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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.

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CIAT/AEAT/IEF
Tax Administration Review

Content

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Message from the Executive Secretary

Dear Readers

Márcio Ferreira Verdi

On behalf of the Executive Secretary of the Inter-American Center of Tax Administrations, it is a pleasure to present to our members and associate member countries tax administration officers, and the international tax community in general, this 39th issue of the Tax Administration Review CIAT/AEAT/IEF. It is published under the technical cooperation agreement between the CIAT, the State Finance Secretary, the Institute for Fiscal Studies (IEF), and the State Tax Administration Agency (AEAT) of Spain.

As in our previous issues, we aim at offering to our readers a variety of topics that address up-to-date aspects of special interests for the diverse tax administrations.

In this new issue, highly interesting topics are examined: Tax incentives as an instrument of regulation of the use of natural resources in Uruguay; the single tax account as business intelligence tool for administrative and judicial collection; a new control and supervision approach to export (Maquila) industry in Mexico.

In addition, the argentinian experience in relation to International double taxation is examined; the evolution in the role of excise tax stamps; and the importance of applied psychology to obtain the optimal solution in audit procedures.

Finally, we renew our interest for the international taxation world; in this case within the BEPS action plan (OECD) and the Brazilian reality; as well as its influence in the rules introduced by the Organic Law of Incentives to Production and Tax Fraud Prevention in Ecuador.

I wish to thank the authors who have been finally selected, as well as those who send their communications, for the effort and dedication implied by the preparation and elaboration of these studies

In the hope that, once again, this publication will be as a useful tool to provide the international tax community with studies allowing the continuous development and improvement of our Tax Administrations, receive my most cordial greetings.

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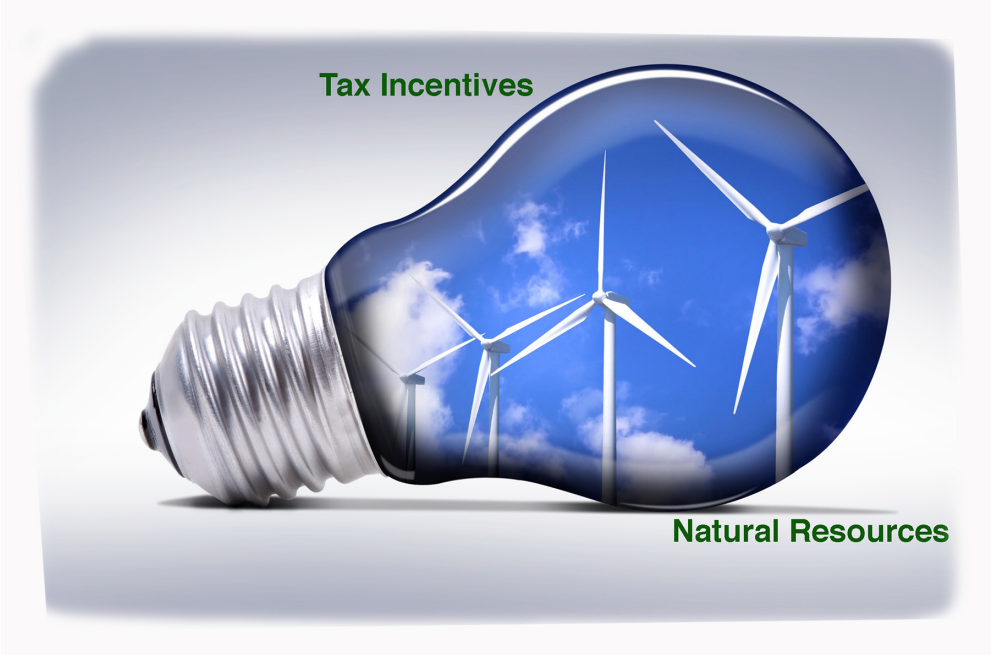
Márcio Ferreira Verdi
Executive Secretary

TAX INCENTIVES AS INSTRUMENTS OF REGULATION OF THE USE OF NATURAL RESOURCES IN URUGUAY

Ana Laura Calleja



SYNOPSIS

There is a world consensus on the need for proper regulation in the efficient use of natural resources. As a result, there have been global efforts in the pursuit of measures and specific guidelines that will ensure the protection and conservation of the environment. In our view the tax stimulus are a valuable tool to meet this need. This paper presents the environmental tax incentives implemented in the Oriental Republic of Uruguay, intended to improve the rational use of natural resources, as well as to prevent, correct or mitigate environmental damage.

The Author: *Certified public accountant, graduated from the Universidad de la República; Postgraduate specialization in taxation from the Catholic University of Uruguay. Member of the Tax Assessment Board from the General Taxation Directorate (DGI).*

Content

We live in a context of increasing pressure on natural resources, which has caused their deterioration and depletion, deforestation, increase in global temperatures, biodiversity loss, and destruction of the ozone layer, desertification and many other environmental problems. There is an imminent need for regulation of the use of such resources that define an important debate about the relationship between production and conservation between economy and environment, politics and ecology.

This environmental problem, which threatens the prosperity of the 7 billion people who inhabit our planet, force us to question ourselves about the value we give to natural resources such as air, water, soil, Earth. The place of nature in our lives; what we consider to be quality of life; what we intend to leave to future generations; ¿are we aware of the gravity of the environmental damage and its causes? What are we doing to mitigate it?

In the 2011 Human Development Report of the United Nations Program for development (UNDP), it is noted with concern that the ecological footprint shows that the world threatened in its ability to generate resources and absorb. "If everyone in the world had the same pattern of consumption than those who live in countries with an index of human development (IDH)[1] very high, and the current technological level, we would need **more than three planet** earths to withstand the pressure that is exerted on the environment"[2]. (We highlight)

In addition, this report underlines that "environmental degradation harms people in multiple aspects and means of life, and beyond the revenue capabilities, affects the health, education, and other dimensions of well-being"[3].

In this context, it is observed that in recent years the dominant political discourse is oriented, in our opinion, quite rightly, to the possibility of considering sustainability[4] and equity together, because they are very similar concepts in their concern for distributive justice[5]. However, this topic is not new since it had already been raised in the report of the Brundtland Commission (1987), and even in the international declarations in Stockholm (1972) and Johannesburg (2002).

The dynamics of sustainable development does not imply, as main objective, an economic-environmental model intended to the recovery of the State of the environmental heritage to their original levels, but the establishment of policies

1. *The index of human development (IDH) is an indicator of human development country, prepared by the UNDP. It is based on a statistical social indicator composed of three parameters: long and healthy life, education and standard of living worth. 1 technical note. Calculation of the human development index. 2011 human development report. UNDP, 2011. P. 185. http://hdr.undp.org/es/content/informe-sobre-desarrollo-humano-2011.*
2. *I2011 human development report. UNDP, 2011. P. 27. http://hdr.undp.org/es/content/informe-sobre-desarrollo-humano-2011.*
3. *OB. cit. Note 2. P. 7.*
4. *Sustainable development is understood in the report of the Brundtland Commission (1987) as: el development that meets the needs of the present without compromising the ability of future generations to meet theirs. In the same vein, the report on human development 2011.PNUD, defines it as: the expansion of the fundamental freedoms of the current generations while we make reasonable efforts to avoid the risk of seriously compromising the freedoms of future generations..*
5. *OB. cit. Note 2. P. 1*

of structural support, which make compatible objectives of economic growth, minimizing the consumption and deterioration of natural resources[6].

In this regard, at the UN Conference on sustainable development, named in short *Rio + 20*, recognizes that in the twenty years since the United Nations Conference on environment and development of 1992, progress has been uneven, even with regard to sustainable development and the eradication of poverty[7].

The Summit stated that a green economy[8] in the context of sustainable development[9] and the eradication of poverty represents an important instrument, among those available to achieve sustainable development[10].

With the aim of promoting the transition to a green economy, the document "*towards a green economy*", of the UN program for the environment (UNEP)[11] stands *inter alia* the application of taxes and incentives tax instruments to modify the preferences of consumers and stimulate green investment, innovation, capacity-building and training market-based.

In our opinion, it is more effective to introduce environmental tax benefits than to create green taxes in order to prevent, mitigate or eliminate negative externalities on the environment. However, we recognize that, for their instrumentation, Governments must be willing to give up part of their collection[12].

This article aims to describe the green tax incentives created in recent years in the Eastern Republic of Uruguay (in later Uruguay) for promoting the efficient use of natural resources, as well as preventing and combating environmental damage.

SCOPE OF WORK

As mentioned supra, the purpose of the present work consists of exposing the tax benefits for environmental purposes implemented in Uruguay in recent years, in view of improving the rational use of natural resources, as well as to prevent, correct or mitigate environmental damage.

Below is the structure of the article. In the first section, we study tax incentives as economic tools aimed to regulate the use of natural resources. In the second section, we will present the status of the Environmental Law in Uruguay. Due to the breadth of the legal norms, we decided to describe the general rules that protect the environment in Uruguay, without focusing, on this occasion, on the legal and regulatory aspects governing specific natural resources. In the third section, we will make a description of the different green tax incentives established in the Uruguayan tax regulations included in the law No. 16,906, investment promotion, to reach finally our conclusions and references.

