunching is usually higher for the self-employed,[44] indicating that a lack of bunching is strongly correlated with missing self-employed income reporters at those levels, specifically the self-reporting professionals. Evidence in the next section supports this explanation, pointing to the constraint of non-compliance from self-reported income as a source of significant revenue losses.

4.4.2. Constraints with the current design

As seen through the Tax Administration data, the current design has a high threshold for paying taxes on earned income. Corbacho et al.[45] shows that to start paying taxes in Latin America a person must earn more than 1.4 times the income per capita, which is not only higher than the OECD country average (0.24), but more than double than the middle income country's average (0.65). Furthermore, a person will pay the higher tax rate in Latin America only if earning more than 9 times the income per capita, also higher than in the OECD countries (2.4) and in other middle income countries (6.5). The situation in Peru is even more extreme as both rates, the threshold as a multiple of income per capita and the highest tax rate bracket as a multiple of income per capita (at 1.7 and 14.4 respectively), are above all other averages.[46] We reach the same conclusion when considering people subject to tax rates between the lowest and highest brackets. As observable in Graph 1, the lowest marginal tax rate bracket that pays taxes in Peru has higher tax rates in the Latin American and other middle income country averages. Conversely, people with higher levels of income are subject to lower tax rates in Peru than in Latin America and other middle income countries.

Graph 1

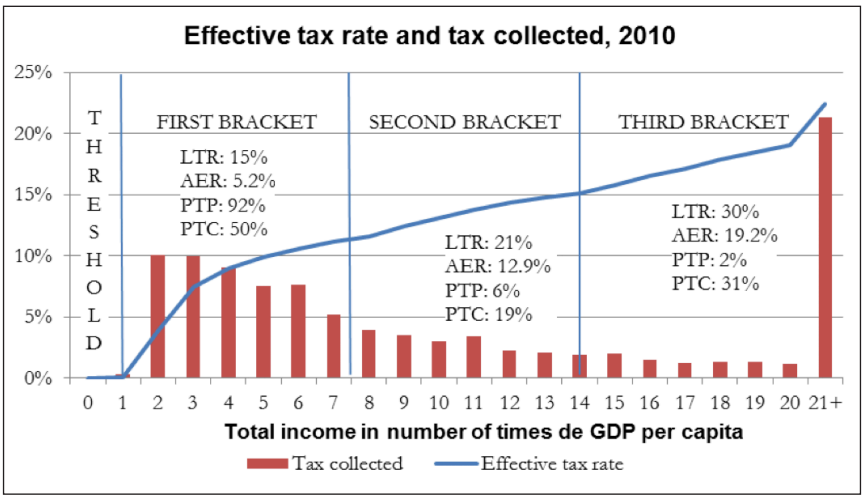


Source: Corbacho et al. (2013) and author's calculations based on 2010 Tax Administration data

44. Ibid. 15
45. Ibid. 2
46. Based on author's calculations using 2010 data from Tax Administration, Central Bank and Ministry of Economy and Finance, the lower threshold, at 1.7 times GDP per capita, is also 3.1 times the annual income under a legal minimum wage.

Corbacho et al.[47] posit that tax payment in Latin America is concentrated in a small number of high-income taxpayers that pay only a small portion of their income, and Peru is not an exception. Using Tax Administration data, we estimate the effective tax rates and the portion of taxes collected by level of income, and find that earners between 10 and 11 times the GDP per capita in 2010, for example, were subject to an effective tax rate of only 13% and were responsible for only 3% of the total earned income tax collected. Furthermore, those who earned less than 10 times the GDP per capita in 2010 were responsible for 57% of the total earned income tax collected, while, as observable in Graph 2, those earning more than 21 times the GDP per capita in 2010 were subject to an effective tax rate of 22.4% and were responsible for 21% of the total earned income tax collected.

Graph 2



Source: 2010 Tax Administration data
Note: LTR: Legal tax rate, AER: Average effective tax rate, PTP: Proportion of taxpayers, PTC: Portion of total earned income tax collected

Under the current design, 85.9% of registered taxpayers fell below the threshold in 2010. Of those who did pay taxes, 92% reported income within the first bracket so they were only subject to the lowest rate of the tax schedule (15%). However, as we see in Graph 2, on average, they were subject to a tax rate of only 5.2%. As a consequence, and due to the large number of taxpayers, this group contributed 50% of the earned income tax collected.

Despite an increase in the registered taxpayers required to pay taxes, from 14.1% in 2010 to 15.4% in 2011, registered taxpayers who pay taxes remain a lower percentage than those in neighboring countries; 40% of Uruguayan registered taxpayers pay taxes, for example.[48] Perhaps the Uruguayan case is the most representative regional case of a well-thought-out reform because it did not only increase tax collection (from 0.9% of GDP in 2007 to

47. *Ibid. 2*
48. *Barreix, A., & Roca, J. (2007). Reforzando un pilar fiscal: el impuesto a la renta dual a la uruguaya. Revista de la CEPAL 92 (LC/G.2339), Santiago de Chile (agosto): 123–42.*

2.3% of GDP in 2008[49]), but also increased the progressivity and the redistribution effect of the tax. Barreix et al.[50] estimate that 40% of the poorest taxpayers, paying 7.4% of total tax collection before the reform, contributed only 1.7% afterwards. Additionally, 20% of the richest taxpayers would contribute 80.5% of tax collected instead of 60.4%. In Chile, an analysis of payroll-employee data shows that those earning a taxable income within the top bracket of the tax schedule are subject to an average effective rate of 28% and responsible for 39.5% of the earned income tax collection. The Uruguayan and Chilean cases provide useful information, indicating potential to promote a well-thought-out reform that leads Peru to an increase in its individual earned income tax collection, while addressing progressivity and redistribution concerns as well.

The concern with increasing progressivity and redistribution is also present in other countries in Latin America. Most countries have more tax brackets and marginal tax rates, and lower minimum and higher maximum tax rates than Peru (Table 3). Furthermore, at least Mexico (in 2014) and Uruguay (in 2012) have recently increased the number of brackets and the top marginal tax rates.

Table 3
Tax structures in Latin America

Country	Number of brackets and tax rates	Tax rates applied to taxable income (%)	Deductions and/or allowances
Argentina	7	9 - 35	Flat and Itemized
Brazil	4	7.5 - 27.5	Flat and Itemized
Chile	7	4 - 40	Flat and Itemized
Colombia	-	1 - 33	Flat and Itemized
Ecuador	8	5 - 35	Flat and Itemized
Mexico	11	1.92 - 35	Flat and Itemized
Peru	3	15 - 30	Flat
Uruguay	6	10 - 30	Flat and Itemized

Source: IBFD, as of January 2014.
Notes: 1/ When the marginal rate in a bracket is 0%, the bracket is not considered in the total.
2/ In Colombia, the ordinary system applied to labor income have 3 brackets of marginal rates (19%, 28% and 33%), and include a mandatory presumptive minimum tax to be paid. However, under the Simplified Alternative Minimum Tax (SAMT) system, applicable to employees and self- employees whose income is lower than certain thresholds, it is possible to end paying less than 1% of the taxable income when considering the first of more than 40 brackets under the SAMT system.

49. *Barreix, A., & Roca, J. (2007). Reforzando un pilar fiscal: el impuesto a la renta dual a la uruguaya. Revista de la CEPAL 92 (LC/G.2339), Santiago de Chile (agosto): 123–42.*
50. *This ratio was 2.9% of GDP in 2012 (CEPALSTAT 2012 database).*

Finally, concerns about the current design are not only with regard to the tax schedule, but also with regard to the avoidance opportunities it creates. For instance, because capital income is taxed at a much lower rate (4.1% in the case of dividends and 6.25% in the case of other capital income) relative to the lowest rate of the progressive tax rate schedule applied to earned income (15%), tax design might be encouraging taxpayers to transform highly taxed wages into lower taxed capital income. Additionally, because the self-employed received a deduction of 20% in addition to the seven tax unit threshold, a payroll employee might be encouraged to ask for only part of their wage as such, and then "camouflage" the difference as self-employed earnings. Consider the participation of taxpayers reporting both type of earnings in 2011 – payroll and self-employed – which was below 30% until reported earned income became greater than 32 times the GDP per capita. Subsequently, the participation of taxpayers reporting both type of earnings increased up to 62%. This reveals the significant size of this opportunity for tax avoidance, especially for higher-income earners, and indicates potential to promote a reform that can also prevent this tax avoidance.

In sum, after analyzing the features discussed in the present section, we believe the most binding constraint to close the earned income tax gap in Peru is in the current design. Considering that the Tax Administration clearly overcame the context that led to the simplification of the tax schedule in 1994, we believe the current tax schedule in Peru has potential for improvements, beyond the reforms undertaken in 2002, 2003 and 2007, which partially amended the oversimplification of the tax regulation and implemented the dual system.

4.5. Implications of labor informality

While the informality of sole proprietorship business owners is not considered in this paper, since these taxes are not filed under earned income, the large number of workers in the informal sector, especially the higher-income self-employed, means losses in the tax base due to informality. The size of the informal Peruvian economy is estimated to be above 60% of total employment since 1997.[51]

Having identified the size of informal markets, the causes for informality in the Peruvian case are necessary to link informality to the earned income tax, and to design policies addressing these specific linkages. A common account is that over-regulated or over-taxed formal sectors can drive away workers and firms to the informal sector if the government is too weak to enforce compliance. Despite the appeal of this explanation, Peru maintains an internationally low tax burden and has maintained a relatively simple earned income tax over the past decade as shown in the analysis of the earned income tax schedule in section 2.

Interestingly, the rise of labor informality from the early 1990s coincided with a simpler earned income tax schedule, showing a negative correlation between taxation and informality. One interpretation could be that the higher informality is partly caused by a simplified tax system, yet the evidence for this is mixed and inconclusive, given the fact that informality and the simplified tax schedule coincided with a period of economic crisis and recession which could have accounted for both phenomenon. Even if this causal chain, from a simpler schedule to informality, was true, it would

51. Ibid. 2

support the argument to design a tax schedule that reduces the jumps in the marginal tax rates by increasing the number of brackets. Thus, while regulation, without taxation, could offer one of the explanations for a higher level of informality, the current tax system and the evolution of informality show a need for an entirely different account for the existence of high informality.

The answer to the informality question lies in structural constraints. Structural adjustment can contribute to the decline of the working population in the formal economy. The mechanism by which this happens is less straightforward, yet Hausmann[52] offers a convincing argument and specifically cites Peru as an example of an economy with structural constraints driving the informal economy. Peru, according to Hausmann[53], requires cooperative arrangements where workers can bring their skills together to build the "know-how" necessary for modern production. Yet daily commute times for low-income formal sector workers is longer in Peru, as well as Colombia and Mexico, for example, and is equivalent to a 45% effective tax rate.[54] The informal sector is then a consequence of the detachment between Peruvian workers and the modern production network. Thus, the Peruvian labor informality is more likely to be a result of urban policies, rather than tax policies. The lesson from dissecting the informality constraint is two-fold. First, tax policy is not the main driver of labor informality. Second, the labor informality constraint might not be addressed directly through tax policies, yet a drastic increase in the complexity of the tax regulations or the tax burden could result in higher labor informality and a greater loss in the tax base. This section also points to the self-employed, once again, as the most vulnerable group to tax evasion.

5. REVIEW OF POLICY OPTIONS

Because the cost of transferring resources from private to public hands is inevitable, an effective tax design must consider reducing the size of the distortionary effects on economic agents' choices, administration costs of tax enforcement and the cost of complying with tax obligations. There is substantial evidence showing that the status quo leaves room for revenue enhancing policy options, while reducing the costs of taxation. In this section we discuss design and non-design policy proposals.

5.1. The tax table design reform proposal

To propose a new design of tax schedule, one must consider that changing marginal tax rates produces an indirect effect in the reported taxable income, besides the direct effect on tax collection. More elastic responses produce greater variations in tax collection due to higher changes in behavior that may reduce the tax base for particular brackets. More importantly, the value of this elasticity not only depends on taxpayer's preferences but could be affected by policymakers.

52. *Hausmann, R. (2013, June 19). The logic of the informal economy. Retrieved January 27, 2014, from Project Syndicate: http://www.project-syndicate.org/commentary/the-logic-of-the-informal-economy-by-ricardo-hausmann*
53. *Ibid*
54. *Ibid*

To calculate these elasticities, an ideal study would require the income distribution per individual before and after changes in marginal tax rates. To the extent of our knowledge, no research has estimated these elasticities for Peru. To do so, we would require data per individual from the Tax Administration.[55] Because access to this data was not possible, the proposal will consider the range of elasticities (0.2 to 0.7) prescribed by the literature, depending on the country and the notion of taxable income.[56]

This analysis comes with some caveats. For example, some aspects not considered by this referred elasticity that may be particularly relevant: (i) change in tax schedules often generates a transfer of taxable income from one kind of income to another (for instance, from labor to capital income) which will be subject to taxation; (ii) the value of this elasticity may be of short or medium-term, and the long term is expected to be lower since taxpayers cannot always modify long-term behavior (for instance, changing professional career); (iii) an increase in evasion due to a change in the tax schedule may also increase taxes collected by the auditing office; and (iv) if change in tax schedules increases income after taxes and consumption, there may be a positive effect on VAT collected.

The recommendations to appropriately redesign the tax schedule follow the evidence we found in the previous sections. First, the evidence for bunching around the first kink calls for lowering the spread in the first jump in marginal tax rates. This can be done by lowering the 15% rate applied to the current lowest bracket or by introducing a new lower marginal tax bracket with a lower rate. This also implies a lowering of the tax payment threshold, which remains too high given the shape of the income distribution. Finally, another additional aspect we must consider is tax avoidance: determining the lowest marginal tax rate must consider the effective tax rates applied to individual capital income and sole proprietorship enterprises.

In this new design, increasing tax revenue should not come solely from taxing more people towards the bottom of the distribution, despite the high threshold. As discussed in detail in section 4.4, evidence shows there is space to increase progressivity and the redistribution effect of the tax. Then, the new design must find a suitable balance between efficiency and social equity objectives, and as a consequence may come with the implementation of additional brackets between the lowest and highest brackets of the current tax schedule as well as a higher top marginal tax rate. A final issue is related to the use of tax expenditures such as allowances, credits and the degree of deductibility of costs related to the generation of income, including the 20% deduction of the self-employed. We will refer to this in Section 5.2.

This proposal can have significant positive consequences on the level of tax evasion. A lower bottom marginal tax rate, as well as a higher progressivity and redistribution effect of the tax could encourage increased formalization, as the cost of being informal should be relatively higher, and the perception of equity or fairness can also rise with the more progressive design. Using 2010 and 2011 Tax Administration data, Table 4 below reviews six simulations and compares them with the status quo.

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55. *Since 2001 was a reform year, using data from 2001 and 2002 could estimate the average elasticity of those affected by changes in the tax schedule in 2002: those earning more than 34 Tax Units. One could also use data from 2002 and 2003 to estimate an average elasticity of those affected by changes in the tax schedule in 2003: those earning more than 61 Tax Units. Finally, to estimate the elasticity for those earning less than 34 Tax Units, one would need to use data from 1993 and 1994, when changes in the tax schedule affected them. Alternatively, panel data from the National Household Surveys are only available since 1998 and are more representative of low-income population. Therefore, using it to estimate elasticities after the 2002 or 2003 reforms would not give us an estimate close to the current reality.*
56. *Sanz-Sanz, J. & Sanz, Ismael. 2013. Política fiscal y crecimiento económico. Consideraciones microeconómicas y relaciones macroeconómicas. CEPAL Serie Macroeconomía para el Desarrollo No 134.*

Table 4
Simulations

	STATUS QUO	FIRST	SECOND	FIRST		SECOND	
				e= 0.2	e= 0.7	e= 0.2	e= 0.7
Number of brackets	3	5	7	5		7	
Threshold in tax units	7	4	4	4		4	
Tax rates (%)	15-21-30	5-15-21-30-35	3-8-15-22-25-30-35	5-15-21-30-35		3-8-15-22-25-30-35	
Maximum effective tax rate (%)	24.1	26.2	28.9	26	25.7	28.6	27.8
Taxpayers below threshold (%)	85	70	70	70	79	70	70
Proportion of tax collection…							
… below 4 times the GDP per capita	22.7	27.5	17.4	25.2	20.9	15.7	15.6
… below 8 times the GDP per capita	48.2	51.26	41.9	49.8	47	44	54.6
… below 16 times the GDP per capita	71.3	72.2	62.3	71.5	70.6	72.2	76.8
Increase in Tax collection as % of GDP		0.17 - 0.14	0.12 - 0.06	0.10 - 0.07	-0.03	0.08 - 0.03	0.01
Increase in Tax collection as % of revenue tax collection		14.3 - 12.6	8.4 - 6.0	7.5 - 7.2	-2.9 - -2.1	5.7 - 3.6	1.0 - 0.7

Source: 2010 Tax Administration data and World Bank.
Note: All estimations are based on 2011 data. The only exception is the increase in tax collection that shows a range when estimations using 2010 and 2011 data produced different results. Letter "e" refers to elasticity. The tax brackets in the first proposal (in tax units) are 4-7, 7-34, 34-61, 61-88 and more than 88. The tax brackets in the second proposal are 4-7, 7-13, 13-21, 21-30, 30-42, 42-61, and more than 61.