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6. *Enterprise and the environment. Coordinators Santos M. Ruesga - Gemma Durán. Publishing pyramid, S.A., 1995. Madrid, Spain. P. 59..*
7. *A new edition of the United Nations Conference on sustainable development, known as abbreviated fashion "Rio + 20", in Rio de Janeiro, Brazil, with the aim of obtaining political commitment renewed in favour of sustainable development took place in June 2012. As a result, the so-called document was drafted "The future we want". P. 5.*
8. *According to the United Nations program for the environment (UNEP), as that should be understood "improving human welfare and social equity, at the same time significantly reducing environmental risks and biological shortages". Towards a green economy. Guide to sustainable development and poverty eradication. Summary for policy makers. UNEP, 2011. Pp. 01-02. http://www.pnuma.org/eficienciarecursos/documentos/GER_synthesis_sp.pdf*
9. *Ob. Cit. Note 4.*
10. *Towards a green economy. Guide to sustainable development and poverty eradication. Summary for policy makers. UNEP, 2011. Pp. 11-12 http://www.pnuma.org/eficienciarecursos/documentos/GER_synthesis_sp.pdf*
11. *owards a green economy. Guide to sustainable development and poverty eradication. Summary for policy makers. UNEP, 2011. http://www.pnuma.org/eficienciarecursos/documentos/GER_synthesis_sp.pdf*
12. *CALLEJA, Ana Laura. Taxes and green incentives in Uruguay. Uruguayan Institute of tax studies (IUET). Tax Journal No. 239. Montevideo, March - April 2014.*

1. THE TAX INCENTIVES AS INSTRUMENTS TO PROTECT THE ENVIRONMENT

Before developing tax benefits in Uruguayan legislation, we consider appropriate to conceptualize some economic instruments that are presented as one more tool to regulate the efficient use of natural resources in order to protect the environment.

The UNEP document "towards a green economy", argues that the establishment of strong regulatory frameworks, properly designed, can identify rights, create incentives that encourage activities for a green economy, increase confidence from investors and markets, reduce regulatory and commercial risks, as well as remove obstacles to environmental investments[13].

We must however take into consideration studies on this topic, that have shown that although the State can influence environmental management through administrative tools, a very strict regulation, in addition to carry high administrative costs, may have a deterrent effect for new companies wishing to enter an industry[14].

In this sense, we agree with part of the doctrine[15] who said that administrative instruments must be complemented with economic and financial instruments as a means to reduce costs and improve the efficiency in the use of resources. Tax incentives are part of these economic instruments.

Tax incentives are fiscal policy instruments that seek to influence the decisions of economic agents. In the words of CRUELLS Hernan and FERRE, Edgardo[16], they consist of particular treatments that the State grants or assigns to certain activities or regions. This is done in such a way that they will be attractive for investment and development, constituting one of the chosen tools within the incentive policies of a specific sector, region or economic activity and they may or not be related to the protection of the environment.

Governments that choose to implement this economic tool are based on the defense of the State intervention in the economic field, as opposed to the principle of economic neutrality applied to the tax system. The intervention of the public sector is also justified in the environmental protection based on negative externalities, public goods and economic theories, which recommend the state action to compensate the inefficiencies of the market[17].

As pointed out by John Presno[18]: Incentives represent a conception of economic policy of finalist type, seeking to guide positively the performance of private operators, encouraging them to invest in those activities that generate positive externalities or discouraging them from doing the opposite.

These tax benefits can be found the so-called green or environmental tax incentives, which are used as economic tools designed to prevent, mitigate or eliminate negative externalities on the environment.

13. *OB. cit. Note 10. Pp. 27 and 28.*
14. *Deniz, Juan and VERONA, Maria. "Tax incentives and the environment. Opinion of the Canary Islands companies in the secondary sector". Research Group INFISOC. Faculty of Economics and business. University of las Palmas de Gran Canaria. Magazine No. 26 of the Canarian Hacienda. 12 http://www.gobiernodecanarias.org/tributos/portal/recursos/pdf/revista/Revista26/RevistaHC-26_1.pdf*
15. *OB. cit. Note 14. P. 11 onwards..*
16. *CRUELLS, Hernan and FERRE, Edgardo. "Tax incentives and renewable energies". CIAT/AEAT/IEF tax administration review. NO. 34. December 2012. P. 3*
17. *Regarding the economic theories: GIL, Macia. "Fiscalidad Ambiental". MADAS. Dept. applied economic analysis. University of Alicante. 2011-2012 academic year.*
18. *PRESNO, John. "Incentivos fiscales a proyectos de inversión"sixth tax Conference of the DGI. UDELAR. 2013*

In our opinion, such incentives can be defined as the benefits provided by a State to certain entities (whereas entity in a broad sense, including both natural persons and legal public or private), with the aim of stimulating practices and friendly activities, without losing sight of the environmental objective which is to mitigate or discourage an activity that harms it.

This kind of incentives usually grants exemptions from taxes on the importation or on-site acquisition of the equipment that it tries to promote, exemptions on income and property taxes, as well as deferral incentives, namely accelerated depreciation of long-lasting equipment.

Now, to give these environmental tax benefits, States must be willing to give up part of their revenue in order to achieve the environmental objective mentioned. This tax sacrifice is therefore called tax expenditure[19].

2. THE LEGAL PROTECTION OF THE ENVIRONMENT IN URUGUAY

This chapter aims to develop the general legal framework of the environmental law in Uruguay, based on the 1997 constitutional reform, where the protection of the environment has been declared of general interest.

We will then develop the legal and regulatory framework that regulate activities and actions in relation to the environment in general, postponing for another opportunity the legal sources that regulate exclusively natural resources, due to their amplitude.

2.1. Constitution of the Eastern Republic of the Uruguay

As effective measures to prevent environmental degradation, the UNDP 2011 human development report suggests incorporate environmental law to the Constitution, which has been incorporated by at least 120 countries. However, the Nations that do not explicitly have that standard interpret the general constitutional provisions as a fundamental right of individuals to live in a healthy environment[20].

As mentioned at the beginning of the chapter, in Uruguay environmental law achieved its constitutional basis since the constitutional reform of 1997, to consider of general interest in the environmental protection in the following article:

> **"Article 47.** - The protection of the environment is of general interest." Persons shall refrain from any act that causes serious environmental depredation, destruction or pollution. The law shall regulate this provision and may provide for penalties for transgressors."

This very important provision gave constitutional backing to the law N ° 16.466 on Environment adopted on 19 January 1994. With the aforementioned law, for the first time in Uruguay was declared of general and national interest protection of the environment against any type of predation, destruction or pollution, as well as the prevention of environmental negative or harmful, and in your case, the recovery of the environment damaged by human activities.

19. *Defined as: the loss of revenue that is generated by deviated from the normal structure of a tax treatment. It is seeking is to favor a sector or group not through an increase in direct public expenditure, but through reductions of taxes charged that activity or group. The effect of this action could be seen as similar to the of grant aid through a game of public spending. General Tax Directorate. Tax education. Tax expenditure. Uruguay: http://www.dgi.gub.uy/wdgi/page?2,educacion2013,dgi--educacion-tributaria--gasto-tributario,O,es,0,*
20. *Ob. cit. Note 2. P. 11.*

Subsequently, with the constitutional reform of 2004, the bases of national water policy were incorporated into that article:

"Article 47- The protection of the environment is of general interest."

(…)

Water is a natural resource that is essential for life.

Access to safe drinking water and access to sanitation are fundamental human rights.

1. The national water and sanitation policy will be based on:

    a. Territorial planning, conservation and protection of the environment and restoration of nature.
    b. Sustainable management, solidarity with future generations, for water resources and the preservation of the hydrological cycle that are matters of general interest. Consumers and civil society, will participate in all levels of planning, management and control of water resources; establishing watersheds as basic units.
    c. Determining priorities for the use of water by regions, basins, or parts of them, the first priority being the supply of drinking water to populations.
    d. The principle by which in the provision of the service of drinking water and sanitation, social order considerations have priority on the economic order.

Any authorization, concession or permission, which in any way violate the above provisions, should be left without effect.

2. Surface waters, as well as groundwater, with the exception of the rain, integrated in the hydrological cycle, are a unique resource, subordinated to the general interest, which is part of the state public domain, such as public water.
3. The public service of sanitation and the public service of water supply for human consumption will be offered exclusively and directly by public entities.
4) The law, with three fifth of majority vote in each Chamber, can authorize the water supply to other country, in case of shortage and by solidarity with this country."

As a comparison with countries in the region, the Federative Republic of Brazil dedicated their constitutional basis to environmental law in the year 1988, unlike the Republic of Paraguay and the Argentina Republic, which included it in 1992 and 1994 respectively.

The incorporation of environmental law in the Constitution, which is currently one of the essential rights of human beings, is a fundamental measure that indicates the high degree of awareness that countries have reached to address environmental problems. Some of these rules are directly operational and others operate as guiding principles in economic and social policy. Anyway, the essential point is that when they are incorporated into the legal system, this ensures the existence of an effective power of reaction to prevent the development of behaviors harmful to the environment[21].

2.2. General Law for the protection of the environment

Among the above-mentioned constitutional reforms, was sanctioned the law Nº 17.283, law General of protection of the environment

20. Ob. cit. Nota 2. Pág. 11.

21. ANDORNO, Luis. "Aspectos constitucionales de la protección del medio ambiente ". Constitutional guidelines. Cafferatta, Nestor. Suma Ambiental. Doctrina-legislación - jurisprudencia. 1ª. Ed. Abeledo Perrot, 2011 - Buenos Aires. Argentina. P. 615.

on December 12, 2000, in compliance with the provisions of article 47 of the Constitution of the Republic.

The message attached to this Bill, the Executive Power (EP) indicated that it expected to provide the country with a modern instrument of environmental policy, assuming the international commitments of the Republic in this regard, which ensure the protection of the environment, and allow its compatibility with the national need for economic and social development.

The aforementioned law declares of general interest:

a. The protection of the environment, the quality of air, water, soil and landscape.
b. The conservation of biological diversity and the configuration and structure of the coast.
c. The reduction and appropriate management of toxic or dangerous substances and wastes any be your type.
d. The prevention, elimination, mitigation and compensation of negative environmental impacts.
e. The protection of shared environmental resources and those located outside areas under national jurisdiction.
f. The international and regional environmental cooperation and participation in the solution of global environmental problems.
g. The formulation, implementation and application of national environmental policy and sustainable development, being understood by sustainable development that development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

The article 6 of the same regulatory body displays principles on which EP must rely to establish the national environmental policy. Among them are prevention and anticipation as a priority to any other in environmental management; the commitment of the whole society to participate in this process. The integration and coordination of the various public and private sectors involved, ensuring the national scope of the implementation of the environmental policy and decentralization in the exercise of the environmental protection tasks.

It should be noted that article 7° of this law establishes that among others, the **economic incentives and taxes** will constitute instruments of environmental management.

In the words of the Cr. Álvaro Romano[22] when the Law project was under study: “the project does not say “tax and economic incentives”, but considers expressly “economic incentives and taxes” as an instrument of environmental management. According to this article, taxes could be used perfectly for environmental purposes in our country without having to confine ourselves exclusively to “tax benefits”.

In the mentioned law, the EP is required to coordinate it through the Ministry of housing, Territorial Planning and environment (MVOTMA)[23], which, as the governing body of the environmental policy in the country, is therefore expected to have more knowledge on the issue. It is in charge of coordinating the integrated environmental management of the State and public authorities in general as well as a issuing a national report on the environmental situation, which should contain systematized and referenced information, organized by topic areas.

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22. ROMANO, Alvaro. T Revista Tributaria Nº 153. “Tributos ambientales”. Instituto de Estudios Tributarios. November - December 1999. Montevideo. Uruguay. Pp. 870-871.

23. The Ministry of housing, Territorial Planning and environment (MVOTMA) was created by law No. 16.112, of June 8, 1990, as governing body of the environmental policy in the country. It establishes, in article 3, the following tasks: The formulation, implementation, monitoring and evaluation of the national plans for the protection of the environment and the implementation of the national policy. Coordination with other national or departmental, public agencies in the execution of its tasks, the conclusion of agreements with public or private national or foreign entities, for performing their tasks, without prejudice to the competences of the Ministry of Foreign Affairs. In addition, control if public or private activities comply with the standards of protection of the environment, establishing penalties for violating environmental protection regulations.

Sanctions are also provided, without prejudice to those that were already regulated by other legal provisions, to those who cause depredation, destruction or pollution of the environment. These are pecuniary, as well as civil and criminal. In the event of serious or repeated infringements by an industrial or commercial establishment, the EP may decide its temporary or definitive closure.

It is worth mentioning that the regulatory body establishes that public authorities should encourage the formation of the **environmental awareness** of the community through education, training, information and dissemination activities aimed at the adoption of behaviors consistent with the protection of the environment and sustainable development.

2.3. National Water Policy

With the law Nº 18.610, on October 2, 2009, the guiding principles for national water policy are established pursuant to the second paragraph of article 47 of the Constitution of the Republic.

Article 8 of the aforementioned law sets forth the principles that govern the national water policy. They include sustainable management of water resources, solidarity with future generations and the preservation of the hydrological cycle, which are matters of general interest. Integrated water resources management must consider social, economic and environmental aspects. The environmental education is a social tool for the promotion of the responsible, efficient and sustainable use of water resources in its various dimensions: social, environmental, cultural, economic and productive. The supply of drinking water to the population is the main priority for use of water resources. Consumers and the civil society participate in all levels of planning management and control.

It is important to stress that, as in the law General of protection of the environment, establishes instruments of national policy of water, among others, the **incentives of any kind for its sustainable use**[24].

2.4 General Procedure Code

To address the environmental problems of global nature, as for example climate change, it has been considered that the fair process implies an equal opportunity so that all countries can influence on the direction and content of international negotiations[25].

In Uruguay we have the General code of the process (CGP), sanctioned by the law No. 15.982 of October 18, 1988, which was essentially updated during the year 2013 by the law No. 19.090 of June 14, 2013. It includes two articles that discuss the active legitimization in the defense of diffuse interests, which did not suffer changes in the current review.

Its article 42° is established for issues relating to the defense of the environment that belong to an indeterminate group of persons. It states that the public prosecutor's Office, any interested and the institutions or associations of social interest according to the law or judgement of the Court will be entitled to promote the relevant process, to ensure a proper defense of the case at stake.

Subsequently, article 6 of the law N° 16.112 30 May 1990, gives active legitimization to the MVOTMA.

"Diffuse interests" typically correspond to an indeterminate group of persons without precise limits in terms of their identification[26]. Adopting a broad approach, the CGP has opted for a

24. Literal J) of article 9 of the law 18.610, on October 2, 2009.
25. OB. cit. Note 2. P. 100.
26. VESCOVI, Enrique, "General of the process code. Reviewed, annotated and agreed." Volume 2. Article 31 to 116. Montevideo, 1993, p. 74.

plurality of legitimate interests, thus expanding the eligible subjects to operate in favor of the interests involved. To such an extent, that it admits the promotion of the respective judgement by any interested, for example a particular in defense of the environment against anyone who causes pollution, harming the public interest[27].

In relation to the above, article 220 of the CGP, complements it with the effects of judicial precedent, ruling that cases promoted in defense of diffuse interests, (referring to the previous article) will have overall effectiveness, except if there is acquittal for lack of evidence, in which case another plaintiff can raise the issue again in another trial.

The exceptional solution that provides the article cited above, avoids the promotion of new and repeated processes on the same facts, while leaving open the possibility of any plaintiff to try the same action, using the new evidence, in the event of acquittal for lack of proof. In this way, stakeholders are prevented from suffering the consequences of a negligent action[28].

3. TAX BENEFITS AIMED AT PRESERVING THE ENVIRONMENT IN URUGUAY

In recent years, a series of legal and regulatory rules that aim to mitigate or eliminate negative externalities on the environment and to encourage good use through fiscal stimulus have been approved in Uruguay.

3.1 Regime of tax benefits through the Investment Promotion Act

Mostly, these environmental tax benefits are based on the law No. 16,906 of January 7, 1998, called Investment Promotion Act. For this reason, we focus exclusively on these profits, leaving to future research other more specific fiscal incentives not covered by this law.

For these reasons, we will begin our analysis describing the regime of the aforementioned law. The Investment Promotion Act is a tax law for the protection of investments, which article 1 establishes that national interest is to promote and protect national and foreign investments.

Chapter I of the law establishes that the State ensures under responsibility of damages, the maintenance and preservation of exemptions, benefits and rights that are agreed by law. It also guarantees the freedom of establishment of investments and equality in treatment, not only for investment but also for taxable investors. Free transfer of capital and profits abroad is also guaranteed and extended to the currency in which the funds can be transferred. Ultimately, it aims to create a stable legal framework that give guarantees to investors, providing equal treatment to national and foreign investors[29].

The Act provides essentially two categories of tax benefits: 1) Automatic or General and 2) those requiring an EP a statement, also called specifics.

27. *OB cit, note 26, p. 78.*
28. *OB cit, note 26, p. 79.*
29. *SONDEREGGER, Johanna. Revista Impuestos & Fiscalidad Tomo IV. "Proyectos de Inversión. Superposición y Pagos a Cuenta". CADE. November 2013. Montevideo. Uruguay.*

3.1.1. Automatic or general benefits

With regard to the first, taxpayers of the tax on the income from economic activities (IRAE) (CIT in English)[30] and the tax on the sale of agricultural goods (IMEBA)[31] who develop industrial and agricultural activities. In this case, those who engage in such activities and invest in certain assets set out in the law can enjoy the following tax benefits:

- Exemption from the property tax (IP)[32],
- Exemption from indirect taxes (VAT - tax and Specific Internal Tax - IMESI)[33] -— for import; a regime of VAT refund for local purchases is also established.

3.1.2. Benefits requiring an EP statement or specific

The CIT exoneration (IRAE) is among the benefits requiring an EP Statement PE. To benefit from this exemption, the company must present an investment project to the Ministry of Economy and Finance (MEF), which can authorize or reject it. Under this system, the company can also enjoy tax benefits for the VAT and Property Tax as well as for import duties and taxes.

Unlike the automatic or general benefit, those belonging to this category can access to the benefits mentioned regardless of the activity carried out.

The specific sectors activities that the EP declares to promote will receive the same benefits, understood as all actions leading to produce market or carry out, as applicable, specific goods or services

3.2. Environmental tax benefits under the Investment Act

We will then make a brief description of the legal and regulatory rules that, through the Investment Promotion Act, intend to stimulate eco-friendly behaviors.

3.2.1. General Law of protection of the environment

The law Nº 17.283, of 12 December 2000 empowers the EP to include the following investments within the scope of the automatic benefit of the Investment Promotion Act:

A. Movable property aimed at the elimination or mitigation of the negative environmental impacts or environmental conditions.
B. Durable improvements to the treatment of the environmental effects of industrial and agricultural activities.