The first simulation in column 3 of Table 4 Table 3 considers a lower threshold at 4 tax units with a change in the lowest marginal tax rate (5%), and a change in the highest tax bracket with a highest marginal tax rate (35%). Despite showing the highest increase in tax collection (0.14%-0.17% of GDP), this alternative also increases the tax burden of low-income taxpayers relatively more than that of the high-income taxpayers (the proportion of tax collected from taxpayers whose annual income is below 4 times the GDP per capita increases from 22.7% to 27.5%). Instead, the second simulation (column 4) attempts to reduce the increase of the tax burden on lower-income taxpayers. To such purpose we develop a more complex tax schedule relative to the first alternative by increasing the number of tax brackets and corresponding marginal tax rates to seven. This alternative shows a lower increase in tax collection (0.06%-0.12% of GDP) because the lowest tail of the distribution, where there are more taxpayers, is only taxed at 3% instead of 5%. The maximum effective tax rate is higher in this second alternative, where high-income taxpayers pay higher effective tax rates than high-income taxpayers in the first alternative.

Finally, using the upper bound and lower bound elasticity values prescribed by the literature (0.2 and 0.7), we recalculated both alternatives to consider the potential distortions and the results are shown in columns 5 to 8. As observable, the largest reductions in tax collection are in columns 6 and 8 where the elasticity is higher (0.7). Interestingly, in the second simulation the estimated tax collection always remains above the tax collected in the status quo and shows more certainty (a narrower range from 0.01% to 0.08% of GDP, or a 0.7% to 5.7% increase in income tax collection depending on the elasticity) relative to the first simulation (-0.03% to 0.10% of GDP).

It is important to notice the changes in the proportion of tax collected. In particular, if taxpayers are very responsive (elastic), the proportion of tax collection from taxpayers whose annual income is below 4 times the GDP

per capita could have an important decrease. In the second alternative, this proportion falls from 17.4% to 15.6%, keeping the tax burden on the lower-income earners at a lower level relative to the first alternative. A final remark relates to the number of taxpayers below the threshold: static estimations such as column 3 and 4 could give a policymaker the impression of an important decrease (from 85% to 70%); however, this decrease is not likely to be as large as shown in the first alternative (79%). Since the second simulation performs better in all the aforementioned criteria, we encourage the Ministry of Economy and Finance and the Tax Administration to work with this alternative over the first one.

Under the second simulation, earned income tax reform can increase tax revenue by about 0.08% of GDP (an increase of 5.7% in income tax collection) only in the first year. In the first year alone, such an increase in tax collection would close roughly 7% of the tax burden gap described in section 1. In the long-run, however, we expect optimistic revenue projections to be conservative when other components of the reform start producing results in closing the gap. For instance, we expect registered taxpayers to increase in number and in general have fewer incentives to misreport their level income due to other interventions. To obtain an idea about the size of this potential, we compare Tax Administration data with household survey data[57]. We found people earning less than 15 tax units (less than 3.5 times the GDP per capita) in the Tax Administration data report income that represents only half of that reported in the household survey data, on average, with percentages ranging from 26% to 93%. Thus, an increase in compliance using a policy that focuses on reducing misreporting can provide a larger increase in tax revenue. Searching for in-house solutions to achieve this objective leads to the following section, where we suggest electronic invoicing to increase tax compliance.

5.2. The electronic invoicing policy proposal

In 2008 the Tax Administration created an electronic invoicing service available to the self-employed, to be issued voluntarily when they provide a service. The usage of this important tool has increased since then. Yet its massive usage – not only for the self-employed but for all individuals – to apply for deductions or allowances, including the 20% deduction for the self-employed, could bring different positive externalities. An expansion of this component should therefore complement the design reform proposed earlier. First, this policy will further facilitate compliance, since, for instance, every invoice would be automatically part of a pre-made tax return that only requires simple verification. As an automatized system, electronic invoicing would also facilitate auditing and reduce administrative costs for the Tax Administration. Finally, by creating incentives for taxpayers to request invoices from service providers, especially professions such as misreporting lawyers or doctors, electronic invoicing also encourages reporting incomes closer to the true incomes, promoting formalization and reducing tax evasion.

5.3. Assessment of primary policy options

This paper considers two possible options. It does not neglect the existence of other enhancements that could be rehearsed, particularly to improve tax culture. However, policies implemented since 2012 showed that Peru is on the right track to achieve improvements in this regard. Option one acknowledges that Peru might face difficulties to trigger a

57. Comparisons are especially valid when considering lower-income earners as the Household survey data is more representative. We compared 2010 and 2011 data.

comprehensive reform and therefore focuses on achieving the tax design proposal described in section 5.1. Option two constitutes the more administratively challenging proposal because it includes the same changes in design while also introducing the electronic invoicing system to reduce misreporting described in section 5.2. In section 6 we will discuss the administrative feasibility and political supportability of these proposals in more detail.

6. IMPLEMENTATION DESIGN: MAKING REFORM HAPPEN

Option one focuses on achieving the tax design proposal without pushing for the massive usage of electronic invoicing. The reason for this is that the latter is more administratively challenging and would require a longer time to be implemented. Option two; however, acknowledges that under certain conditions Peru could, as has been done in earlier episodes, achieved a comprehensive reform. These conditions are explained in this section.

6.1. Specifics of implementation

A reform that proposes to reduce the threshold, change marginal tax rates and modify the tax schedule is likely to create serious opposition. For this reason, we emphasize two strategies in implementation. The first is the importance of a sequential implementation that allows adequate management of risks, and provides policymakers with the space to undertake adaptive actions if needed. For instance, an alternative under the second option is to use the electronic invoicing to phase-in the design reform. Under this proposal, a potential lower increase in tax revenue under our initial estimations should be compensated by more revenues coming from an increase in formalization and a reduction in misreporting. This view is shared by the tax specialists surveyed. There are two alternatives:

- Keep the threshold of seven tax units while gradually allowing a certain number of tax units out of this seven to be deducted if supported by electronic invoices, creating a large incentive for using the electronic system.

- To gradually increase the threshold to a certain number tax units (more than seven), allowing seven tax units in deductions or allowances without requiring electronic invoices, as today, while allowing the difference only if the deductions are supported by electronic invoices. Then, the number of tax units allowed without requiring electronic invoices could be also reduced in phases. This seems to be the view of the Tax Administration official, who posits that the potential loss in tax revenue produced by increasing the threshold would be more than compensated by the revenues coming from a reduction in tax evasion, especially for the self-employed.

Allowing deductions with electronic invoices brings forward another obstacle. On one hand, some argue there should be a list of authorized deductions or allowances like health and education expenses. On the other hand, we, along with specialists consulted, recommend resisting producing a list of deductions, since it would not only increase administrative costs of auditing, but could open the door to future claims to include additional kinds of expenditures and threshold increases.

The second remark in implementation is the importance of delivering information. Some aspects of the reform should be massively public reform should be massively public. First, the number of people who will pay fewer taxes after the reform should be greater than the number of people paying more taxes[58]. Alternatively, communicating to the public that winners include benefitting by transfers or improved public services, expected from an increase in revenue, in addition to those paying fewer taxes can provide public support. Second, higher-income taxpayers should bear a greater proportion of the tax collection. Third, the way taxes are expended should be known by taxpayers, especially for those who will start paying taxes for the first time. In this regard, some scholars suggest that pushing for earmarked taxes, perhaps to fund social programs, though never ideal, may be necessary given the political realities.

Public opinion is sensitive to the manner a reform is presented and to the extent policymakers should aim to present information in non-technical language. A big assumption to discard in this regard is that taxpayers know exactly their location in the tax schedule, the effective tax rate, the decile of income where they belong to, or how many times their annual income is in terms of GDP per capita. Moreover, without certain information taxpayers could be later surprised by the fact that they are now required to pay taxes, even when their capacity to pay taxes might be considered evident. Thus, a context with potential misperceptions by public opinion lights up the importance of signaling, strengthening administration capacities, promoting local solutions, and delivering truthful information about the positive realities the reform intends.

Following the conclusion in section 4.2, we emphasize the importance of complementing the implementation of these proposals with improved practices by the Tax Administration. Specifically, the Tax Administration should continue to reduce the perception of willful omissions going unpunished to raise participation in the electronic invoicing system and facilitate cooperation by the self-employed. For example, the Tax Administration can publish monthly statistics by type of taxpayer on audit rates, collection of accounts in arrears, and returns from non-compliant taxpayers. It can also release outlines of opening balance, intake of cases, resolved cases, and the ending balance for the period. Contacting stop-filers is also important to increase taxpayer awareness of rising rates and allow for a higher perceived possibility of audits.

6.2. Political analysis and feasibility

Taxation is a very technical aspect that requires legislation. The government requires Congress to grant legislative powers in order to issue decrees. Since 2011, a collation in Congress that includes the official party has consistently granted the government legislative powers on five occasions, one of them to legislate in taxation matters. However, this act is not an open authorization to the government to legislate in any taxation matter. The granting of powers comes with an explicit list of what the government is authorized to do. In particular, the last two times the government required legislative powers to reform the individual income tax law (2006 and 2012), Congress granted powers but explicitly prohibited the government from increasing tax rates[59]. This should not be interpreted as a political context where the congress is against changing the tax schedule. Instead, it is an

58. *Under the second simulation, based on the elasticity used, those who pay fewer taxes after the reform represent 35% or 37% of those who pay taxes. This estimate assumes the threshold is reduced to 4 tax units and no deduction is allowed using electronic invoicing as proposed. If a sequential implementation as the ones proposed is put in place, this proportion will be greater.*
59. *Laws No 28932 and No 29884*

indication that if the government wants to do so, it must go through the Congress and a law must be issued instead of a decree. Ultimately, it should be acknowledge that passing the proposal through the Congress would legitimize the reform.

To make this reform happen we propose the following. First, considering the aforementioned context, this reform requires the strong support of the president. Second, we believe this is an opportunity for the Ministry of Economy and Finance to undertake reform by coordinating with the Tax Administration as one team. Third, international experience in taxation reform shows that reform can succeed with the following conditions: elaborating the reform, prior public and academic consultation, and forming coalitions with opposition parties. As expected, delivering certain information is also relevant in the political arena, where an opposition party that misunderstood or opposed a reform can gain important support from the public. Then, to achieve support in Congress, the government should start by opening dialogue with the Committee in Economics, which includes the core of the technical members of Congress, where dialogue is more likely to focus only in technical issues.

Building support requires engaging the following stakeholders: labor unions, private sector associations, and the media. Effective information delivery, especially about the fairness embodied in a more progressive tax design; and emphasizing the technical correctness of the proposal should help gaining support of a government strategy as the one proposed in this section. Undoubtedly, developing a fiscal pact between stakeholders is necessary, yet the reality of doing so remains challenging.

6.3. Administrative feasibility

Implementing a new tax design that involves new brackets and tax rates will require changing the current programs used by the self-employed and businesses filing taxes on behalf of the payroll employees. However, the required changes should be straightforward.

On the other hand, implementing the usage of electronic invoicing requires not only a new program but new software. Based on communications with a Tax Administration official, the program could be developed within the current software used. However, the risk of the system collapsing with increasing electronic invoices requiring verification would be too high. Therefore, the massive usage of electronic invoicing should be developed in new software. The Tax Administration has placed more emphasis on implementing the new after the law issued in 2011. Yet this is a process that would take at least two more years and whose cost is estimated at US$ 50 million.

There are two additional aspects to be considered, while implementing the massive usage of electronic invoicing. First, false invoices might still be issued. In this regard, the automatized system should allow immediate auditing. Second, internet connectivity might be limited in certain areas, restraining the capacity to use the mechanism. Countries such as Mexico and Brazil have worked to overcome similar limitations. Alternatively, implementation in phases as in Chile could be rehearsed.

7. CONCLUSION

Closing the earned income tax gap remains a pending task in Peru. After a comprehensive diagnosis of the potential constraints to close this gap, the evidence points to the design aspect as a binding constraint. We present two proposals, including a comprehensive one that pushes for the massive usage of electronic invoices in addition to redesign. By reducing opportunities to tax avoidance, lowering distortions, and increasing progressivity and the distribution effects of the tax, the potential increase in revenue after implementing a well-designed reform is significant. It seems that lessons from optimal tax theory and reform history, with reliance on proper diagnosis, can reduce the earned income tax gap. For that purpose, it remains important for the Tax Administration to expand audit perception and information dissemination programs. Larger revenue raises funds for social programs and increased productive expenditure, working towards Peru's development objectives.

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COMPARATIVE STUDY OF THE TAX CONSOLIDATION REGIME AND THE OPTIONAL REGIME FOR CORPORATE GROUPS: THE CASE OF MEXICO

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SYNOPSIS

The objective of this work is to make a comparative study of the tax consolidation regime with the proposal of optional regime for corporate groups, seeking to determine whether the new regime is simple in its self-determination, and at the same time, to understand whether the tax administration can easily control it. It is an exploratory and descriptive study, which allows knowing the revenue collected through the tax consolidation regime, and estimate the collection for future periods. The differences between the two regimes for the tax self-determination are analyzed without implying necessarily a higher collection.

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Content

The strategic agenda proposed by the Organization for Economic Cooperation and Development (OECD) for reforms in Mexico proposes eliminating tax expenditures to broaden the tax base, simplify and make the tax system management more transparent. These approaches are consistent with the Mexican Legislation intent to broaden the tax base, reduce tax expenditures (2012b, p. 73), and eliminate the tax consolidation regime. Empirical studies show that the large business groups opt for the Tax Consolidation regime, as well as the small and medium-sized enterprises (Mancilla, 2013a). The documentary evidence shows that the tax consolidation regime is important in terms of collection; the Public Finances obtain a quarter of its collection on tax income from legal entities through this regime.

Among the economic entities which carry out their activities in Mexico, 0.2% of them are transnational corporations that represent 35.2% of the total employment and 73.9% of the total production of goods and service, i.e. almost 74 pesos out of one hundred are produced by transnational corporations (INEGI, 2012, p. 46). According to the OECD, transnational corporations are organizations that claim to respect the legal and social regulations in the States where they are installed, and collaborate to strengthen the legal tax framework, and the international political environment (2011, p15) towards the expansion of corporate groups.

In Mexico, in terms of the income tax, an important group of transnational companies opt for the regime Tax consolidation. This practice is also developed by companies which are established in countries such as Germany, Australia, Spain, United States, France, Italy, Japan, Netherlands, and United Kingdom (Reyes and Hernández 2013, p.75), Belgium, Canada, Korea, Norway, Singapore, Sweden, Finland, Chile, Ecuador, Israel, Romania and Czech Republic (Labrador and Penilla, 2006, p.51-52) because they are countries where the consolidation regime applies. The laws of these countries establish similar tax rules to consolidate; shareholder ownership and tax residence are specific to this end, and the principle of self-determination which is similar in the tax basis; only the United States and the United Kingdom have some exceptions.

The present document aims to perform a comparative study of the current tax consolidation regime and the regime of incorporation that the new legislation will establish.

1. OVERVIEW OF THE TAX CONSOLIDATION SYSTEM

The Tax consolidation system is known in Mexico since 1925. The state considered that societies with a business relationship could merge their accounting and declare their total income jointly (Labrador and Penilla, 2006, p.) 36); it was understood as a right depending on the companies' decision. The regime was repealed in 1951 because it ceased to be enforced, and in 1973 the tax consolidation regime reappeared, with the Decree of tax benefits applicable to the companies that had as purpose to encourage industry and tourism, leading to the current tax consolidation regime (Arizmendi, 2013). The regime allowed adding the results of the companies holding a single taxable base for the payment of the tax.

Tax consolidation is a neutral tax payment regime, since the tax is determined by compensating utilities with tax losses declared by companies that consolidate, "which in strict theory the consolidated Group should pay the same tax which would have corresponded him if it had been organized with the establishment of branches or divisions, rather than form societies with as different legal entity" (Labrador and Penilla, 2006, p.45).

The 2010 tax reform established to five tax periods the deferral of the payment of income tax, "time that was considered sufficient for the financial recovery of the companies with losses" (ASF, 2011, p.2). In the current regime, the companies involved are the controlling company or holding company, and the controlled company or subsidiary, which are resident in Mexico. The holding company is responsible for submitting in a single tax return the results obtained by the subsidiaries. A commercial company is considered Mexican when it was constituted in accordance with Mexican law, which may be General Partnership, limited liability, limited company, and joint-stock partnership.