This standard attempts to implement measures that favor the mitigation or elimination of negative environmental impacts thanks to tax incentives.

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30. In short, the IRAE is an annual tax that is applied to the net income of Uruguayan source of economic activities of any nature. Its aliquot part amounts to 25% (twenty five percent). -Title four of the ordered text 1996.

31. In brief summary, the IMEBA is a tax levied first alienation to any title, for certain agricultural goods, carried out by the producers, who are included in the IRAE, city councils and State agencies. -Title nine of the 1996 ordered text.

32. To summarize, the IP is an annual tax that falls on the net worth (assets less liabilities tax determined according to tax standards) of individuals, households, undivided, resident and legal entities formed abroad as long as they do not act on national territory through a permanent establishment. -Title 14 of the ordered text 1996.

33. Both VAT and the IMESI are indirect taxes on consumption. The first is a general sales tax levied on the internal movement of goods, provision of services within the country, the introduction of goods into the country and aggregated value in the construction done on buildings; while the IMESI is a specific excise tax, which taxes the first alienation, to any title, of certain goods specifically set out by law. - Titles 10 and 11 of the Ordered 1996 Text respectively.

As shown by Cr. Álvaro Romano[34], with this legal framework certain tax benefits are granted to companies that contribute to certain investments to preserve or improve environmental conditions. He adds that this standard is intends to induce economic operators, by means of tax benefits, to implement measures that prevent negative environmental impacts, such as it happens in many countries of the world.

However, at this time the EP has not exercised that power. If it exercises it, taxpayers could benefit from exemptions in the IP, VAT and IMESI, but would be limited to the subjective scope of the Investment Promotion Act. In fact, only taxpayers of IRAE or IMEBA engaged in industrial or agricultural activities could use the regime.

However, if the tax benefits of this law are not accessible by lack of regulation, these entities could be exempt from the referred taxes by presenting an investment project covered by the Decree Nº 2/012, January 9, 2012, or its predecessor Decree No. 455/007 on November 26, 2007.

3.2.2. General regime for the promotion of investments - Decree Nº 2/012, January 9, 2012; and preceding Decree No. 455 / 007, of 26 of November of 2007

As Decree No. 455/007 did previously, the Decree Nº 2/012 allows access to the expected benefits in the Investment Promotion Act, to enterprises whose investment projects or their activity of their sector, are declared promoted by the EP. It should be noted that companies presenting investment projects must be the CIT taxpayers to have access to the tax benefits.

Regarding the objective aspect of the regime, the investments under the tax benefits of the law of promotion of investments and of the Decree Nº 2/012 are the movables assets intended directly for entrepreneurial activity, among others. Non-utility vehicles and movable property for housing are excluded.

In terms of the criteria for granting benefits, priority is given to the attraction of investments that provide:

- generation of employment,
- decentralization,
- increase in exports,
- **use of clean technologies**,
- increase in research, development and innovation, and
- sectoral indicators

As a way to measure the contribution of each project in the fulfillment of these objectives, indicators will be used to qualify them according to an array of objectives and indicators that establishing the Commission of the MEF (COMAP) application.

The Commission is responsible for making recommendation to the PE so that, if it is appropriate, issue a resolution declaring the project promoted, specifying: purpose, maximum amounts and period of the tax benefits granted, among them the IRAE, IP, tax, as well as fees and taxes on imports.

With the approval of this Decree was sought, among other things, to increase the incentives for investment in cleaner production (CP), research, experimental development and innovation (RDI), energy efficiency and adaptation to climate change, because of the positive externalities generated by such projects.

34. *ROMANO, Alvaro. Revista Tributaria Nº 153. "Tributos ambientales". Instituto de Estudios Tributarios. November - December 1999. Montevideo. Uruguay. Pp. 870 a 871.*

The tax benefits provided for in the decree are as follows:

- **Property tax exemption movable property**, belonging to fixed assets by the total number of life, on the condition that such property may not avail themselves to other benefits. With respect to the civil works exoneration will be 8 years if the project is located in Montevideo (capital of the country), and 10 years if it is rooted in the interior of the country;

- **Exemption of fees and taxes on imports including VAT,** of movable fixed assets and materials intended for civil works declared non-competitive national industry by the National Directorate of industry (DNI) of the Ministry of industry, energy and mining (MIEM) and provided that do not benefit from exemption under cover of other tax benefits;

- **Refund of value added tax included,** in the acquisition in square of materials and services for civil works, if properly documented.

- **Exemption from the IRAE,** by an amount and maximum period that will result from applying the matrix of objectives and indicators, which may not exceed 100% of the amount actually invested, or 60% of the tax that must be paid to the exercises included in the promotional Declaration. To determine the amount actually invested, not shall be taken into account the investments that protect in other promotional schemes that are granted exemptions from this tax.

Indicator: Cleaner production

Within the objectives to be applied to obtain tax benefits, we found the use of clean technologies. This term is used to refer to technologies that do not pollute and that use renewable and non-renewable natural resources in a rational way. This technology produces no side effects or transformations to the environmental balance or natural systems (ecosystems)[35].

For measuring the contribution of each project to the fulfilment of this objective, the cleaner production (CP) indicator is used. For its implementation, the COMAP adopts the definition made by UNEP as a continuous application of preventive environmental strategy integrated to production processes, products and services to increase overall efficiency and reduce risks to humans and the environment[36].

The aforementioned Commission allows computing[37] the following goods and services as investment for the calculation of the CP indicator, unless they are required for the development of projects:

- Electric utility vehicles.
- Electric freight elevators.
- Solar photovoltaic panels and solar collectors.
- Wind mills.
- Heat generation equipment that replace fossil fuels.
- Replacement of steam generators to fuel oil for gas more efficient equipment.
- Wood burning boilers.
- Generation of electricity through co-generation equipment.
- Electrical capacitors and LED lighting devices.
- Electronic ballasts.
- Conditioning equipment in environments with technology VRF (variable cooling volume).

35. *http://www.innovartic.cl/tecnologias_limpias.html*
36. *COMAP. Annex II "Guide for the calculation of CP": http://www.mef.gub.uy/comap/anexoII_guia_calculo_p+l.pdf.*
37. *For projects submitted under cover of the Decree N° 2/012 effective 16/04/2012. Projects filed prior to that date or covered to Decree No. 455/007, were governed by the provisions of the following Annex: http://www.mef.gub.uy/comap/20120203AnexoII_guia_calculo_indicador_%20P_L.pdf*

In the event that the projects include other related investments generate positive externalities[39] so are considered such investments in the indicator, they must achieve a saving or efficiency above of the minimum parameters required by the rules issued by national or departmental public bodies, and if not there will be to establish international standards.

The following table can be seen that since the implementation of this new regime of investment promotion, a growing number of companies choose to use the indicator of cleaner production, which means that they choose to invest in cleaner technologies, i.e., more favorable to the environment.

Table 1
Number of projects that used the CP indicator and related Investments by year
Period: January 2008 - August 2014

Year	Projects that used the CP indicator	Investment in CP (in thousand U$S)	Total investment projects using the CP indicator (in thousand U$S)
2008	8	44,837	65,165
2009	27	284,020	304,306
2010	39	75,949	146,082
2011	69	35,984	166,054
2012	142	214,217	487,538
2013	89	1,591,836	1,722,237
Jan-Aug 2014	52	592,827	645,856
Total	**426**	**2,839,670**	**3,537,238**

Source: Support unit to the private Sector (UnAsEP) of the MEF; http://www.mef.gub.uy/unasep_institucional.php.

As noted in the following table the already enrolled companies have chosen the CP indicator in more massively than the new companies have; however, according to the report, in the implementation of the projects promoted by the law 16,906 and its regulatory decrees[39] they have a higher degree of compliance with the indicator.

38. *Such as: energy efficiency; saving in the consumption of water, raw materials, inputs and waste; recycling internal for the purpose of savings in energy, water, waste and improve the quality of products and environmental quality; use of best available technologies (BAT). Environmental improvement of the quality of air, water and soil; keep the human health; changes in products and processes aiming at the improvement of the quality.*
39. *Prepared by the UNASEP, MEF. September 2014.http://www.mef.gub.uy/unasep/estudios/20141008informe_cumplimiento_proyectos_promovidos_ley16906_actualizado.pdf. P. 14.*

Table 2
Classification of companies that used the CP indicator, new and in process, by year
Period: January 2008 - August 2014

Year	New companies	Investment in CP of new companies (in thousand U$S)	Enrolled Companies	Investment in CP of companies in process (in thousand U$S)
2008	1	15,814	7	29,024
2009	2	195	25	283,824
2010	5	66,145	34	9,804
2011	6	1,039	63	34,946
2012	19	153,669	123	60,548
2013	21	1,274,849	68	316,987
Jan-Aug 2014	16	458,947	36	133,880
Total	**70**	**1,970,657**	**356**	**869,013**

Source: Support unit to the private Sector (UNASEP) the MEF; http://www.mef.gub.uy/unasep_institucional.php.

In addition, the cleaner production indicator seems to be more attractive for small and medium-sized enterprises than for large enterprises. However, as might be expected, in monetary terms the investment in cleaner technologies is substantially higher in major projects.

Table 3
Classification of SME and Large companies that used the CP indicator, by year
Period: January 2008- August 2014

Year	SME projects	Investment in CP de SMEs (in thousand U$S)	Large Projects	Investment in CP of Large (in thousand U$S)
2008	3	17,223	5	27,614
2009	9	14,289	18	269,730
2010	24	67,803	15	8,145
2011	45	8,822	24	27,162
2012	97	21,270	45	192,947
2013	47	118,221	42	1,473,614
Jan-Aug 2014	29	40,978	23	551,849
Total	**254**	**288,608**	**172**	**2,551,062**

Source: Support unit to the private Sector (UNASEP) the MEF; http://www.mef.gub.uy/unasep_institucional.php.

The analysis by sectors of activity shows that companies corresponding to the industry sector trade and agriculture have opted for this indicator more massively than those of service and tourism have.

Table 4
Number of Projects that used the CP indicator by activity sector, per year
Period: January 2008 - August 2014

Year	Agriculture	Commerce	Industry	Service	Tourism
2008	2	0	5	1	0
2009	1	0	24	1	1
2010	3	4	21	4	7
2011	13	20	20	8	8
2012	37	48	24	19	14
2013	15	12	49	10	3
Jan-Aug 2014	10	3	28	6	5
Total	**81**	**87**	**171**	**49**	**38**

Source: Support unit to the private Sector (UNASEP) the MEF; http://www.mef.gub.uy/unasep_institucional.php.

In addition, when analyzed in monetary terms, we can see that the industrial sector is the one that most invests in clean technologies.

Table 5
Investment in CP in activity sector, by year
Period: January 2008 - August 2014

Year	Agriculture	Commerce	Industry	Service	Tourism
2008	110	0	43,412	1,315	0
2009	183	0	283,684	130	23
2010	1,624	135	71,399	1,966	825
2011	7,423	2,517	24,762	535	747
2012	21,152	6,358	180,334	5,219	1,155
2013	19,709	2,315	1,567,725	1,885	203
Jan-Aug 2014	6,106	373	583,990	1,399	959
Total	**56,306**	**11,697**	**2,755,306**	**12,449**	**3,912**

Source: Support unit to the private Sector (UNASEP) the MEF; http://www.mef.gub.uy/unasep_institucional.php.

3.2.3. Management of used lead, acid or disposable batteries

There was a need to establish a regulation that ensures proper management of used lead-acid or disposable batteries. Because of the law of environmental protection developed in Chapter 2, reduction and the proper use, handling and disposal of waste, both substances especially that are considered toxic or hazardous are considered as of general interest. The EP gives priority to the establishment of a system of national scope, that order the recovering, collection and proper treatment of lead-acid batteries used or disposed of, without distorting the market, identify and assign responsibilities to stakeholders.

In that context, the Decree No. 373/003 of 10 September 2003 was issued. It establishes that management, recovery and where appropriate, the disposal of batteries or electric lead-acid accumulators, used or merely discarded, including their components, whatever its owner or holder, must be carried out so that it does not affect the environment, being forbidden to place, store, transport, process, abandon or dispose such batteries in places not qualified for it.

Article 2 of the decree is included within the scope of the Investment Promotion Act[40] i.e., imports of machinery and installations for the implementation and execution of the operations of recovery and recycling of batteries and its separate components containing lead are exempted from VAT and IMESI. If they are purchased on site, the included VAT is refunded.

To benefit from this exemption, certification of the National Directorate of environment (DINAMA) of the MVOTMA is required. The destruction or disappearance of such goods prior to the term maturity must be accredited by the beneficiary to the aforementioned directorate. In the event of any breach of the foregoing, the granted benefits are cancelled, and the beneficiaries would have to pay any taxes with the fines and surcharges from the date they should have been paid, without prejudice to the sanctions that correspond for breach of the standards of environmental protection.

3.2.4. Renewable energies

Uruguay has a long-term energy policy (2005-2030) which was approved in 2008 and ratified by a multi-party Commission in the year 2010. It reflects the importance of this issue and confirms the energy policy as State policy, which includes a strong renewable energy commitment since Uruguay has an important availability of natural resources for the generation of solar power wind and hydro energy, as well as interesting opportunities from biomass[41].

The World Wildlife Fund, World Wild Fund (WWF), in the report "leaders in clean energy"[42] in Latin America highlighted the leadership of Uruguay in renewable energy and said that Uruguay is defining the global trends of investment in renewable energy. It is the first in the top five of countries worldwide with the highest percentage of the gross domestic product (GDP) invested in renewable energy. In 2013, it ranked fourth as the country that attracted the absolute largest amount of investment in Latin America (in renewable energy) and in 2014, it ranked first in Latin America in terms of the highest rate of growth in investment in clean energy.

Uruguay currently has developed a legal framework oriented to the development of these energy sources, which provides significant tax exemptions.

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40. Article 7 of law N ° 16,906, January 7, 1998..

41. Uruguay XXI. "Renewable energy, investment opportunities"... Promotion of investments and exports. August, 2014. P. 1. http://www.uruguayxxi.gub.uy/inversiones/wp-content/uploads/sites/3/2014/07/Informe-de-energias-renovables.pdf

42. WWF. "Countries Top renewable energy in Latin America". November 2014. http://www.wwfca.org/?235411/lideresenenergialimpia..

3.2.4.1. Wind energy

As discussed in paragraph 3.2.2, Decree Nº 2/012 of January 9, 2012, regulating the Investment Promotion Act, the methodology of evaluation of investment projects and provides attractive tax benefits for CIT taxpayers which submitted projects to the COMAP and are approved by the EP. To access these benefits, investments must be included in the definition in article 3 of the Decree, among which is the intangibles established by the EP.

From 2014, with the entry into force of the Decree Nº 23/014 of 30 January 2014, are considered intangible assets included in the concept of inversion of the above-mentioned article investments in wind **power generation**. They must be intended for the connection of the national interconnected system, in accordance with signed contracts with the national administration of power plants and power transmission (UTE), from the moment in which occurs the transfer of their property to the aforementioned entity.

As developed in section 3.2.2, the investment projects are submitted to the COMAP, which is responsible for making recommendation to the EP. If it is appropriate, the EP issue a resolution declaring promoted the project, specifying the purpose, the maximum amounts and the term of the tax benefits granted, which include the IRAE, IP, VAT as well as fees and taxes on imports.

The CIT exoneration is defined depending on the application of a matrix of indicators and the score obtained. There are two indicators that relate directly to the activities of the energy sector: the P+L (cleaner production), developed in the cited section, and the technological level of the processed product (sectoral indicator for industrial activities)[43].

The P+L indicator computes as private investment in the energy sector: photovoltaic solar panels and solar collectors, wind mills and thermal generation kits that replace fossil fuels, generation of electricity through co-generation, devices of LED lighting, electrical capacitors and electronic ballasts. In addition to the above-mentioned goods, projects involving investments linked to generate energy efficiency above the minimum parameters required by the rules issued by national or departmental, public bodies should be computed for the P+L indicator, prior evaluation of the COMAP.

In addition, the technological level of the developed product indicator can be specifically considered in investment related to industrial activity, and aims to promote the development of high added-value production processes.

The COMAP requires that companies presenting projects whose purpose is the generation of electrical energy from non-conventional renewable sources, will be computed for the matrix of indicators with the maximum score for the technological level of the developed product. Companies that do not have as main activity power generation are also included in this evaluation[44].

3.2.4.2. Solar thermal energy

With the Nº 18.585 act of September 18, 2009, the research, development and training in the use of thermal solar energy is declared of national interest. This standard is intended to accompany the international trend in the need to go replacing the generation of energy from traditional sources, such as hydrocarbons, by the generation of renewable energy, such as for example solar thermal.

Thermal solar energy reduces emissions linked to environmental impact and greenhouse

43. *UNASEP. "Investment promotion. Renewable energy. Tab theme 1/2014 ". July 2014. P. 5. http://www.mef.gub.uy/unasep/fichas_tematicas/20140801_promocion_inv_energ_renov.pdfç*
44. *COMAP. Annex IV. 3: MIEM sectoral indicators. http://www.mef.gub.uy/comap/anexo_IV_3_miem.pdf*

in particular and enables compensation procedures referred to in the Clean Development Mechanism considered in the Kyoto Protocol.

The EP may grant exemptions provided for in the law of promotion of investments referred in the preceding paragraphs, for the manufacture, deployment and effective utilization of this energy.

Solar collectors

The EP is also empowered for the total or partial exemption from VAT, consumption taxes and customs taxes, to national and imported solar collectors not in competition with the national industry, as well as imported goods and services not in competition with the national industry, necessary for their manufacture.

Regulatory decrees[45] made use of the Faculty granted by law, and establish the exemption from VAT on the sale of domestically produced solar collectors.

For the purposes of applying the law analyzed, devices capturing solar energy and battery for use exclusively in solar energy systems are considered solar collectors. Water heaters that do not use solar resources (article 1 of Decree No. 451/011) are not included.

Through the resolution of November 16, 2012, the EP said that domestically considered solar collectors would be those using inputs that have a national component greater than or equal to 35%. The term input includes direct labor, utility, components and raw materials used in the production of the goods concerned.

When machines, equipment, materials and services are purchased on site to manufacture solar collectors, they must include VAT, unless they were exonerated, in this case it will be refunded through credit certificates. If these goods are imported and do not compete with the domestic industry, they are exonerated from surcharges, fees and taxes that apply on importation, including VAT[46].

It is important to highlight that the wish to insert this technology in various sectors of activity in Uruguay, sets a compulsory schedule to include them in all new construction or rehabilitation of existing large consumption sectors such as hotels, health centers and sports clubs.