The Holding companies are owners of more than 50% of the stock with voting rights of one or more subsidiaries, including when they are controlled via other companies which in turn are subsidiaries of the same holding company. The right to vote is not limited and is defined by the trade legislation as shares benefits. "Under our country's Tax consolidation plan, the consolidated Group of companies is considered, for tax purposes, as a single unit, [...]" compensating tax losses of the current period against tax income from companies of the same group" (Puente 2011, p. 69).

The stock with voting rights of subsidiaries owned by holding companies must be more than 50%, property of one or more companies, unless these companies are resident in any country with which it has comprehensive information exchange agreement. Exempted Legal entities, financial entities, foreign residents (even with permanent establishment), companies in bankruptcy and companies registered in the simplified tax regime do not have the option to be of a holding companies or subsidiaries.

The tax consolidation regime is an optional regime for groups of commercial companies resident in Mexico, which allows an economic entity known as controlling company, constituted by two or more companies called holding companies or subsidiaries, to determine a single tax result on which a single consolidated tax rate is applied (Arizmendi 2013a). The regime describes the group as a single taxpayer. The holding is responsible for presenting the consolidated results of the parent company with its subsidiaries. The consolidated tax results is determined by adding the annual taxable profits corresponding to the holding company and the subsidiaries, and subtract their tax losses; the amount of the

losses arising from the sales of shares issued by the subsidiaries is also subtracted to determine the tax outcome. Once the tax is calculated, provisional payments and withholding taxes are taken into account to determine the consolidated balance.

Table 1
Determination of the consolidated tax result

(+)	The exercise of the subsidiaries tax utilities
(-)	Tax loss for the year of the subsidiaries
(+/-)	Utility or tax loss of the parent company
(-)	Tax Lost prior to the consolidation of subsidiaries and Parent company
(+/-)	Modification to the profits or losses of subsidiaries
(-)	Loss on sale of shares deductibles
(+)	Loss on sale of deducted shares
(=)	Utility or consolidated tax loss
(-)	Consolidated tax losses from previous years
(=)	Consolidated fiscal result

Source: Elaboration based on the income tax law, art. 64

The controlling company which had opted to determine its consolidated tax result will use the consolidated tax net account (CUFIN). Each year the consolidated CUFIN is determined. Income from dividends will be considered only if received by the parent company and the subsidiaries from legal entities unrelated to the consolidated entity. Dividends or profits will be those paid by the holding company. Income, dividends or profits, subject to preferential tax regimes, will be those received by the holding company and the subsidiaries at the date in which the taxes for the period have to be paid.

All the subsidiaries and the parent company are required to remain in the regime during five tax periods or until they breach the requirements, or become separate entities. Authorization is required from the Finance Secretary and Public Credit to be consolidated and this way the administrative formalities are semi-centralized by the Public Finances. The authorization to consolidate takes effect in the following fiscal year. The subsidiaries joining the consolidation before the effect of the authorization will be incorporated in the financial year following the one of the authorization to consolidate. The societies that are incorporated at a date subsequent to the authorization date will be incorporated the year following their purchase with more than 50% of shares with voting rights.

The parent company must notify within fifteen days of the date of purchase, directly or through other subsidiaries. In case that the subsidiaries are incorporated between the date of filing the application and the notification of the authorization, they must notify it 15 days of the date of notification of the authorization. In case of deconsolidation of companies, the term for notification is 45 days following the date of the separation.

The holding company, which has the option to consolidate, must keep the accounts that allow to establish the consolidated tax income, as well as all dividends or profits; records of profits and losses generated by the subsidiaries in each financial year; records of profits and losses obtained by the holding company for each exercise, even of profits and losses arising from the sales of shares. The registries must allow determining the net tax income that would have corresponded to the holding if it had not become a consolidated group. In addition it must submit the consolidated return within the four months following the tax year-end,

which determined the consolidated tax result and the annual tax. If the return shows a tax debt, the holding company must pay it with the return itself. If one or more of the subsidiaries submit an additional return in order to correct errors or omissions, the holding company must correct its tax result and pay the taxes (when applicable).

Among the obligations of the subsidiaries are: submitting their return for the year and calculate the tax as if there were no consolidation, as well as calculating provisional payments. The Net tax account for the income of each subsidiary will be integrated and a registry of net tax profits to be integrated with the consolidated net tax profits of each year. When a subsidiary carries out operations with its holding company or one or more subsidiaries which sell land, investments, stocks and social parties, among other operations, they must be performed in accordance with the transfer pricing methodology.

The main benefit of tax consolidation system is in the cash flows since the payment of the tax is deferred until the moment in which the group is split or when the group generates profits. This benefit is in force until notice to the tax administration service to stop consolidating and copy of the financial statements of the holding and subsidiaries are audited for tax purposes, and the calculation of the tax resulting from the deconsolidation to determine the tax debt for each company, or the tax credits in their favor, to be presented together with the notice, and a copy of the financial statements submitted for tax purposes with all their annexes.

The “deconsolidation” proceeds if a parent company does not incorporate a subsidiary whose assets represent 3% or more of the total value of the assets of the group at the date when the incorporation should take place. It is also applicable when the parent company does not include in the consolidation of a same tax year, two or more subsidiaries whose assets represent a whole 6% or more of the total value of the assets of the group. It applies in case societies which are not controlled by the group are added to the consolidation, or in the case that the parent company disappears by merging. It also applies when one or more companies whose total assets represent 85% or more of the total value of the assets of the group are divested or withdraw from the group.

In case of merging, it is considered that the subsidiaries which disappear during the merger are divested. In case the societies are in suspension of activities during more than one year, they also must be withdrawn from the group, or when activities are reported as two times suspended in a period of five years. The determination of the disincorporation or deconsolidation is determined in accordance with the following tax process:

Table 2
Determination of the fiscal result after the deconsolidation / withdrawal

	Utility or tax loss consolidated before the withdrawal
(+ / -)	Tax losses carry forwards from prior years
(+ /-)	Loss on disposal of shares
(+ / -)	CUFIN non paid dividends
(+ / -)	Balance of the CUFIN difference ***
(+ / -)	Difference of balance of the UIFN registration
(=)	Fiscal outcome after the deconsolidation / withdrawal
(X)	Rate
(=)	Total tax income to pay

Source: Development based on the income tax law

1.1. The collection in the tax consolidation system

The tax administration service is the administration in charge of the processes of collection, audit, attention and legal monitoring of all taxpayers. It is in charge of monitoring the large taxpayers which make up corporate groups, in order to determine the CIT for the results of the group. The effect of the application of the rule creates a benefit in the cash flows of the group which leads to the deferred payment of the taxes on the income until the moment in which the group or any of its companies is deconsolidated or "desincorporated" or by generating profits, so that the payment of the income tax differed indefinitely until the 2010 tax reform that limited the deferral of the payment of the tax to five exercises.

The High Audit Council of the Federation has audited the financial management of the large taxpayers to submit the information to Public Account (ASF, 2011, p.1), particularly the amount raised under the general regime of legal entities act was studied. 2011 public accounts published collection by concept of law a total of $629,040.72 million pesos of ISR which includes the collection of legal entities (45.55%), individuals (1.85%), withholding legal entities and individuals (52.40%), income from abroad (0.19%), and other legal concepts (0.01%). The total collected income tax includes tax from legal entities, simplified regime, interests, dividends, pension funds, retirement, and the tax consolidation regime, which corresponds to 11.39% of the total income tax collection and 25% of the collection from legal entities, $71, 673.07 million pesos from interim payments and final payments of the period.

TABLE 3
Income tax collection in 2009
(Thousands of Mexican pesos)

Concept	Total income tax collected	%	
Legal entities	**286,515,594.80**	**100**	**45.55**
Legal entities	19,156,881.90	6.7	3.05
Simplified regime. Own tax	2,722,919.50	1	0.44
Simplified Tax regime, tax from subsidiaries	724,027.00	0.30	0.12
Consolidation	**71,673,074.70**	**25.00**	**11.39**
General Regime	184,713,518.50	64.5	29.36
Dividends	6,306,899.90	2.2	1
Pensions, retirement and seniority premiums	1,218,273.30	0.4	0.19
Total income tax collection:	**629,040,729.40**		**100**

Source: By author, based on data from: EAI 2009, ACTCI, SAT

According to the budget of tax expenditures[1], as reported amount in the budget, - self - applying indirect support from the Government to various sectors of the economy or taxpayers using the tax framework, allowing beneficiaries to defer the payment of taxes – a total amount of $12,478 million pesos was considered as tax expenditure, however the deferred income tax will be paid and recovered in future fiscal years.

The OECD believes that the Mexican business income tax system has certain weaknesses that result from the use of tax planning by transnational corporations, mentioning that "certain changes in the rules could help to prevent abuse" (2012, p. 76). This weakness in relation to a tax reform, refers to "the limitations to the consolidation of losses from recently acquired companies that can be used to compensate the taxation of profits within corporate groups", and is exemplified by the abusive practice of companies that "generate heavy losses that the consolidated company can later decrease" (p. 77).

2. THE OPTIONAL REGIME FOR CORPORATE GROUPS

The new regime considers the companies within the group as holding and subsidiaries, and these can apply for joining the optional regime. The holding society and the subsidiaries have to notify to stay in the program, and they are removed from it when they stop to meet any of the requirements. Inclusive societies must be resident in Mexico, and be owners of more than 80% of the shares with voting rights of the subsidiaries, and in no case they will own one or more other companies, except if they are residents abroad with comprehensive exchange agreement. The subsidiaries are those in which more than 80% of shares with voting rights are owned, direct or indirectly or both, by a holding society. Indirect possession is when the holding company controls one or more other companies which in turn control others in the same holding group.

The income tax of the period to postpone is determined from the tax profit or loss for the period. The holding company obtains the total tax result of the group, adding the tax result of the period from the societies and compensating tax losses with the profits of the group. The holding will calculate a factor of tax result for the period between the sum of the tax results for the holding company and its subsidiaries. If the integrated fiscal result is negative, it is zero. The company determines the tax for the period by totaling the tax amount corresponding to the integrated group with the tax from non-integrated elements. The difference between the tax corresponding to the integrated participation and the amount obtained from the integrated participation will be multiplied by the factor of integrated tax result. The resulting amount will be the period amount, which may be deferred for a three tax periods. The integrated participation is the stock participation in the social capital of an integrated company by a holding company either directly or indirectly. The participation of integrated subsidiaries will be 100%. The nonintegrated participation is the investment by the holding company in shares from other companies without taking control of them.

Determining the income tax of the Holding company and its subsidiaries for the period, as well as the tax that may be deferred, is based on the following:

1. *They are estimates of revenues that the Treasury does not perceive, "for the idea on the part of the taxpayers of the differential treatment contained in legal systems".*

Table No. 4
Determination of tax based on the optional regime for corporate groups

(+)	Tax result of the group	
(-)	Tax losses of group (not updated)	
=	Tax result for the group	
	Integrated tax result	= Factor of the integrated tax result
(+)	Tax result of the group	
		Payable Tax
	X	Integrated participation
	=	Result
	X	Integrated tax result factor
	=	Integrated participation amount
		Payable Tax
	X	No integrated participations
	=	Result
	X	Tax result factor
	=	Not integrated participation amount[2]
		Integrated participation amount
	+	Not integrated participation amount
	=	Tax period total amount
		Integrated participation tax
		Minus amount of integrated participation
	=	Tax to defer for a period of three years

Source: Compilation by the author based on the ISR 2014 Law proposal.

To obtain the authorization to integrate the tax result, the holding company must have a written agreement from the legal representative for each of the integrated companies to determine the income tax. The application for authorization must be submitted no later than 15 August of the year before the one for which the integrated tax it is intended to be determined, together with the supporting documents requested by the SAT. The request must mention all the integrated companies.

Holding societies are required to carry the CUFIN (net tax profits account) identifying for each period the UFIN (Tax result) of the integrated participation of each society, the

2. *Not integrated participation is the share ownership not detained by the holding company, directly or indirectly, in the equity of an integrated society.*

participation for which the current period tax is paid, the integrated participation for which the tax of the period is deferred and the nonintegrated participation for each fiscal year.

When the holding company ceases to request the option of incorporation of societies, it can no longer be considered as holding or stop to meet the requirements and each company must separately enter the tax that has been deferred during the period of integration. They will also be prevented from newly applying for the option during the three following years.

3. RESEARCH METHODOLOGY AND OBJECTIVE

This research has essentially a qualitative nature in an interpretive reference framework of conservative hermeneutics. The study is transversal and aims to analyze the tax consolidation system for corporate groups and their effect on Public Revenue. The optional regime for corporate groups that the Executive submitted to the Congress of the Union, and the public accounts report, specifically the category of tax income revenue, are studied. Information from experts on the issue is also studied and analyzed.

Since the topic is highly specialized, Hernández calls it "initial immersion into the field" (2006:272), which shows at first a general overview of the consolidation regime and at the same time the effect that it has on collection. The proposal of the finance reform initiative on the optional regime for corporate groups that the President of Mexico submitted to the Federal Congress is also shown. It's a study with an exploratory transactional design and descriptive scope. The study ends with the intention to understand the differences in the tax consolidation system compared to the new optional tax regime for corporate groups, in an exercise on the probable collection increase.

3.1. Unit of analysis

Because it is a hermeneutic study, this research starts with the deontic analysis of the tax consolidation system that the income tax law establishes, and the theoretical analysis that technical experts have applied to the tax regime. To strengthen the regime importance, the collection is reviewed in terms of the amount published in public accounts in 2011 in relation to the amount collected by this tax regime. Subsequently is reviewed the decree initiative that will be issued in the new income tax law, proposed by the President, to finally make the comparative study and understand the differences between the existing regime and the new regime.

4. RESULTS

From 1982, the legislative authority ordered legal changes that were applied to the tax consolidation regime of the current tax exercise. Also the changes operated in the sphere of the Executive with the regulatory provisions and administrative tax miscellaneous resolutions. The tax changes became effective when the administrative authority applied its control powers to taxpayers who opted for the regime: however, the control process was complex and difficult for the authority. The consolidation regime is a highly specialized topic and requires disciplinary training to apply descriptive and prescriptive provisions, and follow the

regulations in force, resulting from tax reforms and changes that the legislature proposed to review and determine the consolidated fiscal result.

It is sufficient to enumerate the determination and comparison of the CUFIN from the subsidiaries against the CUFIN from the parent company, the determination of losses, dividends paid out of the CUFIN, shareholder participation from the holding company in a subsidiary company, the net reinvested profit account (CUFINRE) and the consolidated CUFIN account, the net amount of the parent company, the determination of the special consolidation concepts. This has to be added to the tax reforms in each fiscal year that affected the determination of the calculated tax, and the deferred consolidated tax, to understand a combination of current and previous fiscal rules. To this must be added the restructuring of groups to transfer control; mergers, demergers, incorporation of companies, liquidation; this requires a strict and orderly accounting control of each company of the group to determine a proper tax calculation to enter and to defer. These factors have weakened the control and supervision of the Tax Authority on companies who opted for this regime (Presidencia, 2013, p. XXXIX). Therefore, the authority proposed eliminating the tax consolidation regime and establish the optional regime for corporate groups.

The main advantages of the tax consolidation regime are the immediate implementation of the tax losses of the subsidiaries and the parent company with fiscal profit which allowed the deferral of the tax for five years. Others advantages are the deferral of the tax on dividends paid during five periods; the possibility of applying certain benefits to established international treaties; optimization in administrative proceedings to have one represented by the group. The income tax Act proposes an exit from the regime with two alternatives for the calculation of the deferred tax to December 31, 2013, as well as a regime of payment split into five exercises to cover it.

To carry out the exit from the regime, in case companies are in the five year period of taxation, they may apply the provisions of the consolidation regime, and as long as they are within the five years, should calculate and find the deferred tax through the instalment payment regime.

The resolution of the lawmaker was to limit the tax deferral, but in fact, the tax consolidation regime was not eliminated, but its name was changed into the regime so-called “optional regime for corporate groups”. The new regime allows the tax control of the subsidiaries, and the attributive provision allows deferring tax during three years, rather than the five years allowed by the previous consolidation regime. Among the benefits of the new regime is the tax simplification to determine the tax based on a factor of consolidation, a condition that provides tax certainty; and the losses one hundred per cent of the subsidiaries will not be deferred. It is a tax regime providing the authority with more control to the companies of the group, and facilitates the control on enterprises belonging to business groups.

The new regime contains descriptive, prescriptive and other provisions that the consolidation regime included, in relation to the requirements to enter the regime to the cases of mergers, splits and liquidation of companies.