In addition, the CIT regulations[47] allows using the benefit of "exemption for investment" the solar collectors or solar panels made by the agricultural sector as improvement sets for their sector.

Also in March 2012, the Solar Plan oriented to promote the use of solar thermal energy in the residential sector began to be implemented in Uruguay. It finances and gives bonuses to the acquisition of solar panels.

3.2.4.3. Electric power through non-traditional renewable sources

The Decree No. 354/009 of August 3, 2009, for the energy sector in general, which had already declared promoted the generation of electricity through non-traditional renewable sources and the transformation of solar energy into thermal energy.

With this Decree, the following activities are declared promoted under the Investment Promotion Act:

- the generation of energy from non-conventional renewable sources or through co-generation,

45. *Decree No. 451/011 of December 19, 2011 and Decree No. 325/012, October 3, 2012.*
46. *Informative mode, Decree No. 325/012 expected regulatory changes for the purposes of the tax exemptions starting from March 1, 2016 and from March 1, 2021.*
47. *Article 116 of the Decree No. 150/007, April 26, 2007, regulation of the IRAE.*

- the transformation of solar energy into thermal energy,
- The conversion of equipment and integration of processes, aimed at the efficient use of energy.
- The national manufacture of machinery and equipment for the above activities.

For the purposes of the provisions in the referred decree, are considered non-traditional renewable sources small hydropower, wind energy, thermal and photovoltaic solar energy, geothermal energy, tidal energy, wave energy and different sources of biomass used in a sustainable way.

Thus, it is considered efficient use of energy (EUE) all changes resulting in an economically convenient decrease of energy required to produce a unit of economic activity. They must meet energy requirements of services requiring an equal or higher quality level and a decrease of negative environmental impacts whose extent covers the generation, transmission, distribution and consumption of energy.

Also within the concept of EUE is included the replacement of traditional energy sources by non-traditional renewable energy sources allowing diversification of the energy matrix and reducing emissions of polluting gases.

Co-generation means the simultaneous generation of electrical (or mechanical) energy and useful thermic energy to some process, using the same energy source. For the purposes of this Decree, the systems that can be classified as EUE shall be considered as co-generation systems.

For the purposes of this Decree, fossil fuels and large hydropower energy are considered as traditional energy sources.

The mentioned activities are exonerated from a percentage of the CIT, which can reach up to 90% (ninety percent) of the tax net income for a certain period. Throughout fiscal years, the percentage of reducible income goes declining.

The benefit applies starting from the year 2009 with a term of ten to twelve years, depending on the activity. To obtain the exemption, companies engaged in such activities must be submitted to the COMAP the corresponding request for exemption. This includes an affidavit, from the National Directorate for energy and Nuclear technology (DNETN), establishing the activities to be developed by the applicant which applies for the exemption, investments in machinery, components, equipment, and supplies to perform, discriminating by type, value and quantity of such goods.

In this way, the COMAP with the advice of the DNETN, will determine if the request complies with the requirements established by the decree and shall establish the procedures of control and financial and accounting information to be submitted by the beneficiaries according to the activity that they will develop and the magnitude of the project.

3.2.5. Biotechnology industry

With the Decree No. 11/013 of 15 January 2013, is declared promoted the biotechnology industry, which includes the activities of generation of products, services and biotechnological processes in the national territory, applicable to strategic productive sectors, including the environmental.

The promotion of these activities falls fully into the goals of the Investment Promotion Act. For the purposes of this Declaration are defined as biotechnologies any technological application that uses biological systems, living organisms, or derivatives to make or modify products or processes for specific uses. Biotechnological products are any products that incorporate biological systems, living organisms, or derivatives in their production process; and biotechnology service are the production process by which biological systems, living organisms, or derivatives are incorporated into products or processes for specific uses.

The tax benefits imply a CIT exemption for the promoted activities, beginning in 90% (ninety percent) in 2012 and decreases to 50% (fifty per cent) over a period of 10 years. Net tax revenues used for the application of the percentages referred to cannot enjoy other benefits in terms of CIT. The tax arising from applying the corresponding aliquot to the remaining income may not be exempted under cover of other benefits.

To obtain to the exemption, the companies that carry out such activities must submit an affidavit with the description of the activity before the MIEM, which, with the advice of the COMAP will determine if it complies with the requirements established by the Decree on.

Note that the recently published Act 19.317 of 18 February 2015 declares of national interest the development of biotechnology and its applications as fundamental factors for technological innovation, productivity, compe-titiveness, sustainable development and the well-being of the population, establishing the regulatory framework for the promotion of biotechnology.

Article 3° mentions that the object of this law is to promote research, technology transfer and the application and development of biotechnology both national and departmental levels. The following article states that the purpose of this legal standard is to promote economic and sustainable development of the country while preserving biological diversity without affecting the health of the population or the environmental balance.

The activities of biotechnology and their applications covered by the Act are, in our view, more spacious than tho.se promoted in the Decree 11/013, which generated the need for new regulation[48].

Finally, article 7° declares general interest activities referred in the regime for the promotion and protection of investments set forth in the Investment Promotion Act.

3.2.6. Solid waste

In order to minimize the impact on health and the environment arising from the treatment and final disposal of solid waste, the Decree No. 411/011 of November 2011, under the Investment Promotion Law, promote the activity of treatment and final disposal of solid industrial waste. Within the framework of the national system of industrial solid waste management and the agreement concluded between the Municipal Intendancy of Montevideo (IMM), the MVOTMA, and the Chamber of industries of Uruguay's on June 5, 2009.

The tax benefits are granted as follows:

- **Exemption of fees and taxes on imports, including VAT,** to goods aimed at integrating the cost of investment in fixed assets, directly imported by the organization that develops the promoted activity, provided that they have been declared as not in competition with the national industry;
- **Refund of value added tax** for the acquisition of goods and services to integrate the cost of investment in fixed assets directly applicable to the promoted activity.
- **Property tax exemption** on real and personal property that are incorporated to carry out the promoted activity;
- **CIT Exemption** for the income derived from the promoted activity.

To qualify for the tax exemptions established in the referred decree, the taxpayers who develop the promoted activity must be submit to the COMAP a statement with description of the activity to develop which are considered included in the exemption, as well as a detail of the investments to be carried out.

48. Article 5 of the Law 19.317 of 18 February 2015.

4. CONCLUSIONS

There is a global consensus on the need for proper regulation in the efficient use of natural resources to achieve a better quality of life, and more importantly to ensure the survival of the planet inhabitants. As a result, global efforts are undertaken in the pursuit of measures and specific guidelines that will ensure the protection and conservation of the environment.

In our opinion, State policies play a key role in the pursuit of measures and specific guidelines that for the protection and conservation of the environment. However, in this work we have shown that administrative instruments may not be structured in isolation but that they require, in our view, a multidisciplinary approach to promote consistent and coordinated use of various tools and mechanisms at work.

In the previous sections, we have seen as of utmost importance that countries establish solid, clear and precise legal frameworks as a fundamental measure to regulate the efficient use of resources. We must take care not to convert them into obstacles for the development of enterprises, or an entry barrier for the installation of new ventures, or carrying high administrative costs both for the State and for such ventures.

Therefore, we share the view of much of the doctrine, in that the administrative instruments must be applied with economic and financial instruments such as the tax benefits. In our view, the fiscal stimuli are a valuable tool to regulate the efficient use of natural resources, when they are designed so that they are true instruments of support to the legal standards of environmental protection, harmonizing the objectives of economic growth with environmental damage reduction and minimization of natural resources consumption.

We find that the development of a social policy that will allow economic activities to affect positively the environment through tax benefits is more effective and beneficial for the care and prevention of the environment. We consider it as a more effective measure, since these instruments are intended to influence the decisions of economic agents, especially in the environmental management of enterprises, for the efficient use of natural resources. But we are aware that to implement it, the Governments must be willing to give up part of their collection for providing tax credits to these entities that take actions or measures to generate positive externalities on the environment.

In our opinion, Uruguay has directed its production processes towards more environmentally friendly and beneficial practices. This work discussed the environmental tax incentives included in the Investment Promotion Act, among others the stimuli in the clean energy investment. In that sense, it is projected that for 2016 Uruguay will be the country in the world with highest percentage of wind energy in its energy supply[49].

Also in Chapter 3, we described the tax benefits that the CIT taxpayers whose investment projects were declared promoted by the EP if they invested in environmentally friendly technologies, and observed that since the implementation of these stimuli, companies are increasingly investing in technologies that produce positive externalities for the environment, mainly in the industrial sector.

Finally, among the major future axes of work, we feel that doing more empirical works it would be rewarding. They would allow informing society in general, and mainly

49. *http://www.elpais.com.uy/economia-y-mercado/uruguay-sera-pais-mundo-mayor.html*

companies and investors on the effects of the implementation of these tax stimuli, conducting surveys and interviews with employers leading to more environmentally friendly practices or those who contribute to develop activities to protect the environment. In this way would be encouraging and building in every human being a solid environmental culture that ensure the path to a truly green economy. We definitely deserve it.

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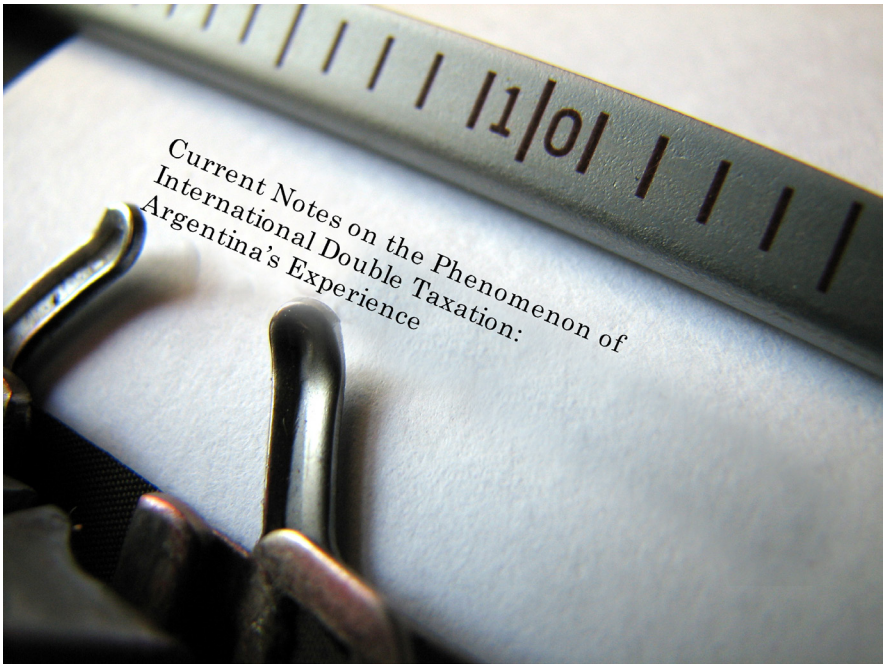
CURRENT NOTES ON THE PHENOMENON OF INTERNATIONAL DOUBLE TAXATION: ARGENTINA'S EXPERIENCE

Ricardo Echegaray



SYNOPSIS

This study aims to analyze the current international scenario, in the light of the recent movements that have occurred in the field of international taxation, as well as the way in which this framework has influenced in the actions and decisions of the Republic of Argentina Tax Administration.

Our purpose is analyze such phenomenon in the global context and explore solutions that this Administration has been implementing both at the unilateral and multilateral levels, based on trends and current standards.

The Author: *Ricardo Echegaray. Federal Administrator of Public Revenue of Argentina. Former President of the CIAT Executive Council 2013-2014.*

Content

In recent decades, in an increasingly accelerated manner, the globalization phenomenon has exercised great influence in the economic structures.

When we talk about globalization and its effect on the world's economies, we do not refer to a new phenomenon but more precisely, sustained growth and impact on international operations.

We have defined globalization as the phenomenon of opening economies and borders, result of the increase in trade, capital movements, movement of people and ideas, the dissemination of information, knowledge and techniques and a deregulation process[1].

This fact has been transformed and assumed expensive dimensions, having now transcended the actions of companies - in particular of the large economic groups – from mere role as source of work and wealth, to become fundamental actors in the economic, but also social development of communities.

Under that premise, it is undeniable that globalization as such has a decisive influence in the tax systems of the States[2].

In this transnational scenario, countries must be careful to reach a balance in their tax policy between the legitimate right to exercise their tax sovereignty and taxing taxpayers in their jurisdiction, on the one hand, and the need to avoid double or multiple taxation that may hamper international operations and cross-border capital, on the other hand. They must not lose sight of the existence of other undesirable phenomenon such as double non-taxation.

1. INTERNATIONAL DOUBLE TAXATION

The fact that the income or assets of a company or individual that acts in several jurisdictions can be subject to taxation in two or more countries gives rise to the phenomenon of double international taxation.

Double or multiple taxation occurs when there are jurisdictions with overlapping tax power.

Double international taxation may take place in the field of international transactions, through the interaction of the tax systems worldwide.

Undoubtedly, this fact, considered undesirable, affects the normal development of international economic relations and international businesses, but also the neutrality that tax systems should provide in regards to the circulation of capital.

1. *Ricardo Echegaray, "Tax administration versus the global taxpayer", La Ley, Buenos Aires, 2013.*
2. *The tax system for the modern society holds great importance, not only as a necessary element of collection of tax revenues to genuinely financed the maintenance of the State, but also in its fundamental role of 'pillar' or scaffolding on which human development, economic progress with social justice, economic productivity and, in sum, the harmonious growth of the nation.*

Facing such problems, that affect growth and prosperity, the states have undertaken efforts to eliminate this phenomenon, to minimize the damage to trade and the difficulties to the sustained economic growth, but while at the same time keeping affirming their sovereign right to set their own tax rules.

When we refer to the design of solutions to the problem of double taxation, outlines the implementation by States of different mechanisms, both at national level, such as the credit for similar taxes paid abroad or the exemption of foreign source income, as well as international level, from the subscription of agreements for avoiding double taxation.

We do not exhaust these lines with unilateral methods to avoid double taxation, which, in general terms, import the implementation of measures in the internal law to minimize these adverse effects. More precisely, we want to introduce in this analysis the solution of international acceptance, which greatly mitigates the international economic double taxation by means of specific agreements signed by the States.

2. AGREEMENTS TO AVOID DOUBLE TAXATION

For that, indeed, since long ago bilateral treaties have been signed, whose main objectives are, first, to encourage economic growth through the removal of double taxation and other barriers to trade and investment and, in the background, improve the fiscal administration in the two Contracting States, through the reduction of opportunities for international tax evasion[3].

Broadly speaking, we can say that agreements for avoiding double taxation are international treaties signed by countries and governed by international law. As in any international treaty, the State, which consent to be bound by their provisions and must then comply with these provisions based on the principle of good faith.

Now, these challenges inevitably lead to the need to agree on the way in which States are to share the costs of the Elimination of international double taxation, cost that translates into lower tax revenues to be obtained by each of them. Also, import this set the political positions with regard to the desirability of adopting solutions which give preeminence at the beginning of subject real, as the criterion of territoriality, or at the beginning of subject personal, as the criterion of residence.

Whatever the degree of development of the signatory countries of a tax Convention, and its consequent preference or political line of negotiation on the matter, the truth is that there is always the manifest will of the parties to eliminate the distortions generated by the international double taxation. In one way or another, the states manage to agree a bilateral mechanism that distributes the tax powers and the costs of elimination of double taxation, through limitations to the imposition on one of them and the granting of credits or exemptions in another. They always attend to the general benefit of the legitimate recipients of those treatments, which are residents in those countries.

This is what we may call the normal situation, where States that are trying to eliminate double taxation. However, at the same time they seek to minimize the impact that this generates in tax revenues, by accepting certain concessions in favor of its counterpart.

3. *Draft Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries - United Nations - 2001.*

However, tax administrations we are now increasingly frequently, situations in which global taxpayers[4] use their influence to gain tax concessions apparently legal, but that mock the genuine expectations of the States in the negotiation and signing of the tax conventions.

The global trend indicates that this kind of behavior is growing, both in magnitude and in degree of sophistication.

Indeed, using aggressive tax planning, certain taxpayers with structured global operations seek to unlawfully access to tax benefits that are intended for them, largely for not being resident in any of the States part of a tax Convention. In other cases, for entities resident in the States party to the Convention, artificial structures are set up in jurisdictions with fiscal opacity and low level of effective taxation. They are used to take advantage of low levels of taxation at source and the deferral (or non-payment) of the tax in the jurisdiction of residence, achieving the effect that we know as **double non-taxation**.

This being said, and whatever the legal characterization of behaviors that lead to double non-taxation, it must be admitted that its existence could never be understood as a manifest intention of the signatory States of a tax Convention. Not even as an implied complacency with regard to a situation arising from the application of the rules of the Convention and its interrelationship with the internal tax regime in these countries. Indeed, the absence of taxation for the use of artificial legal structures is considered in the majority of countries as an abuse of the legal system, whether considered as an abuse of the internal legal rules or also as an abuse of international treaties. In such cases, the international tax planning crosses the threshold of what is tolerable in any legal system that seeks to be fair[5].

International tax planning is not a legal Institute but a coordinated set of behaviors to create relationships and legal situations aimed at optimizing the tax burden[6].

The harmfulness of tax planning lies principally in the prejudice caused to the community, to evade the taxes necessary so that the State can finance the provision of goods and public services, infrastructure projects or the redistribution of wealth that allows the development of the common good.

In this context, it has become essential to tax administrations to develop a framework for joint action to adjust the practices that each one implement nationally and adapt them to the needs of today's globalized world, in order to fight efficiently against the evasive behaviors of economic groups who plan their global tax burden.

As the leaders of the Group of 20 have rightly stressed, "despite the risks facing people nationally, we agree that multilateralism is of even greater importance in the current situation and it keep being be our best resource to solve the problems of the world economy"[7].

4. *Concept developed by the Federal Administration of public revenues, which allows knowing the comprehensive taxation of taxpayers and concentrates economic groups, both locally and internationally, and in relation to the different taxes, customs duties and social security that impact on the activity of the taxpayer.*
5. *Vogel, Klaus, "Double Tax Treaties and Their Interpretation", Berkeley Journal of International Law, Vol. 4, Issue 1 (1986), p. 79.*
6. *Adonnino Pietro, "La planificación fiscal internacional y los paraísos fiscales",, Asociación Argentina de Estudios Fiscales, 2002, p. 2.*
7. *G20, 2012.*

4. THE BEPS INITIATIVE

In that context, in which multilateralism is declared as the way of attacking the problem, the Group of 20 requested to the Organization for cooperation and economic development a full and coordinated multilateral action plan to treat the problems of the tax base erosion and profit shifting**.**

Such an initiative in the fight against the erosion of the tax bases and the relocation of utilities became known as the Plan of action BEPS for its English acronym (base erosion & profit shifting)[8].