5. CONCLUSION

Regardless its name, the continuity of the tax consolidation regime is still a way to encourage investment, and although the period to defer the tax is limited to three years, it is probable that entrepreneurs who plan investing in Mexico may consider that the regime continues to be competitive and consistent for the generation of employment.

The hermeneutic analysis of the tax regulation has stressed that in both tax systems, companies have to self-determine their taxes, evaluate them, make provisional payments, which gives evidence of compliance with the principle of doctrinal Justice. The tax deferral does not mean a tax privilege, since the deferral of the income tax does not mean a tax reduction (Arizmendi, 2013b). It is important to reiterate that the application of the tax consolidation regime by companies or the optional regime for corporate groups is a tax figure established in law, which allows paying tax at another time in the future.

We did not find evidence that the tax consolidation regime enacted in 1973 has fulfilled its objective. In the law project presented to the Congress for the tax year 2013, it is not explained why this tax regime is maintained while an initial idea of the Government of the Republic was to remove it, and an agreement on this issue was signed by the three political forces of this country and by the President, in the document called “Covenant for Mexico”.

Empirical evidence shows that one of the benefits of the consolidation regime for the country is the amount collected by this concept (Mancilla, 2013b), the volume of employment generated by those corporate groups, as well as their high production of goods and services (INEGI, 2012). It is probable that within these corporate groups, the regime results in a greater profit than the revenue received by the country, however the Government does not have the mechanisms to compensate the absence of this public income, and could not generate the volume of employment and the production of goods and services that these corporate groups that opt for the consolidation regime bring to the country.

Final considerations in the first place, are to question the purpose of changing the name of the tax system. Secondly, it is to ask whether, with this new optional regime name for corporate groups, the preferential treatment of these companies is abandoned. Thirdly, if the Public Finances will collect more revenue with the new optional regime than what was collected under the tax consolidation regime. Finally, considering that certain changes in the rules can help to optimize and improve control, in this sense, and to understand that collection under the new optional regime for corporate groups may not necessarily represent an increase in revenue because the tax is collected in a shorter term (three years), and clearer rules have been established for the tax determination.

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E-FISCO: THE CONFLICT BETWEEN REVENUE COLLECTION EFFICIENCY AND THE FUNDAMENTAL RIGHT TO PRIVACY: THE EXPERIENCE OF BRAZIL

Marcelo Miranda Ribeiro

SYNOPSIS

New information technologies enable the development of complex control systems, as well as the creation of different accessory electronic obligations. The emerging electronic TA is revolutionizing the mode of interaction between the tax administration and the taxpayers. A huge opportunity is opened to the State to increase revenue and efficiency and at the same time to reduce management costs. On the other hand, the use of these systems puts taxpayers under continuous scrutiny. Such situation creates a conflict in the public interest between tax collection and the fundamental right to privacy. The purpose of this article is to evaluate the performance of the e-Fisco from the perspective of the intensive development of computerized control of tax systems.

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Content

Taxation is justified by the need to maintain essential public services and redistribute income. Therefore, the tax is much more than a source of income for the State, being a true instrument of Justice, in the sense of taxing all citizens on the basis of their ability to pay tax and thus promote true redistributive justice.

Thus, to achieve the common good, the State requires the participation of all citizens according to their capacity to contribute. After all, when everyone pays equally everyone can pay less; but in general, there is an increase in the income of the Government and greater legitimacy of the tax system.

There is no doubt, therefore, that the revenue collection is one of the crucial activities of the State. It should be noted, however, that the public interest of complying with tax collection and the interest in the tax collection are not necessarily coincident. To make it happen two conditions are necessary: that the resources are destined specifically for the common good and that the collection procedure is respectful of the tax constitutional principles and fundamental rights. Thus, for example, the imposition of a tax that violates the principle of contributive ability, even if it would solve the problem of public health in Brazil, may not prevail.

On the other hand, it is known that although essential, the tax normative is among those with strong social rejection. Being considered an unfriendly normative, the effective fight against the various forms of tax evasion is a truly daunting task, so only a strict control will allow to comply with it (NABAIS, 2003, p. 20).

Therefore, the greater the effectiveness of the control, the greater the efficiency of fiscal justice will be. It should be noted, however, that if on the one hand this aspect requires that the public entity receive the indispensable tools to satisfy its financial needs, on the other hand, such power cannot sacrifice individual guarantees that are supported by the constitutional legal order.

This conflict between the power to control the tax and the duty to support it are strengthened, as we will see, with the new systems of electronic control of tax obligations, a result of the intense technological development in recent years. What happens today is that in Brazil, the tax administrations have created numerous electronic tax obligations. At the Federal level we can mention the systems of control and supervision, which however go beyond the requirement of the transmission of digital returns. It is shown, for example, with the implementation, of the Public Tax Accounting System (SPED, electronic invoicing) and the Beverage Control System (SICOBE).

With the implementation of these systems, the State widely increases its revenue collection efficiency. On the other hand, taxpayers are increasingly exposed to a power of oversight that is gradually more intense, penetrating and permanent. A conflict of a constitutional nature may thus arise. If on one hand the Tax Administration has the authority to supervise, on the other hand, cannot be allowed such activity to be practiced at extreme levels, under penalty of

affecting the free exercise of economic activity and the fundamental right to privacy.

What is at stake is, therefore, the balance of interests between the right to privacy and the public interest in the increase in tax collection. The topics to be examined are the following: how should the privacy protection rules be interpreted against the equally constitutional requirement of collecting revenues for achieving the objectives of the State? Do we need to create a balance between these values in order to obtain the best result in a specific case, or does the public interest justify the use of these new forms of control in all cases?

With this objective, the duties of collaboration between the taxpayers and the Administration, and the control duty of the TA will be analyzed first. Next, we will examine how new information technologies revolutionize the relationship between the tax authorities and taxpayers, with the surge of the so-called e-Fisco. We will then describe some electronic control systems already in operation in order to demonstrate this new reality. Next, the fundamental right to privacy will then be studied, to finally assess the conflict between the search for revenue collection efficiency and the Right to Privacy.

1. THE DUTIES OF COLLABORATION AND THE POWER OF CONTROL

The Federal Constitution establishes the duty of the State control in article 145, § 1, second part, of the Magna Carta, which is expressed the following way: “Whenever possible, the tax will have to be personal and shall be estimated in accordance with the economic capacity of taxpayers, leaving the specially empowered tax authorities to verify the effectiveness of these objectives and identify, respected individual rights and in accordance with the law, the heritage, revenues and the economic activities of the taxpayer.”

Likewise, the national tax code, in its article 195 and 197, establishes the obligation of the taxpayer to cooperate with the Public Finances. In addition, the law 9.784/99, which regulates the administrative procedure within the scope of the Federal public administration, determines in its article 4, inc. IV that the duties of the taxpayers before the Administration are, among others, to provide the requested information and to contribute to the clarification of the facts.

Finally, the taxpayers, and even third parties related to tax responsibility, have the duty to cooperate with the tax administration. In principle, the legislator has, therefore, a relatively wide power to discipline and impose those duties of collaboration, while, in theory, the taxpayer does not have a right to refuse to comply with this duty.

From this power to control and collect, which is of vital importance for the maintenance of the State, a variety of additional tax obligations have been imposed on taxpayers.

It is clear that such obligations have the function of providing the administration with the elements required to calculate the tax amount. But if the control is a right of the Administration, such right cannot affect the citizen to the point of hindering the free exercise of economic activity or sacrifice hard-won rights. Therefore, the excessive creation of accessory obligations can go against the public interest since the excess may represent a violation to the principles of free enterprise and proportionality.

It has to be pointed out that Brazilian taxpayers are more and more compelled to complete numerous electronic statements or returns, which main goal is not always lead to a better business activity, but rather to facilitate activities control and tax collection.

The reality that such additional obligations intend to reproduce is rather complex, because the National Tax System is complex. This complexity creates high costs of compliance for businesses. Therefore, not only the Brazilian tax burden is high, but also the cost for tax compliance of companies is also too high. It should be noted that the cost of compliance is what taxpayers have to comply in terms of main and accessory obligations established by the State, i.e. the cost of adjusting their behavior to the tax rules.

It is also demonstrated that the worst aspect of the Brazilian tax system is not only the high tax burden, but also the high cost of management. That was the conclusion of the "2012-2013 Global competitiveness report", published by the World Economic Forum. In a ranking of business competitiveness in which Brazil appears in the position number 48 among the 144 countries analyzed, the factors considered as most problematic for doing business in the country were: tax regulation (18.7%), inadequate infrastructure (17.5%), tax burden (17.2%) and government bureaucracy (11.1%), among other factors (labor regulations, inadequate education, etc.) I.e. in Brazil the "tax regulation", achieve its worst record, an issue obviously related to the development of these electronic systems of tax control (2012 World Economic Forum, p. 116).

Not only that, to further help the State in its "creative" task of elaboration of such obligations, the current stage of technological development, in particular the rise of the Internet, helps a lot. What we see then is that these obligations are increasing with the progress of computerization and the complexity of the national tax system.

However, as indicated in the aforementioned § 1 of article 145, the respect of individual rights is the reference to guide any action of the tax administration in the context of its tax collection function. Therefore, the power of control is not absolute and must be weighed against the fundamental rights of taxpayers that, in turn, are not absolute either.

In this sense, a conflict with the constitutional status may arise. If on the one hand the Tax Administration has the duty of monitoring, on the other hand, cannot be allowed that such activity is practiced at extreme levels, hindering the free exercise of the economic activity (sole paragraph of article 170 of the CF/1988) and the fundamental right to privacy (art. 5, X, of the CF/1988).

In addition, there has to be a balance of interests between the right to privacy of the taxpayers and the public interest in tax collection. Before this conflict of fundamental rights and in accordance with the rules of constitutional hermeneutics, which establishes that two actions of constitutional order cannot, in practice, conflict with each other, a balance between them must be sought.

This way, to preserve the duties of legitimate collaboration, there should be some minimum precautions to safeguard the rights of taxpayers. First, they must be provided in the law; they cannot be excessive, or if there are some less complex, cheaper and just as effective procedure for the same purpose, they must be preferred; and if compliance with the administrative requirements results in the violation of a fundamental right, the case should be analyzed, the level of violation of the right guaranteed should be evaluated to determine whether the imposed obligation should be eliminated or no. Finally, this conflict should be resolved by the weighting of the principles in the light of the specific situation in order to provide most reasonable and proportionate solution to the case.

2. E-FISCO: THE MODERNIZATION OF THE ADMINISTRATION - TAXPAYER RELATIONSHIP

There is a clear influence of new technologies in the formation of the modern Tax Administration. As we will see, they introduced a new form of relation between the Tax Administration and the taxpayer, with the emergence of the so-called Electronic Tax Administration or e-Fisco. After all, with the development of complex computer systems, the working method of the tax authorities is changing radically, since it was previously performed on base of paper documents (books and invoices, for example) and now it is almost entirely digitalized. In addition, an important change is imposed in the form of additional obligations by taxpayers.

In other words, today, the tax authorities work crossing electronic information from various sources and auditing electronic tax and accounting books with the help of intelligent processing systems. Therefore, the Internet has become an effective means of control.

Taxpayers, in turn, comply with much of their tax obligations, main or accessory, on the Internet. Approval is usually done upon completion of the electronic return. Negative certificates can also be obtained. Fees, issuance of documents, a variety of services are provided to citizens and enterprises in the global network of computers, so taxpayers today, provide all the necessary details to the Tax Administration, without having to perform physical visits.

Another result arising from the increased application of technology is the significant reduction of the cost necessary for operations, thanks to the reduction of officials involved in the tax activity, thus bringing great savings to the tax entities. In short, the tax situation is totally different from a few years ago. The control activity became more dynamic and automatic, because the taxpayer enters data directly in the database of the audit entity. The preferential workspace between the tax authorities and the taxpayer is online.

As a result of this revolution, the purpose is to have more efficiency in the fight against tax evasion, since it establishes an online monitoring of public finances. For tax entities it is an “optimal business”, given the difficulties of being physically present in a country with millions of taxpayers. Nothing is more natural, therefore, than the use of computer technology to create a tax intelligence system capable of crossing data and operations on a large scale.

The e-Fisco, however, requires a large transfer of responsibilities and costs from the activities of the tax administration towards taxpayers. In addition, having high costs, it is important for tax administration to consider the issue of the taxpayer with few economic resources to fund the expense of providing the State with the requested information. This is a fairly important issue, since it can stimulate the small taxpayer towards informality or otherwise make it more vulnerable to fiscal sanctions, due to the risk of providing low-quality information to the Tax Administration.

In addition, with the new control systems, the control procedure path will be almost completely online. The participation of the taxpayer will be summarized in the transmission of electronic accessory obligations, the compliance with the requests to be submitted, also, by electronic means and the science of tax reporting, if applicable. The right to the spontaneous reporting, as established in article 138 of the national tax code can be lost, since the taxpayer comes to be constantly controlled.

The new scenario, therefore, requires full respect

of the fundamental constitutional guarantees for the development of the tax legal relationship in order to promote the balance between the parties. This new reality cannot have the sole purpose of increasing revenue efficiency, which only means to increase tax collection. The expansion of the efficiency of the TA, reducing tax evasion and a better environment for business competition are not justifications by themselves to allow the proliferation of these control systems, which risk of cramping or even derail the free exercise of economic activity and the fundamental right to privacy.

To demonstrate this reality, here are described, briefly, some electronic systems developed for tax-efficiency. The description is superficial and non-exhaustive, i.e., there are many others that could be mentioned. The intention, however, is only to give a notion of how Internet and the technological development are present in the current tax situation and how they modify the Taxpayer-TA relationship

2.1. Income tax: A pioneering initiative

The computerization of individual income tax in Brazil began in 1964. Initially, the technology used was to punch cards for input of data and central computers with limited capacity for data processing. Over the years, the technology has evolved considerably. In 1995, the income tax started to be delivered through the transmission of data, and, since 1997, through the Internet. In 2000, more than 10.1 million statements were presented and, in 2012, more than 25 million statements were delivered through this channel. In 2014, Internet is the only possible means of delivery of the income tax return to the TA

For taxpayers, the transmission of these returns, without having to go to the tax authority, greatly facilitates compliance with the tax obligations. In addition, the efficiency of revenue collection machinery has increased a lot in quality. What is needed now, are computers with high processing capacity to analyze millions of returns in a short time and select those that show some kind of inconsistency or evidence of evasion to be directed to the tax network.

To further facilitate the task of the TA, the number of returns that allows comparing the data with the information contained in the Income tax return income is large enough. There are, for example, the DOI (Declaration of real estate operations), DIMOB (Declaration of information on real estate activities), DMED (health and medical services reporting) and DIRF (tax statement on the income retained at the source). Crossing these income tax declaration with simple calculation operations, greatly reduce tax evasion, as it prevents including false information for tax-deductible expenses and prevents the omission of taxable income as, for example, the rentals.

The range of information held by the Secretariat of federal revenue of Brazil also so large that from the tax year 2014, it will be available to the taxpayer the completed income tax return information will be available to the taxpayer, so the taxpayer simply has to confirm it or not. Another novelty is the presentation of the statement using mobile devices like tablets and smart phones. Finally, progress in this area is notable.

2.2. Paulista tax invoice

At the State level, a very interesting initiative is the Fiscal Paulista invoice. This system is a program of fiscal stimulus to the citizenship, which aims to encourage consumers to demand the delivery of the tax document at the time of the purchase of goods or services by the taxpayer and the tax on the circulation of goods and provision of services of interstate and inter-municipal transportation and communication, the ICMS. Stimulation is performed with the generation of credits to natural persons, companies of the national Simple, entities of social assistance and condominiums.

To this end, the consumer must request the fiscal document from the time of purchase and inform the CPF or CNPJ to qualify for loans and compete for prizes. Commercial establishments periodically sent such information to the State Tax Administration, which will calculate the credit to the consumer. The credit may be used, for example, to reduce the amount of the IPVA, deposit on current account or savings account.

With this system, the Government of the State of São Paulo is intended to reduce the burden of tax to the consumer, since up to 30% of the ICMS effectively paid each month by the establishment is distributed to buyers who provided your CPF / CNPJ in proportion to the value of your purchase.

To the tax administration, the benefits are enormous, since considerably expands the base of taxpayers by the demand of issuing invoices and tax receipts, provides a greater electronic matching of information and, therefore, the improvement of fiscal controls.

Note that the Internet is a technology indispensable support for the achievement of the paulista tax invoice. This is because, once the consumer requested the fiscal document at the time of purchase and advises his CPF / CNPJ, the company issuing the tax document and transmit it electronically to the Secretariat of finance.

In short, the paulista tax invoice was established in order to increase revenues, by transferring to the citizen a part of the Faculty's control, i.e., expands the power of control without increasing the cost to the Government. This is because, to generate credits, taxpayers are encouraged to give follow-up to the purchase made, so that if it does not appear in the system only should report to verify what happened: a system error or an "oversight" of the seller.

2.3. E-invoice (NF-e)

The electronic invoice (NF-e) project involves the Federation, the States, the Federal District and municipalities. It has as objective the implementation of a national e-billing model to replace the current system of issuance of the tax document on paper, with legal validity, guaranteed by the digital signature of the sender. It simplifies the obligations of taxpayers and allows, at the same time, the monitoring in real time of commercial transactions by the tax authorities (Brazil's Federal Revenue Secretariat. Electronic invoice).

The benefits are many. In regards to the tax administrations, there is no need to spend large amounts of resources to capture, process, and store and provide information on transactions of taxpayers. With respect to the taxpayers, there is no need to assign human resources to the registration, accounting, storage, internal audit and presentation of information to the different spheres of Government that, in the fulfilment of their legal powers, may require them, usually through statements or other accessory obligations.

Therefore, the integration and exchange of information are intended to rationalize and modernize the Brazilian tax administration, reducing costs and bureaucratic barriers, facilitating the fulfilment of tax obligations and the payment of taxes, as well as strengthening control and supervision through exchange of information between tax administrations.

In simple terms, the company issuing the NF-e generates an electronic file containing the tax information of the commercial operation, which must be digitally signed in order to ensure the integrity of data and the authorship of the issuer. This electronic file, which will correspond to the electronic invoice (NF-e) is then transmitted via

the Internet to the jurisdiction of the taxpayer which pre-validate the file and returns a protocol of receipt (authorization of use), without which there can be no transit of goods.

The NF-e is also transmitted to the Secretariat of Federal Revenue, which is the national repository all the NF-e issued and to the TA of the of the operation destination in the case of Interstate transactions. The Tax Secretaries and the federal income secretary will make consultation available through the Internet, to the recipient and other stakeholders that have the access key to the electronic document.

To monitor the transit of goods, a unique and simplified graphic representation of the NF-e, called DANFE, is printed on paper with highlighted, key access for consultation of the NF - e via Internet and a bar code that facilitates the capture and the confirmation of the information of the NF - e by tax units.

The DANFE is not an invoice nor does it replace the invoice. It is an auxiliary query tool, since it contains the key to the NF-e, which allows the holder of the document to confirm its existence through the national environment (RFB) or or the Ministry of Finance website.

As can be noted, the NF - e favors the TA, as it provides more consistency in the tax information from companies, promotes the integration and cooperation between the tax administrations of different political entities, prevent the multiplicity of work routines and the lack of compatibility between the economic data of taxpayers. The biggest difficulty for tax administrations is only the need to make investments to capture, process, store, and provide a multitude of information about transactions made by taxpayers.

For the taxpayers, the benefit of the NF-e is saving the use of paper, as in this case, the procedure is purely online and with digital signature. The printing is optional for both the issuer and the recipient. For the transport of goods, in which the tax invoice must be presented at the control offices, the process is fast since it is not necessary for the NF-e to be joined to the merchandise, which is accompanied only by the DANFE. In addition, with the NF-e, the trend is that companies gain efficiency and economy in the accessory obligations, since it allows the integration of the political entities control systems through the standardization and sharing of accounting information. Accordingly, with the application of the NF-e, it is possible to eliminate much of the evasion, generating a fair competition for companies that pay their taxes correctly.

2.4. The Beverages Control System (SICOBE)

The Control system of beverages production (Sicobe) is a device installed by the currency House of Brazil in the industrial plants of beer, soft drinks and water bottling, under the supervision, monitoring and compliance with the safety and fiscal control requirements established by the Secretariat of Federal Income. In addition to the quantity of products manufactured by the industry, the Sicobe also identifies the type of product, packaging and their respective brand (Brazil's Federal Revenue Secretariat. Beverage Control System).

Drinks are also marked by Sicobe with codes that will operate as a kind of digital signature, which will allow the Secretariat of federal revenue to track individually each drink produced in the country. These codes contain information, among others, the manufacturer, the trade mark and the date of manufacture of the product. As a result, the Sicobe will enable the Secretariat of federal revenue to control, in real time, all the process of production of beverages in the country, through the use of equipment and devices of control, registration, recording and transmission of information to the database.

The compulsory installation of production counters in the beverage industry was established by law No. 58-T article. 10.833/2003,

included in the law No. 11.827/2008 to adapt to the new system of taxation of the sector, based on the type of packaging, brand and price. The installation of the Sicobe will be held free of charge for the drinks producer, which will be responsible only for the compensation to the House of Currency of Brazil for the procedures for preventive and corrective maintenance of the system, which costs may be deducted from the PIS or the Cofins in each settlement period. To get an idea of the efficiency of the Sicobe, a report in the newspaper Folha de São Paulo (ROLLI, C.; FERNANDES, f., 2010), 04/06/2010, reported that the collection of federal taxes in the beverage industry increased by 20% in 2009, as the Secretariat of federal income will be in charge of controlling the production of beer, soft drinks and mineral water with the installation of the Sicobe in 108 factories in the country.

This is because, in practice, the Administration keeps an electronic eye on production line and, after the departure of the goods from the factory, tracks them at the point of sale and circulation. Thus, this technology is able to count each product manufactured by the industry and identify the tax payable by the company. On the other hand, in addition to preventing tax evasion, it also combat the existence of clandestine factories, because only products having the seal of the Casa de la Moneda may circulate in the country

2.5. SPED: The Tax "Panopticon"

The public system of Digital deed (SPED) is based on the Constitutional Amendment No. 42, adopted on 19 December 2003, introduced by the clause 37 of the Federal Constitution, Article XXII. This provision states that the tax administration of the Federation, the States, the Federal District and municipalities will act in an integrated way, sharing files and tax information. On basis of this provision was established, by the Decree No. 6022, on January 22, 2007, the SPED (Brazil. Federal Revenue Secretariat. Public system of Digital Deed).

The SPED is a modernization of the accessory obligations for taxpayers. Its objectives include: the integration of the tax authorities through the exchange of tax and accounting information; simplify and standardize the accessory obligations; and accelerate the identification of tax offences, with better control of processes, the speed of access to information and a more effective control of operations through data collection and electronic audit.

It began with three major projects: Digital Accounting (ECD), Fiscal Digital Accounting (EFD) and the electronic invoice (NF-e). The SPED accounting aims to replace accounting on paper for Digital accounting (ECD). It is the obligation to transmit, through the Internet, newspaper, accounting books and records written records of seats included in them. The Tax SPED, meanwhile, is the Fiscal Digital Accounting (EFD), which is a set of documents and tax records of interest to the tax authorities. It contains several books of taxes: Of registration, registry of outputs, inventory registration, registration of calculation of the ICMS e IPI calculation registry.

There are also other projects under implementation, such as the Digital tax accounting of the PIS and Cofins (EFD-PIS/ Cofins), the corporate income tax calculation book income (e-Lalur), the Digital tax accounting for the social enterprise (payroll) and the Balance sheet information (statements of accounting and financial information - financial companies) which will include financial statements and a series of economic-financial data of the companies involved in the project, which will be used to generate statistics, credit risk analysis and economic studies, among other uses. The e-Lalur will make a "draft" of the financial status of the CIT and CSLL of societies which have to calculate these taxes using the actual profits system. If the taxpayer is in agreement with the submitted values, he just signs the book and submits it. Finally, EFD-Social aims to cover the payroll accounting and employee record book.

The idea is that taxpayers have different tax and accounting information in an online environment, in principle, to facilitate the relation Administration-Taxpayer, but, in fact, to provide to the State with almost all the accounting of taxpayer, with a permanent online control of their tax obligations.

Another very important issue in relation to the SPED is its enormous complexity. To illustrate, take the case of the PIS/Coffins EFD: the digital files has more than a thousand fields to be reported, as can be verified in Executive Declaratory Law Cofis No 37/2010, which is a 109 pages document that explain how information must be completed.

In addition, the SPED complexity is accurately reflected in the complicated federal tax legislation, so the amount of information that must be provided is high, the regulation in this area is abundant, penalties for errors are severe and economic costs for companies which develop systems to comply with the obligations imposed by SPED are relevant.

At this point, it is important to mention the observation by Ives Gandra da Silva Martins (2006, p.) (39), who believes that highly complex tax systems are less efficient because they require higher costs from the administration to audit taxpayers and, for taxpayers; are far more costly to comply with their obligations and management.

The SPED represents, in any case, a new paradigm of relationship between tax authorities and taxpayers. It marks a new phase for compliance with accessory obligations and control by the e-Fisco procedure. As a result of this new model, more efficiency in the fight against tax evasion is expected. On the side of the taxpayers, the benefits of the new system consist of simplifying their tax administration procedures, because it is no longer necessary to print and store accounting and tax books, in addition to opening prospects for reducing several other accessory obligations.

The SPED and the NF-e make it possible, it is imperative to observe, the application of the “tax Panoptic”, since increasingly fewer people are able to control an increasingly wider range of taxpayers. The panoptic, as evidenced by Michel Foucault (2002, p.) (166/167), it conceived as a radial construction, with pavilions from a common Center, where all the daily activities of the residents can be monitored, with a minimum of effort. For the author, the panoptic induces in the citizen “a conscious and permanent state of visibility that ensures the automatic operation of the power.” It has to do with a surveillance which is permanent in its effects, even if is discontinuous in its action” (FOUCAULT, 2002, p.) 167)

Finally, the use of the SPED greatly increases the efficiency of collection, creating conditions to reduce tax evasion. However, its complexity and level of interference in the private life of taxpayers shouldn’t go beyond what is reasonable, under penalty of hindering the free exercise of economic activity and the fundamental right to privacy.

3. THE FUNDAMENTAL RIGHT TO PRIVACY

The fundamental right to privacy this considered in article 5, paragraph X of the Federal Constitution of 1988. It states that intimacy is considered a right distinct from the rights to privacy, honor and reputation, when the doctrine hitherto considered that these were an expression of intimacy (SILVA, 2006, p. 206).

The Constitution, moreover, doesn't provide specific reference to the right to privacy. Hence comes the understanding, for some scholars, that the right to privacy is a concept consisting in the rights to intimacy, private life, honor and reputation. This is also the position of Luiz Roberto BARROSO (2007, p. 201), for whom:

The intimacy and private life are different spheres, included in a broader concept: the right to privacy. The recognition of the existence of spaces that should be preserved from external interference results from this concept, because they involve the way of being of each one, their peculiarities. [...] As a general rule, there will be no public interest to access such information.

José Afonso da SILVA (2006, p.206) adopts the same position which uses the term "right to privacy" to cover all manifestations of the intimate and private sphere, including the rights to honor, and the image of persons.

In our opinion, however, the Constitution included the right to privacy, calling it "private life". In this way, paragraph. X of the Federal Constitution distinguishes the rights to privacy and intimacy.

The right to intimacy refers to the "most inner scope of the persons, their thoughts, ideas, emotions, etc." The idea is of interiority, field in which people should be free from any interference (PEREIRA, 2011, p. 111). That's why intimacy should always be kept secret, inaccessible and hidden, being known only by the person. Thus, the diary, the secret under oath, the intimate convictions, impenetrable personal modesty situations are examples of situations protected by the fundamental right to intimacy (VIEIRA, 2007, p. 36).

Privacy (or private life), in turn, would be everything that does not belong to the innermost scope, but that does not reach to the public sphere. This way, everything that involves a bilateral relationship, but that the individual wants to keep confidential is protected by the right to privacy. Thus, for example, a phone conversation with a friend, a postal correspondence, tax information (which implies the relationship with the IRS), bank details (involving the exchange of information with the Bank), or medical information are data which are protected by the fundamental right to privacy. In summary, the privacy right is more exposed and subject to the rules and customs of social coexistence. What is the difference between the rights to intimacy is the degree of exclusivity that each one imposes to third parties: intimacy excludes any form of communication with a second person, while privacy allows a communication that may involve other people, but excludes any form of exposure to the general public (PEREIRA, 2011, p. 116).

Taking into account the above, it means that the right to intimacy is an exclusive right of the natural person, since it is a human right to live their lives independently, without any interference of others. Thus, the secret banking, fiscal, commercial and accounting are framed in the present study, as a right to private life or privacy, which protects non-public personal information, but that involves third parties. Therefore, the conflict discussed here refers to the right to privacy, since it involves the transmission of a series of fiscal, accounting and business information to the tax administration.

4. THE CONFLICT BETWEEN REVENUE COLLECTION EFFICIENCY AND FUNDAMENTAL RIGHT TO PRIVACY

Finally, we come to the analysis of the conflict between the public interest in tax collection and the use of computer controls increasingly more invasive to the taxpayers' privacy. The problems that arise are: how should the constitutional mandates of privacy protection is interpreted against the requirement for income tax for the State purposes which are also constitutional? Is it needed to create a balance between these values to reach the best result in a particular case, or a priori the public interest justifies the generalized use of these new forms of control?

This is a very important issue, because as stated by José Afonso da Silva (2006, p. 210):

The extensive system of computerized information generates a process for the analysis of people, whose individuality is completely invaded. The danger is greater if the use of computers facilitates the interconnection of folders with the possibility of forming large databases that reveal the life of individuals, without their consent, and even without your knowledge.

Moreover, taxpayers not only must pay taxes, they are also limited in their privacy as they are required to provide a series of information to the State in order to support the control of tax entities, to develop costly computer systems to comply with these obligations, finally the relation taxpayer-administration is a true submission to the power of the State. Hence the debate between the legitimacy of control and collection measures and the respect for the fundamental rights is justified.

It should be noted, however, that the topic here exposed, although it is related, it should not be confused with tax secrecy issue. The issue that must be addressed is if the Administration can, on a permanent basis, have access to all commercial and tax data of taxpayers, i.e., the establishment of a continuous control status.

The violation of bank secrecy by the tax administration, for example, was considered unconstitutional by the Supreme Federal Court,[1] under the pretense of privacy principle. But, of course, there is no secret for the Administration, in relation to the tax information. But what about the commercial information, the comparison with the data of credit cards, of transactions of goods, medical expenses, among many others? It should be recognized that much of the information received or collated by the Secretariat of the Federal Revenue may violate the taxpayer's privacy. Before that, we have to analyze the conflict between efficiency and the fundamental right to privacy.

In line with what Stefano RODOTÀ (2008, p. 35) says, the current problems on privacy shows the need to ensure a "maximum opacity in information susceptible of discriminatory practices and the maximum transparency in those that, referring to the economic sphere of the subject, are competing to support the relevant collective decisions".Thus, information on political opinions, religious beliefs, race, health, sexual habits, genetic data, involving the right to privacy must be fully protected, and may not be sold, transmitted or accessed by

1. *On the issue of banking secrecy, the Supreme Court declared unconstitutional the Complementary Law 105/2001 which authorized the Treasury to violate taxpayers' bank secrecy without judicial authorization, considering that there was an improper invasion of the fundamental right to privacy. Minister Carmen Lucia disagreed with this decision, under the terms of the dissenting vote stating, "No violation of the privacy of citizens, but only transfer to another body of the protected information." In addition, section § 2 of art. 5 of the law states, "the information transferred in the heading of this article will be limited to records relating to the identification of holders of operations and transferred monthly lump sums, prohibiting the inclusion of any element that identifies its origin or the nature of the costs of them."I mean, how can the monthly summary of financial operations information allow the knowledge of someone's privacy, especially in the case of the collector body? BRAZIL. Supreme Federal Court, Special Appeal No. 389.808/PR, Brasilia, DF, December 15, 2010.*

third parties, and those who hold them have the obligation to keep it absolutely secret and being responsible for civil and criminal proceedings, in the event of violation.

On the other hand, economic information, guaranteed by the fundamental right to privacy, implies the guarantee that such information may not be public. However, this right, at least in regards to the economic sphere, must yield to the collective interest. It is not credible that in a State of law the collecting entity may not have free access to financial transactions of taxpayers.

Privacy, in this case, is only important for those who have something to hide. Therefore, access to all and each of the economic data for the tax administration should be unlimited, but, obviously, should only be used in order to verify the taxable event and, also, to ensure an absolute safety in relation to the access by third parties.

Therefore, access to economic data of all citizens and companies, including banking, does not offend the fundamental right to privacy, because the idea of banking secrecy and tax violation is related to the communication given to third parties. There is no breach of privacy when information is transferred, by legally acceptable reasons, maintaining the confidential nature.

This is indeed a very visible trend. There is, as CASTRO (2002, p. 12-3) says, an international movement of easing bank secrecy without the intermediation of the judiciary. The reasons justifying this trend, which includes countries like United States, Spain, France, Belgium and the Netherlands, among others, is explained by the author above mentioned author, “is in the need to fight money laundering from criminal practices and facilitate new levels of compliance and tax collection”.

Therefore, the economic sphere must yield part of the overprotection assigned in the past. This progressive transparency has its origin in the growing need for resources for the welfare state (RODOTÀ, 2008, p. 78). Privacy, in the postmodern context, must not be any more only a protection of property element, especially that of illicit origin.

It is appropriate at this point to emphasize that the Brazilian jurisprudence still did not escape the patrimonial origin of the right to privacy. A prime example is the labor jurisprudence, in which privacy gives way to power steering of the employer. According to the jurisprudence of the Superior Labor Court (TST), the employer can monitor and follow-up on the employee’s activity in the work environment, corporate email, i.e., look at the messages, both from the formal and material point of view. Thus, the proof obtained by these means is not illegal for establishing a just cause for the dismissal since for example sending pornographic material to a co-worker can be a motive. There is, in this case, in accordance with the TST, a violation of the rights set out in paragraphs X and XII of article 5 of the CF/1988. But if it also adopts the same logic the Supreme Court used to considered bank secrecy unconstitutional, the right to intercept the content of corporate electronic mail messages should come only with a judicial authorization. These conflicting decisions simply reflect the historic origin of privacy – the logic is the protection of property.

It is understood that even if the TST applied the proportionality principle in the case, annihilating the right to the privacy, on having consolidated the position of which one does not even allow “privacy expectation in the work place.”In addition, the Constitution makes distinction between personal communication and professional communication, protecting the secret in both cases, since what is intended to protect is not limited to the content of the

communication itself, and much less to the average employee, and yes to the intimacy and privacy of the partners or recipients of the communication (VIEIRA(, 2007, p. 139-142).

Another very interesting example, says CASTRO (2002, p. 23) that in the declaratory action of unconstitutionality Nº 1.1790-DF, the Supreme Court adopted that coexistence between the protection of privacy and so-called consumer files, maintained by the credit provider or integrated databases, became essential for the mass society economy. But as the author questions, "why training and the use of 'consumer files' can co-exist with the rights to privacy and private life, and the transfer of financial information to the Administration not?"

However, it is understood that the right to privacy cannot be a subterfuge for citizens to hide from the state their assets and incomes, i.e., to protect their selfish interests. In this sense, the incompatibility between the ideas of the democratic rule of law and the inaccessibility of the tax administration of the economic activity of taxpayers, since the tax revenues are the main way to achieve social justice. It is concluded, therefore, that "the presence of the public interest relativizes the restrictions on access to the nature or financial facts which disseminates private life" (CASTRO, 2002, p. 22).

Therefore, there is a "hard core" to use the expression of RODOTÀ (2008, p. 95), impenetrable to anyone. This core consists of the elements that make up the right to privacy (secrets, personal diary, sexual preference, etc.) and those who, belonging to the kernel's protection of the right to inviolability, can generate discriminatory practices (religious faith, sexual orientation, information relating to health, etc.). Meanwhile, the information contributing to the satisfaction of the collective interest should have their protective environment weakened. This as I said, what happens with the economic information in relation to tax administrations.

Privacy-related problems are, therefore, quite complex. This is because the right to privacy reflects an inaccurate content. In addition, the existing jurisprudence clings to its origin to reduce the States' interference in private activities. However the content of the concepts has a dynamic appearance. In the case of privacy, the changes due to new technologies and the need for a fairer distribution of the tax burden, require an evolution in its concept. In addition, it is worth noting that taking from tax administrations the prerogative of having access to economic information from taxpayers is the same as taking away from the State an essential function.

It should be noted, however, that the technological possibility, the public interest in tax collection and revenue efficiency may not mean the right to invade the lives of citizens and businesses. So even if these new electronic obligations can be legitimate, they must impose limits to the State. These limits are economic (costs to taxpayers may not derail the development of economic activities, verification that requires an analysis of both the amount of obligations and its content), safety (the State must guarantee the inviolability of the collected data) and context (can be used only for the purpose that was intended). Thus the need for simplification of the tax administration and technology to benefit both sides of the relationship of virtue is relevant.

Therefore, the biggest problem lies in the quantity and quality of the data collected, often disproportionate in comparison to the purposes intended. In addition, once it is collected they should receive a safe treatment, in order to ensure their integrity, authenticity and confidentiality. Hence the understanding, in line with what VIEIRA (2007, p. 233.) shows, that there are three parameters that should guide to public power in the management of the data collected: quantity, quality and the data connection to the purposes intended; access

restricted to persons who need to know them and security at all stages of the processing of the information.

In terms of taxes, due to the above mentioned, it should not be said that efficiency translates simply in search of the maximum revenue. Understanding the efficiency principle in tax matters requires us to consider compels us to consider the objective of the taxation activity, without losing sight of the objective of the State, which is the realization of the common good, because, in fact, taxation is simply an way to allow the state to comply with this purpose (MACHADO, 2006, p. 53.).

One realizes that it is not easy to choose between the two values that decide what should prevail and to what extent. At the same time, the peaceful coexistence between the protection of individual rights and the progressive opening of the society is needed. Obviously, this opening does not imply the right of the State to know that part of the information of citizens located in the "hard core" of privacy. But the State the most important actor in the role of equitable distribution of the tax burden, must, however, have a wide and unlimited access to the taxpayers' economic data. Therefore, we must find a fair balance between the individualistic notion of privacy and the satisfaction of social needs, because the efficiency legitimizes the indiscriminate use of control tools by the State or nor the public interest will give power to invade the most intimate life of people. In addition, information that companies must provide to the Administration are those specific to their economic activities, which usually they already provided. Therefore, it cannot be considered as part of the private space of the taxpayers.

In conclusion, the fundamental right to privacy cannot be a justification for taxpayers to hide from the State tax legal actions, because the Constitution does not protect a non-justifiable right to privacy.

5. CONCLUSION

Little more than 30 years ago, the tax administration was limited to papers and bureaucracy. The Internet and the transmission of data was only a draft. With the changes that have occurred, the Administration turned to the digital age. The control power grew, there was a huge transfer of tasks to taxpayers which were at first the State responsibility and taxpayers became much more vulnerable.

This new modus operandi allows the Administration to have a massive control over taxpayers, which otherwise would be impossible (PEREIRA, 2000, p. 205). Technological advances led to the development of systems capable of expanding the power of the State on a greater number of taxpayers and a wider wealth management, reducing the possibilities of tax evasion

However, the electronic controls cannot be imposed to taxpayers only with the aim of increasing revenue collection efficiency, against the fundamental rights of taxpayers. The benefits of technological advances should also impact on citizens, in order to facilitate the fulfillment of accessory obligations and reduce the tax burden.

Therefore, the power to submit cannot only be based on the public interest, because the Constitution gives individuals individual areas of action which are intangible to the State. It is true that the economic content of the right to privacy cannot survive within the contemporary State. It is not possible to have privacy as an instrument to defense property, mainly from illicit origin. It is necessary to reorient the content of

privacy beyond its individualistic dimension. Today's society requires an absolute shielding of information that could lead to discriminatory practices and maximum transparency to the information concerning the economic sphere of the subjects that will help inform the decisions of collective interest.

It is concluded therefore that the public's interest in the collection of taxes lifts some restrictions on access to economic data revealing the private life, but this, by itself, does not justify the tax panoptic. For this to happen, the level of restriction to privacy, the economic costs imposed on taxpayers and the reasonableness in the imposition of the required information must be taken into account in assessing the level of State interference in the private lives of citizens and companies. However, it is clear that the efficiency and the public interest are important values that are competing with others to legitimize the role of the e-Fisco.

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THE VAT CONTROL STRATEGY AND THE INCOME TAX OF CONSTRUCTION COMPANIES IN PERU: PROGRESS AND PENDING AGENDA

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SYNOPSIS

This paper summarizes the control measures implemented in Peru to manage non-compliance in the Construction Sector. It also analyses the sector and the array of options to develop effective controls that will reduce non-compliance activity. Some evasion practices are identified in the article and alternatives are proposed to manage them by giving examples on how the country has tackled these problems, which are common to many tax administrations.

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Content

In recent years, within tax administrations, a strong trend of fighting noncompliance considering the challenges of each economic sector can be observed.

Peru as many countries in the region has an important gap in all kinds of infrastructure, including housing and sanitation, and meeting these needs generates a high demand for the execution of different types of construction contracts.

Many of the consumers and suppliers of the market do not have conflictive interests; this make more difficult the implementation of effective controls, and this way helps the Peruvian tax administration faces many control challenges.

The present study describes the construction activity in Peru recognizing not only their direct importance but also their indirect importance in the economic chain.

We also evaluate the complexity of the different types of construction contracts as well as control measures implemented in the country to manage non-compliance in the construction Sector, in order to do so, we describe the controls implemented and explore possible controls which could be implemented by considering some factors that allow us to target and segment the control of the activity.

This study explores the importance that the input-output of the sector could have for an effective control. We also identify some evasion practices detected in the country and propose alternatives administrative practices.

This work can help as reference to other tax administrations that have to deal with complex situations similar to those faced by the Peruvian Tax Administration.

1. CHARACTERIZATION OF THE CONSTRUCTION ACTIVITY IN PERU

Construction has special characteristics that distinguish it from other activities. Each work or project must be understood as unique and specific; in addition, by the way how these activities are carried out and qualify as construction activities, the dates of beginning and of completion of the works do not match the taxable year, and this is an additional complexity that is resolved in some occasions through the granting of deferment regimes in order to recognize the taxable income.

The activity consumes many resources: materials, equipment and supplies, including specialized manpower, this is why it is recognized as having an important direct and

indirect influence on the countries' development as a result of their multiplier effect on the economy.

There are various methods for obtaining and to execute construction activities, an appropriate classification is according to the type of contracts: there are public construction contracts and private contracts. Hereinafter we will develop each of these two types.

1.1. Public construction contracts

They are contracts which are executed through certain selection processes. In our country, these can be: Public tender, publict contest, direct and minor adjudication adjudication.

The rules[1] in force determine the characteristics, requirements, procedures, systems and arrangements applicable to each selection process. For a matter of formality, the contract shall be held in writing and should be adjusted to the Proforma included in requirements with the modifications approved by the entity during the selection process.

These types of contracts are administrative type of contracts since one of the parties is a Public entity. The initiative comes from the public administration that makes a tender or a public offering.

An interesting issue in these types of contract is the fact that there is no negotiation of the contract, unlike what happens in private contracts, the counterpart adheres to the requirements issued.

It must be clarified that in these cases the contract comes into force when the conditions written in the Bases are met[2]. In general, other modifications can be expressly added in the regulation, but it should be understood that both the entity and the individual have no power and jurisdiction to modify the contractual terms.

Public construction contracts are awarded in any of the following modalities:

- **Public tender**. It calls for constructions contracts and for the acquisition of goods and supplies within the margins established in the annual budget law.
- **Public contest**. It calls for services of any nature including consultancies and leases within the margins established in the annual budget law.
- **Direct adjudication**. Applies to the procurement and contracting made by the entity, within the margins established in the annual budget law, in these cases, the process requires the convening of at least three suppliers.
- **minor adjudication**. applies to the procurement and contracting made by the entity which amount is less than a tenth of the threshold established by the annual law on budget for the bid or tender as appropriate.

1.2. Private construction contracts

In our country this type of contract is regulated in Article 1771° et seq. of the Civil Code, which provides: "For a construction contract the Contractor undertakes to make a certain work and the client to pay compensation".

In this regard, our legal system recognizes that the rules of the Civil Code, on construction contracts, are supplementary to the parties will, the Contracting Parties (individuals) can freely agree on the terms and conditions of the construction work.

So, the specifications of the contract are defined by the parties depending on the personal, technical and economic requirements of the work. In some cases, this particular issue may complicate the control of the activity.

1. *The legislation that regulates the generality of public works contracts is the hiring and acquisitions of the State law passed by Decree Legislative N° 1017 (06/03/2008) and its regulation D.S. No. 184-2008-EF (01-01-2009).*
2. *In general the conditions are usually in a document known as a concession, contest or awarding.*

2. CONTRACTING SYSTEM AND MODALITIES

Systems, modalities and financing of contracts used in the country, including the private sector, are established in the Law for Public Procurement and State Contracting, Article 26° inc. e).

In the selection processes, the entity determines in the bases the acquisition or procurement system to be used according to the nature and to the main object of the contract.

Among the options that can be regulated according to the characteristics of the different works, we can find the following:

- **Lump sum contract:** In this type, the bidder makes his proposal to execute the work for a comprehensive fixed amount and for a certain implementation period. The bidder must submit the proposal detailed item by item. This system is only applicable when the quantities and qualities of the provision are fully defined by drawings and technical specifications.
- **Contract by unit prices, rates or percentages:** The bidder makes his proposal offering prices, rates or percentages based on the databases reference amounts, and which are valued in relation to its real execution, as well as for a specific timeline for completion. In these cases, the bidder shall also submit the total value of the economic offer.
- **Mixed scheme lump sum and unit prices contract:** This system is normally applied if technical file or several technical components correspond to amounts not defined with precision. For this type not defined the unit prices system can be used, and for those amounts and magnitudes that are fully defined in the technical file, the lump sum system can be applied.

Contracts also have important features based on the way of the contract execution; therefore there are contracts which can be:

- **Turnkey basis:** The bidder offer altogether the construction, equipment and assembly until the construction is operational, including the technical file.
- **Contest offer:** with this type the bidder attends offering: technical documentation, execution of works, deadlines, and if it applies the land. This type may only apply for works under the lump sum system, and if the reference value corresponds to a public tender.
- **Controlled administration:** the Contractor undertakes to carry out economic and technical direction of the service. The new law of State contracts does not refer to this type of contract anymore.

The following are the different ways for financing contracts:

- **Financed by the entity:** The entity finances the work direct or indirectly.
- **Financed by the contractor:** the Contractor undertakes directly the total or partial financing of the contract.
- **Third-party management:** The full or partial cost of the work, service, purchase or supply and financing costs are covered by a third party committed with the bidder and the entity.

As it can be seen, there are many possible combinations that make that the contract, by itself already complex, has important aspects that need to be considered at the time of performing the control of the work for determining the taxation that each option may have.

3. ANALYSIS OF THE SECTOR

The construction activity is part of the Division F within groups 41 to 43 of the International Standard Industrial Classification (ISIC) of the Nations United. 4[3]. Based on this classification, building construction activities, civil engineering works and specialized construction activities are considered to be a construction activity.

For years, the construction activity has become an important pillar for the growth of the Peruvian GDP; on the chart shown below you can see its importance in the country's GDP.

Table 1
Growth of national GDP and sectorial year 2011
(Year Base 1994)

Sector	Weighting 1 /	Percentage change 2011 / 2010 January-December
Overall economy	**100**	**6.92**
DI - other taxes to products	**9.74**	**7.17**
Total industries (production)	**90.26**	**6.90**
Agricultural	7.60	3.78
Fishing	0.72	29.73
Mining and hydrocarbons	4.67	-0.22
Manufacturing	15.98	5.56
Electricity and water	1.90	7.40
Construction	**5.58**	**3.43**
Trade	14.57	8.82
Transport and communications	7.52	11.01
Financial and insurance	1.84	10.49
Services to companies	7.10	8.65
Restaurants and hotels	4.17	9.64
Government services	6.33	4.88
Other services 2 /	12.29	7.02

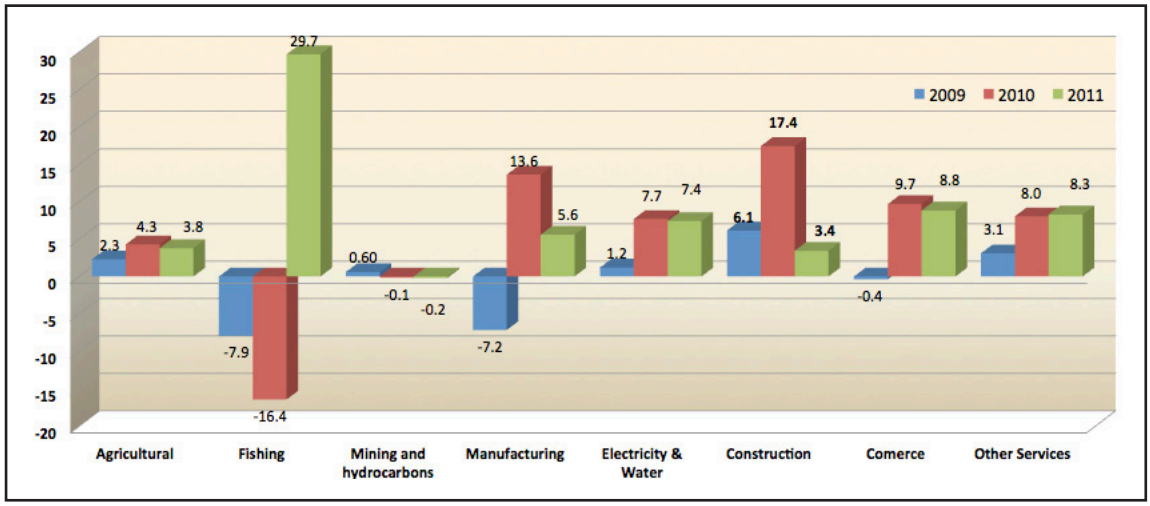
1/ Corresponds to the structure of the GDP base year 1994
2/ Includes rental housing and personal services

Source: INEI

3. *ISIC currently in force in the country is Revision 4, on the following link you can see which are the economic activities included in Section F: http://iinei.inei.gob.pe/iinei/siscodes/ActividadesMarco.htm*

The construction sector is one of the sectors that have shown better performance, since they have positive growth rates for the period 2009 to 2013. The dynamism of the construction sector in Peru is the result of many factors among them: the development of different projects mainly linked to the mining sector; the development of the infrastructure of the country as a result of the construction of roads, ports and airports; as well as the development of real estate and hotel projects as well as offices and shopping centers. The following graphic shows the changes in the economic sector in the years 2009, 2010 and 2011.

Graphic 1
Variation of GDP by economic sectors 2009-2011
(Change in %)



1/ includes the forestry sector.
2/ includes non-metallic mining.
3/ includes taxes on products and import duties.

Source: Central Reserves Bank of Peru- BCRP

The participation of the construction sector in the domestic production has been increasing since 2002, to 6.7% in 2010 and 6.5% in 2011; these figures show the growing importance of the sector in the country's economy and its dynamism in recent years.

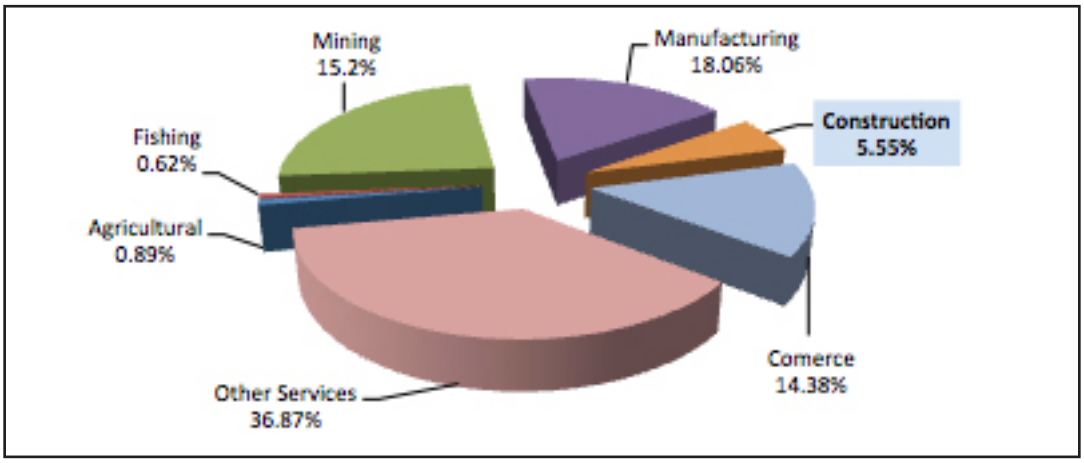
In 2011 the construction sector collected S/.3,561.2 million, which meant an increase of 22.6% over the 2010 collection (S/.2,904.3 million), and this is in accordance with the 3.4% growth experienced in the production of the sector.

Collection of the construction sector (S/.3,561.24 million[4]) was 5.55% of the total of internal taxes collected by SUNAT (S/.64,155.1 million). The following graphic shows the sectorial participation in the internal taxes collection in 2011.

4. *This participation is above sectors like Agriculture (0.9%), Fishing (0.6%); but below other sectors such as Other Services (36.9%), Manufacturing (18.1%), Mining and Hydrocarbons (23.6%) and Comerce (14.4%).*

Graphic 2

Participation of the construction sector in the collection of internal taxes in 2011



Source: National Superintendence of Customs and Tax Administration (SUNAT).

The participation of the construction sector in the collection of internal taxes has been steadily rising, from 2.9 percent in 2005 to 5.6% in 2011. Despite the international crisis, which effects were reflected in the 2009 (U.S. real estate crisis) and 2011 (Euro zone crisis), the sector has been growing, but since 2009, a slowdown has taken place.

4. THE SCOPE OF CONSTRUCTION ACTIVITY

A particular aspect of the construction sector is the formation of new companies, in some cases formed of already existing companies, whose purpose is the grouping into consortia to carry out large-size works given in concession, especially in the country's infrastructure.

The construction sector also has the particularity that interrelates strongly with other sectors of the economy, providing them with revenues; and at the same time the sector provides them with infrastructure.

5. THE PROGRAMS THAT BOOST CONSTRUCTION IN PERU

The growth shown by the construction sector has been fueled by a growing demand for housing and infrastructure. Much of the growth of housing construction is a consequence of the growth in the so-called "self-construction", which includes not only the construction of new housing but also extensions and/or renovations of housing by the owners in urban areas.

The main characteristic of this activity is that it takes place on premises outside the official cadasters[5], and for which do no authorization is requested, making this activity an underground economy activity; and therefore, it escapes the Administration´s controls since they are in areas that have not been registered and in which there is no supervision.

In terms of the housing and infrastructure increase, this has been favored by most private and public investment which is reflected in an expansion of the sector by the construction of houses, roads, construction of schools and health centers, mining complex, construction of new factories, shopping malls and office buildings, ports, etc.

This happens in all industries directly linked with this economic activity, increasing the demand for products directly related to the construction work or products for completed projects and refurbishment products[6].

In addition the Government encourages and promotes the construction sector through different programs and laws; these include the following programs:

- **Program Mivivienda[7]:** The new credit MIVIVIENDA is a product from the MIVIVIENDA S.A. Fund; it is offered through various financial institutions in the local market. This product includes the offer given by the former credit project Mi Hogar.
- **Program your own ceiling[8]:** Is a housing system created so people with low-income could buy a home which has all the basic services: electricity, water and drainage.

  The objective is to promote, facilitate and establish adequate and transparent mechanisms for people to access to decent housing, within their economic possibilities; as well as stimulating the effective participation of the private sector in the massive construction of social interest housing.

- **Law N ° 29230 "works for taxes"[9]**: this law is a mechanism which allows a private company to run a public infrastructure, and deduct the expenses from their income tax." The main objective is to encourage public investment projects, prioritized by regional or local governments.

5. *This despite the fact that in recent years, the Government through the COFOPRI (http://www.cofopri.gob.pe/) is strongly encouraging this activity.*
6. *As is the case of manufacturing metal products for structural use (construction bars, wire rods, plates, etc.) industry lime cement and plaster, clay products and non-refractory ceramic structural use (floor covering, bricks, tanks, sinks, toilets, bidets), glass industry (safety glass) and the industry involved in the manufacture of insulated wire and cables, paints and varnishes, appliances, wood products, among others. The following graphic shows the various industries linked to the construction sector.*
7. *To learn more about this program visit: http://www.mivivienda.com.pe/PortalWEB/ these are not the only programs promoted by this government entity.*
8. *To learn more about this program visit: http://www.mivivienda.com.pe/portalweb/usuario-busca-viviendas/pagina.aspx?idpage=30*
9. *To learn more about this program visit: http://www.obrasporimpuestos.pe/ some relevant documents may be obtained from: http://www.obrasporimpuestos.pe/0/0/modulos/JER/PlantillaStandard.aspx?are=0&prf=0&jer=35&sec=0*

6. THE PRODUCTION PROCESS OF CONSTRUCTION ACTIVITY

The production process of the construction sector is not unique, it differs depending on the type of project that is required and the conditions of the geographical area where this takes place, so it is difficult to describe a single process if it is not linked to a type of project, but in general the production process of the construction sector can be described as follows:

- Topographic Survey of the area.
- Preparation of building plans.
- Trenching.
- Hauling of excavated material.
- Interior leveling.
- Purchase of supplies.
- Storage.
- Construction of bases and foundations.
- Construction of walls, divisions and floors of the building.
- Various installations (electricity, water, drainage, etc.).

In general, you can recognize two very strong stages in construction, the first stage design and planning and the second execution, they can be recognized in the execution of a building, or civil works or a maintenance and/or rehabilitation construction, as it can be seen in the following table:

Table 2
Summary of the production process in the construction sector

PHASE	BUILDING (ED)	CIVIL WORKS (OC)	MAINTENANCE/ REHABILITATION (MR)
Design and planning	X	X	X
Execution:	X	X	X
1. Preparation and conditioning of ground	X	X	
2. Lifting structures	X	X	X
3. Finishes and services	X		
4. Civil works-specific processes		X	
5. Specific processes rehabilitation			X

Source: Report of the construction Sector in Peru.

For the above activities it is necessary to contract specialized goods and services which are as complex as the construction itself. In large-scale construction the use of procurement, construction, management and construction contracts (EPCM[10] in English) usually is becoming a standard, especially in the case of construction.

10. It is recommended that you deepen on the complexity of these contracts and referrals in the tax aspects can have. In the following website: http:// fidic.org/ is one of the entities which standard is widely accepted and that helps complement the understanding on the different operation forms

7. TAX REGIME APPLICABLE

With regard to VAT

- **T.U.O. of VAT and SCT Law[11]:** According to paragraph c) article 1 of the mentioned legal body, construction contracts are taxed with VAT. According to paragraph d) the first property sold by the builders is also taxed with the same tax; as well as the subsequent property sold by the companies involved with the constructor, where the property has been acquired directly by the constructor or by companies financially linked to it.

  It should be noted that in order to reduce tax evasion in the construction sector, SUNAT included construction contracts taxed with VAT in the detraction system or in the advance payment of this tax. According to the Superintendent Resolution N ° 293-2010/ SUNAT, construction contracts detraction rate is 5% and it is in force from December 01, 2010.

- **Legislative Decree N° 973:** Establishes the Regulation for Anticipated Recovery of the Tax on General Sales Regime, addressed to individuals and legal entities investing in any economic sector generating third category income (businesses).

  The regime consists of VAT returns which taxed imports and/or local procurement of new capital goods, intermediate, new goods, services and construction contracts[12], made in the pre- production stage, to be directly used by the beneficiaries of the regime for implementing the projects in the investment contracts and that were taxed with VAT or export operations.

With regard to the Income Tax Law (IT)[13]

The specific regulation for the construction sector:

Article 1° of IT includes as taxed revenue the results of the alienation of rustic or urban areas for the urban development system and real estate, covered or not under the horizontal property regime, where they have been acquired or built, totally or partially, for the purpose of alienation.

There is a presumption of regularity in order to distinguish between a real estate property sale for ending the investment made by individuals without a business (capital income taxed with an effective rate of 5% on the differential between the sale value and the adjusted cost of acquisition) of the estate sale for profit and which is third category income. The real estate property sale is from the third alienation[14].

The computable cost shall be determined according to the form established for 3 situations, i.e. acquisition, production or construction costs and amount of the value of the assets, as established in Article 20° on the Income Tax Law.

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11. See http://www.sunat.gob.pe/legislacion/igv/index.html

12. According to IAS 11: "... specifically negotiable agreement for the construction of an asset or combination of assets that are closely interrelated or interdependent in terms of their plans, technology and function or their objective or end-use". This agreement involves: the contractor (natural or legal person who performs work) and the client (owner, contractor or Customer entity). The construction contract, is also defined as a contract of results by which the Contractor undertakes to make a work determined by their drawings and/or technical specifications and the Committee to pay compensation

13. See http://www.sunat.gob.pe/legislacion/renta/index.html

14. According to the provisions of Article 2° of the Law N° 29492 (published on 31/12/ 2009) which amended Article 4° of the Income Tax Law in the part that refers to the habitual in the alienation of real estate

According to Article 63[15] of the Income Tax Law, the construction companies that execute contracts which results correspond to more than one taxable year, may benefit from one of the following methods, without prejudice the payments that are required, in the form established by the regulation:

a. Assign to each taxable year the gross income resulting from applying the amounts charged by each work, during business, the gross profit percentage calculated for the total of the respective work.

b. Assign to each taxable year gross income to be determined by deducting the amount charged or receivable, the executed works in each work during the trade period, the costs for such works.

These provisions have a correlation for the purpose of IT anticipated payments, according with the Article 36 of the regulation of income tax law[16].

8. TAXATION ISSUES OF THE CONSTRUCTION ACTIVITY IN PERU

In recent years, there has been a significant increase in the construction sector, due to the demand of infrastructure, construction of tracks and trails, as well as those related to the construction of houses in the public and private sectors.

This growth has not been reflected in the increase in tax revenue that corresponds to the economic construction activity, which would be justified by the introduction of incentives and benefits[17], but especially by the development of new evasion or avoidance practices that taxpayers would use in the development of their activities.

Here it is necessary to make an important delimitation, although it is true that for the sector´s risk management it would be necessary to evaluate a control strategy for each identified compliance gap, in this paper we will focus on the control of the veracity gap.

Between evasion/avoidance forms referred to income detected in audits, we can mention the following:

- Omission of income: by not giving invoices for services rendered (effect in VAT and IT).
- Undervaluation of income, by partially declaring operations (effect in VAT and IT).
- Deferral of income, to simulate events which must be considered as deferred income resulting from the application of accounting standards or the application of a preferential treatment included in the IT rule (effect IT).
- Simulate atypical contracts in order to separate the procurement, administration or engineering from the main contract seeking to reduce the fiscal cost of the general agreement (VAT and IT).

The first two forms relating to income are normally carried out by the so-called “Swallows” builders, those who appear only for the execution of a work or project and which then disappear from the market once the contract was executed.

The following two are mainly done by large companies that use regulatory gaps as a mechanism that enables them - at least until it

17. *The measures which have the greatest impact on this line are: i) the exemption to VAT payment for the first real estate sale that do not exceeds 35 UITs and the construction and repair of units of the armed forces which carry out the navy´s industrial services. The UIT is the tax reference unit for 2014 this stage is set at S/3.800 , little more than US$ 1.300.*

is observed by the Administration – to defer the recognition of income and/or reduce the amount of taxes to take advantage of lower rates that - within the Peruvian legislation – some taxpayers have access to due to this type of the activity, especially for the non-domiciled ones.

Between evasion/avoidance forms referred as costs/expenses which are most frequently detected during the audits, are:

- Invoice register of international suppliers for various services and/or technical assistance, which execution and effective implementation has not been accredited (effect in IT).
- Expenses for insurance or financing services provided by non-domiciled companies to cover risks, endorse the company, granting credit lines (effect in IT).
- Registration of maintenance and/or repair costs, land movement, fees, engineering, commissions and brokerage without documentary support and uncredited effective implementation (effect VAT and IT).
- Register as expenses the acquisitions of property, plant and equipment (effect IT).
- Excess of expenses for depreciation of elements of property, plant and equipment (effect IT).
- Duplicate registration costs and/or project costs with a duration of more than one year, or affect the current period with expenditures corresponding to previous years (effect IT).
- Use of false invoices to prove tax credit for VAT purposes and costs/expenses for IT purposes by seeking to "whiten" the purchase of goods or the use of services of informal providers (effect VAT and IT).
- Use of false invoices to proof tax credit for VAT the purposes and costs/expenses for IT purposes due to false operations registered with the aim of withdrawing money from the company for bribes payments or with the purpose of reducing the amount of tax by the company by generating "unreasonable" procurement (effect VAT and IT).

9. THE CONTROL OF CONSTRUCTION ACTIVITY MODEL

Based on the previous listing the different modalities can be classified in 7 general types, they can also be analyzed in terms of the probability of occurrence considering the risk management of the size of the taxpayer.

We then analyze the importance of the matrix product input, and knowledge of stakeholders (suppliers and customers) in order to have a control strategy. From the above, there are possible actions for risk management that can be executed, and then we develop the main problems regarding the audit that need to be resolved by the audit.

9.1 Risk of evasion practices according to the taxpayer size

The above listed behaviors can be rearranged in frequency detected in a control process and in which size of taxpayer they are more commonly found.

To identify risks with respect to VAT and the income tax and associate these with the size of the taxpayer, we can build the following matrix following the probability of detection of the practices to be fought against, according to an expert's judgment:

Table 3
Risks in GST (General Sales Tax) and Corporate Income Tax

RISK FACTOR	VAT		INCOME TAX	
	LTP	SME	LTP	SME
DEFERRED INCOME	H	M	H	M
FAKE INVOICES USED FOR LOCAL OPERATIONS	M	H	M	H
NO DEDUCTIBLE TAX CREDIT	M	H	M	H
FAKE TRANSACTIONS WITH FOREIGN COMPANIES	L	L	H	L
OVERVALUED TRANSACTIONS WITH RELATED COMPANIES	H	L	H	L
UNSUBSTANTIATED EXPENSE	M	H	M	H
ADVANCE RECOGNITION OF COSTS / EXPENSES	M	H	M	H

LTP: Large Taxpayers, SME: Small & medium entreprises, H: High probability, M: Medium probability, L: Low probability.

The table above can help us raise the control strategy over the risks posed to control both the taxpayer and its suppliers based on their size.

As it will later be seen, it is unrealistic to consider a control strategy without support elements that are decisive for effectively approaching risk management, the same that exceed the ad-hoc regulatory framework.

Thus, in our experience, and by international experience, it is necessary to count with elements such as a good cadaster as well as public entities that are related to the activity[18], process information in an effective and reliable manner, and have a direct interest in the activity in order to support the control.

If these features are not given, the Administration must adjust its strategy and its actions in order to adapt to its constraints, this does not mean that it should renounce to build (or promote) in the medium and/or long term a better control environment.

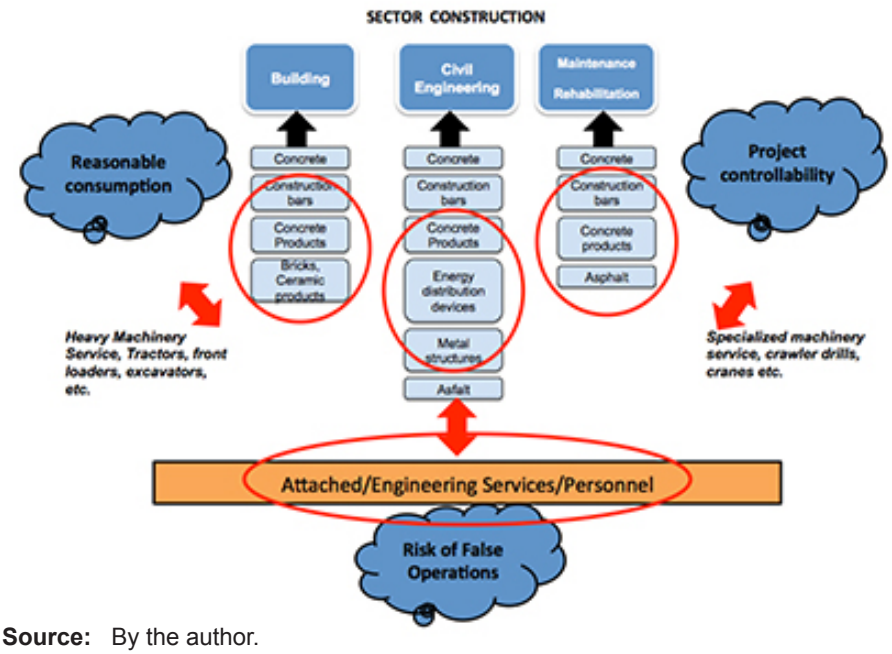
9.2. The input-output matrix and its usefulness for the control strategy

The input-output matrix of the construction activity, shows us a list of inputs (goods and services) key for the production process from which the marketing/benefit may arise controls that allow to improve the traceability of transactions allowing to uncover operations not reported or sub-declared, which is the basis for establishing a control strategy that maximizes the return on the fiscal effort.

Thus the cement, construction bars, articles of concrete, bricks and ceramic products, electrical power distribution equipment, asphalt, and heavy machinery (or services provided with them) are supplies which performance and production can be controlled through few companies that are their producers/importers and usually display good levels of compliance.

18. For example Public Records, Local Governments that authorize the constructions and in whose favor there are property taxes, Civil Defense Agencies to inspect the works, etc.

Graphic 4
Matrix input construction sector products



Source: By the author.

The information produced by the companies that produce / import these goods tend to be reliable so from the control of their sales (supplies or machinery[19]), actions to find non-declared or sub-declared operations can be performed.

The above graphic shows that most of the supplies/services necessary for the construction of buildings and civil works and infrastructure, are similar, so the control should consider the advantages of riding a mechanism to check the activities and therefore generate more effective control of the activity.

This could be done through the obligation to declare the sales of those products which may be for the execution of construction contracts from which control actions start, Peru had chosen the acquisition via the increase in the price of some products to which a perception is added[20] so for the purchaser to reduce the cost must identify himself and ask for an invoice for cost/ tax credit, by identifying active normal controls of the administration.

If the purchaser does not so, the cost of the products is increased, as long as the taxpayer must support the tax credit (VAT) to which a percentage of perception is added, which acquisition cost is more expensive and in this way, the Treasury recovers even partly the added value that was generated.

19. *The machinery to be controlled is the heavy, high-value machinery, used intensively in order to recover the investment. In some cases the equipment is so specialized that it is purchased for a specific project, and must be made abroad. In this case the Customs controls allow finding who is the buyer and which company benefits from the service performed by the no resident, in order to collect the corresponding taxes.*
20. *Learn a bit more about the operation of the regime of perceptions in Peru in: http://www.guiatributaria.sunat.gob.pe/index.php/contribuyentes/empresas-y-negocios/igv-isc/483-03-regimen-de-percepciones-del-igv-operaciones-de-venta-del-apendice-i*

The analysis of the control strategy should take into account the concentration and the reliability of the producers of the goods/services/supplies needed in the activity, so for example, in the Peruvian case, the production of aggregates (sand, gravel and stone) for construction is mostly carried out in quarries by small extremely informal non-metallic miners, in this case try to mount a control of this supply would not be efficient[21].

9.3. Controls for public works

In order to establish obligations for information to State entities that execute construction contracts allows the tax administration determine with certainty who have made construction contracts and in what amounts. Here is a point for the agenda of the country.

Control in the execution of public works, can be of very good quality, and given the requirements of documentation and control that tend to be imposed with respect to the use of public funds[22] by the Internal Control State agencies.

Thus for example the risk of underreporting is one that can reduce the obligations of institutions for information from the State in favor of the Administration, so this can quickly determine when a taxpayer does not declare or sub-declare income.

Default risk can also be significantly reduced, as long as there is a timely detection, many Governments are migrating to unique box models, if the debt is timely detected, the Administration can take precautionary measures to ensure the payment of the debt.

Another mechanism that can be implemented is to force contractors to have a letter of guarantee for a certain time allowing the Administration, execute the debt that could be determined in the process of auditing.

Risks connected with costs expenses are cross-cutting, and therefore the Administration can and must be unique, but we must recognize that there are two very important risks regarding State contracts, being that in some cases there may be bribes to contractors, so they will be tempted to include vouchers for not real operations as a way to give the money used to bribing in order to make it difficult to control, payments are usually carried out by services which auditability is complicated.

Another risk factor is the acquisitions of goods and services in the black market in order to reduce the cost of execution of one work, since the State attempts to hire companies that offer the lowest prices. Since a certain level of operation production costs cannot be optimized, the informal market is used for the purchases, using later false invoices to try to prove the costs/expenses.

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21. *In this input, since the production is quite fragmented and is very informal, is given the opportunity to check in the opposite way, instead of controlling the acquirer, you can check the producer. The controls should be based on the improvement of the control of the quarries and in control in consumption by the activity of formal construction. In addition, it is feasible to determine reasonably -as a result of visits and checks carried out by specialists in the field - the amount of aggregates extracted from a quarry and apply to be the case, the presumption of input on the same product, claiming the income to which the treasury has the right.*
The removal may have been performed directly by the owner of the concession, or may have been carried out indirectly by a third party to whom you are authorized the removal of the products, in this case the determination also can be done at the head of this party. To achieve above however, there must be a framework that allows both the determination based on alleged and the possibility of attributing joint and several liability to the owner of the quarry.
In the Peruvian model, the acquirer of these goods, in both want to deduct the cost/expense and use the tax credit the transaction is forced to detract a percentage of the value and deposit it in a special account in the name of the vendor with which you try to recover at least in part to the amount of tax that these taxpayers stop paying. Learn more about the operation of the regime of detractions Peruvian in: http://orientacion.sunat.gob.pe/index.php?option=com_content&view=section&id=12&layout=blog&Itemid=184
22. *In Peru, for example, there is the national register of contractors and subcontractors in civil construction see: http://www.mintra.gob.pe/mostrarContenido.php?id=111&tip=9, Another entity is the OSCE See: finally the SIAF http://portal.osce.gob.pe/osce/, according to which the greater part of the public sector pay run See https://www.mef.gob.pe/contenidos/siaf/manuales/Manual_Programacion_Calendario_Pagos_y_Ajustes_PCA_SIAF.pdf*

9.4. Controls for private construction projects

Here we must separate between construction companies operating in "environments that could be controlled" and those that operate out of the said control.

Regarding the last group, as in the case of tax debtors who operate to provide services to individuals who run the self-construction activity, must recognize that control may not be effectively be performed at an acceptable cost-benefit[23].

Several factors converge to this: the lack of a reliable land registry[24] of the estate, the limited capacity of the State entities linked to the authorization and supervision of the execution of works makes little effective control, the interest of all purchasers to obtain the lowest possible prices, making them to hire any company without confirming its quality, etc.

Consider a control in this scenario would require perform field controls which tend to be very expensive and that on many occasions should be done in areas where there are not sufficient guarantees for the exercise of the control work.

In this scenario the Peruvian system of increasing the main construction activity inputs through the application of perceptions of the VAT system at least partly recover revenue that is lost by the informal operation of this market.

Companies operating in markets could be controlled, if allowed to pose control strategies. Even when companies try to be totally or partially informal, their transactions leave "trace" that can be followed to determine of the correctness of their statements.

Regardless of whether it is or not a building, a civilian work or a work of maintenance and/or rehabilitation, we can consider our controls on the basis of improving the detection of execution of works, in order to combat non-compliance.

Here, we can distinguish two types of companies: those that carry out specific projects and have no interest to keep their name and build a reputation and on the other hand those companies in which their business model required to build a reputation, the last ones are which are normally responsible for high value projects, residential complexes, infrastructure, etc.

The difference between the two companies finally is the moment in which the Administration must control them, for the first group an early detection of the execution of the work and a timely audit may be concurrent (extremely) or close to the conclusion of the work[25]. The risk profile will help to distinguish between one and another profile which determines when will be the most opportune control time.

To deal with the problem related to the expenses/ costs, there is a risk that operating in highly competitive markets where informality reduces operating margins, eventually the taxpayers looking for diverting funds and/or to compromise with informal providers in order to reduce their costs.

In order to combat this during the audit, there are three main questions that will guide the Auditor in the approach of its audit procedures:

a. Were acquired goods and services registered in the accounts?
b. Are acquired volumes reasonable with the size of the work?

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23. The use of technology (google-earth or google-street view for example), allows you to raise the monitoring by areas and establish the execution of construction works

24. With the correlative of the improvement in the declaration-payment of property taxes and income tax for natural persons.

c. Are traded values of goods and services purchased and the services provided within the market value?

The answer to these questions will be conditioned to the existence in the accounting of minimum characteristics of auditability that allows validating the items through the implementation of audit procedures a) and b) inside of the context of the project for which in some cases the auditor should rely on the work of an expert.

With respect to this last one, the support of the expert, we believe that it is not enough to improve the chance for the Administration to detect operations. An important factor that should be improved is the skill for the determination of the consumption probabilities, given that - as we have already developed - one of the factors detected is the accounting of expenses/costs for goods, services or supplies in quantities not commensurate with the work performed.

For this purpose, there are two levels of work, the first: improving the ability of Auditors to assess the reasonableness of the consumption and accounting documentation which establish if operations were between the parties, at the times specified by documents, in the amount of goods or services received and the market prices that corresponded with costs/expenses/ tax credits generated in the acquisition of goods and services necessary for the construction, and can be controlled.

And the second level, starting from the incorporation of experts (civil engineers) a more precise work is performed, which may eventually include the inspection of the work concurrently and/or ex post in order to establish the reasonableness of consumption on-site. In these last two aspects, there is still a gap between what the country has and what it should have.

In the pending agenda, there is also the need to organize and streamline the process that gives support to the control model, which we have seen, in the Peruvian model measures exist but they are not integrated and organized such a way to achieve more effective control.

10. REGULATORY FRAMEWORK NECESSARY TO SUPPORT THE CONTROL OF THE SECTOR

Observation	Management Alternative
Invoice register of international suppliers for various services and/or technical assistance, whose causation and effective implementation has not been accredited.	Correctly define causality and minimum requirements for accreditation rules. Agreements for the exchange of information with other tax administrations in order to establish the existence and expertise of the companies. Market value or transfer pricing rules
Expenses for insurance or financing services provided by non-domiciled companies to hedge risks, advocating the company, granting credit lines.	Define the minimum requirements for accreditation of insurance and financial expenses. In some countries given the form of regulation of the financial or insurance system deduction would not be allowed,
Record costs of maintenance and/or repair, land movement, fees, engineering, commissions and brokerage without documentary support and uncredited causation and effective implementation.	Correctly define causality and minimum requirements for accreditation rules, including Association (matching) rules. Determine minimum and maximum % allowing assessing the reasonableness of the use of these items.
Register as expenses acquisitions of property, plant and equipment.	Control of fixed assets including depreciation charged to the project. The control must include, if the depreciation method used involves the use of the hours / machine, the allocation of the hours to a specific project.
Excess of depreciation for items of property, plant and equipment that have inferior rates of depreciation.	Control of fixed assets including depreciation charged to the projects.

Duplicate registration costs and/or costs for projects with a duration of more than one year, or affect current period expenditure corresponding to previous years.	Obligation to keep records that will allow the control of the accumulation of costs per project and the justification on how overheads and indirect costs of the project must correspond, maintaining the uniformity of the allocation factor.
Use of false invoices to prove tax credit for the purposes of VAT and costs/expenses for purposes of the IT by simulated seeking to "whiten" the purchase of goods or the use of services from informal vendors	To fight in an indirect way this type of non-compliance is very intensive in audit resource, in this case the deterrent effect of the audit and the questioning to the taxpayer can be complemented with the addition of a retention or retirement scheme that reduces the gap between the tax that was levied and the tax that was paid.
Use false of invoices to proof tax credit for the purposes of VAT and costs/expenses for purposes of the IT by false operations registered with the aim of withdrawing money from the company for payments of bribes or with the purpose of reducing the amount of tax by the company generating "unreasonable" procurement.	Ditto to the above. As an expert support engineers support the auditor would allow to control this practice.
Omission of income: by not giving invoices for services	Generate obligations of informing the acquirers, in general by opposition of interests which need to show proof of costs/expenses and tax credit is a good mechanism. Where there are no conflicting interests, the control should arise from field work.
Undervaluation of income, partially declaring the operations	The same as above, supported by engineers as experts support the auditor would allow to control this practice.
Deferral of income, to simulate events that make that it must be deferred income as a result of the application of accounting standards or the application of the preferential treatment contained in the rules of the IT.	Unless there is a specific treatment in the income rules, the application of the rules of recognition of income and costs/expenses contained in IAS 11 - construction are a good baseline.
Simulate atypical contracts in order to separate the procurement, administration or engineering of the main contract of work seeking to reduce the fiscal cost of the general agreement.	Here the work of experts is imperative in order to complement what depends from the contracts. Develop a framework in the legislation to establish the true nature of the taxable fact.

11. CONCLUSIONS

- The application of controls for the construction sector as shown is viable, however, the environment of the activity and the general framework of the State activity must be considered for developing more effective controls.
- It is necessary to acquire a good knowledge on how the production/marketing activity around the input-output matrix is organized in order to select milestones of effective control.
- It is feasible to incorporate desktop controls based on the analysis of the information that can be obtained from the obligations to inform the SUNAT, field controls (inspections and audits) can thus only be used in the case of material inconsistencies that indicate the desirability of a check.
- In high risk activities, the incorporation of prepayments[25] of the tax systems, operated by customers and/or suppliers as applicable is a mechanism that allows reducing evasion at a reasonable cost of management.
- The effectiveness of control, as in many activities, requires an adequate legal framework, predictable and clear, decreasing the litigation due to improper interpretation of the rules.

25. *It seeks to generate risk not only to determine the debt and execution, so that figures such as attribution of joint and several liability and/or liens are instruments that may arise in attention to the risk profile of the taxpayer.*

- The control requires the development of capabilities in tax administration, mainly linked to improve detection capability, and improve the capacity of determination. For the last one the existence of specialized Auditors and the incorporation of experts from the activity to support the Auditor are essential in order to control much of the problems that have been mentioned.
- In the pending agenda, there is also the need to organize and streamline the process that gives support to the control model, since as we have seen, the Peruvian model includes measurement but it are not integrated and organized in such a way that a more effective control could be achieved.

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