This document identifies 15 action plans through which these tax strategies can be addressed to combat the tax bases erosion and the relocation of utilities, ensuring coherence in international taxation, aligning tax rights with substance and improving transparency.

It focuses, indeed, on combating the tax base erosion and profit shifting in order to restore the taxation at source as well as in the residence in a series of cases in which, otherwise, both cross-border revenues would remain without tax or would stay with very low taxation.

This initiative of the Organization for Economic Cooperation and Development attempts to identify aggressive tax planning issues that are common to the Member countries. It detects the causes that allow the tax engineering that leads to the tax bases erosion and designs common strategies to modify legal schemes that allow multinational groups to take advantage of existing loopholes, as well as disrupt fraudulent mechanisms.

The novelty of this plan is that it has provided awareness of the true extent of the problem of harmful tax planning and the need for a coordinated and structured solution based on international cooperation, in order to achieve an efficient result.

The G-20 20 has repeatedly endorsed the action plans and has urged all developed and developing countries to participate. Recently, they called to implement the commitments in the fight against tax evasion. There, from rthe resounding investigation known as "Swissleaks", the director of tax affairs of the OECD, Pascal Saint-Amans, emphasized the need to adopt policy changes. This leads the Organization for cooperation and economic development on behalf of the Group of 20 to design the plan of action against the Tax Base erosion and profit shifting (BEPS), which plans establishing a single multilateral treaty, affirming that it is to eradicate the **double non-taxation**.

Such affirmation, it is worth mentioning, has mostly provided a solid backing to the international policy of renegotiation of agreements to avoid double taxation which is actively developed by the Federal Administration of public revenues of the Republic of Argentina.

Indeed, the context in which we have been describing demonstrates the complex reality of international business transactions and the need for the tax administration to act on this situation with efficiency and strategic planning.

8. *Www.OECD.org website offers a list of participating countries and of the plan of action, its context, and progress.*

5. ARGENTINA'S EXPERIENCE

In the specific case of the Argentina Republic, in recent years significant advances in the detection and correction of some problems that arose because of aggressive tax planning have taken place, through the misuse of benefits provided in agreements to avoid double taxation.

Among the strategies designed to strengthen the control of international operations of the so-called global taxpayers, the Federal Administration of Public Revenues coordinates the implementation of a policy issued by the national Government and involving the Ministry of Economy and Finance and the Ministry of Foreign Affairs and Worship. This policy relates to the concrete and precise identification of the effects that the various tax conventions subscribed by our country have had on the Argentine economy, not only from the point of view of the tax result, but also in other macroeconomic aspects.

To do this, the Committee for the Evaluation and Revision of agreements to avoid double taxation[9] has been created. It is integrated by the Ministry of economy and finance, the Ministry of Foreign Affairs and worship, and chaired by the Federal administrator of Public Revenues. It was promoted to regularly monitoring the tax implications of the above-mentioned conventions, as well as the analysis and evaluation of existing agreements or which those intended to adopt in a multidisciplinary way not only from the point of view of the fiscal result but also in other macroeconomic aspects.

The main tasks of this Committee were to design and implement comprehensive and coordinated evaluation mechanisms, oriented to determine if the tax sacrifice imposed by the resignation of the tax authority through the application of the conventions to avoid double taxation in force is justified.

Based on the above, then, the Commission proposes, based on the evaluations, the courses of action that it considers appropriate, such as the partial modification, full renegotiation or denunciation of the existing conventions.

The work of this Committee, for example, reached the conclusion that there were certain tax treaties requiring partial modifications, in order to maintain the balance between tax sacrifice and economic benefits. The consequence of these determinations was the suggestion to re-negotiate these agreements or, eventually, dismiss them. We refer to the conventions to avoid double taxation signed with the Republic of Chile, the Kingdom of Spain and the Confederation of Switzerland.

After the technical and diplomatic conversations needed to achieve the modification demanded by the Argentina, the result was not satisfactory in any of the cases and no agreement could be reached.

The agreement between the Republic of Argentina and the Kingdom of Spain for the avoidance of double taxation and prevention of Tax Evasion in respect of taxes on income and on capital[10] generated adverse effects because of the impossibility of taxing certain elements of assets in Argentina. Another reason was the possibility of using its provisions to avoid fair taxation through the interposition of legal figures in Spain taking advantage of preferential tax regimes in that country.

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9. *By joint resolution No. 56/2011-No. 80/2011 Ministry of economy and finance and the Ministry of Foreign Affairs, international trade and worship.*
10. *Agreement approved by the 24.258 law (Official Gazette, 19/11/1993).*

With the application of the Convention between the Republic of Argentina and the Confederation of Switzerland to avoid double taxation in respect of taxes on income and on capital[11], maneuvers of tax planning through the use of clauses of the Convention were detected, which provided for exemption from taxation at source in the case of royalties. The research provided evidence of different multinational companies based in third countries would have constituted subsidiaries in the counterpart of the Convention thus avoiding the payment of tax at the source of royalty income by different concepts. Once subsidiaries were constituted, the intangibles, which gave rise to the payment of royalties, were assigned and taxation at source, which previously applied to the respective payments, was thus avoided. Given the limited sharing of information with such counterpart, it was not possible to obtain the evidence necessary to dismiss these maneuvers through the General anti-abuse provisions of Argentine law. Another additional reason resulted in the impossibility of applying the taxation at source with respect to capital taxes on shares and investments in Argentine companies.

Investments and holdings of residents in Chile in companies based in Argentina and other elements of assets as well as the sanction by the Andean country of the preferential regime "Societies business platform" were impossible to tax. This made harmful for Argentina to keep applying the Convention between the Republic of Argentina and the Republic of Chile to avoid double taxation in respect of income taxes, gains or benefits and on capital and successions[12].

Thus, important decisions were taken to protect the tax base, in view of the problems involving the application to the Argentina Republic of the agreements with Chile, Spain and Switzerland, leading in each case to corresponding diplomatic communication for suspending the treaty application[13].

Within a framework of mutual understanding and comprehension of the issues, in all these cases it was possible to agree on a tax treatment attentive to the Argentine position.

From the above, negotiations were undertaken with these States, receiving the text of the new conventions agreed upon the issues raised by our country with a strategic improvement of the Argentine position.

As shown by these cases, the task of the Argentine tax administration in terms of identification and disruption of manoeuvers and abuse of agreements to avoid double taxation has intensified in recent years through the actions of assessment Committee and review of agreements to avoid double taxation. The main input in the work of this Commission is the information from the databases of the Federal Administration of public revenues and its efficient exploitation through information crosses and sectorial research.

The new approach that Argentina is introducing is therefore an express reference to the possibility of a periodic review of the Convention in the light of the above objectives. Of course, the parties must also agree on both the frequency of revisions and levels of detail that they wish to insert regarding the definition of objective parameters to be used in the compliance evaluation of such objectives.

In short, beyond the possibility that a review is a faculty inherent to the parties based on their sovereignty, it appears very useful to insert in the text of the Treaty that both parties understand the relationship between the elimination of double

11. *Agreement signed on 23 April 1997, amended on 23 November 2000, not ratified by law, provisional application from 1 January of 2001 according to the additional Protocol thus stipulated it, signed in Buenos Aires on November 23, 2000.*
12. *Agreement approved by law 23.228 (Official Gazette 1/10/1985).*
13. *The cessation of the effects of international treaties with Spain and Chile took place on January 1, 2013; in the case of Switzerland, on January 16, 2012 the intention of not continuing with its provisional application was communicated.*

taxation and the development of economic relations between them.

There is no doubt that the strong momentum of the g-20 has contributed to the effective international exchange of tax information.

The results that have been achieved, thanks to the work of the Global Forum, on transparency and exchange of information and the peer review group, show the need of global political support to the issues of transparency in international taxation that existed in the previous years.

These accomplishments range from significant growth of information exchange agreements signed since the formation of the current Global Forum in 2009[14], to the significant improvement in the commitments of transparency and cooperation demonstrated in many countries that until then had shown less willingness to exchange tax information.

Also in the same vein, we should highlight the strong support for multilateral approaches to information exchange that are proposed as efficient solutions for the rapid development of broad international cooperation networks[15].

In this sense, the Federal Administration of public revenues has taken due note of the current international tax scenario needs and has promoted the entry of our country as the first South American member to the Convention on mutual administrative assistance in tax matters of the OECD and the Council of Europe, after its modification and expansion in 2010[16].

This adds to the extensive network of international agreements available to the Administration for the exchange of information, either through clauses incorporated in treaties for avoiding double taxation and in other cases through the signing of bilateral agreements allowing the exchange of information[17].

Recently, the Group of 20 proposed a new global standard for the automatic exchange of information on financial accounts[18], for increasing the fight against tax evasion.

The Organization for Cooperation and Economic Development and the Group of G-20 have developed this standard, which is similar to the model of information exchange that many states have used to implement the FATCA[19]. The Global Forum was also tasked to implement a mechanism to monitor and review the implementation of the standard. That is, to determine which countries are able to implement the automatic exchange of information.

The Federal Administration of public revenues signed on October 29, 2014 the Global Standard on automatic exchange of information for financial accounts.

Argentina lies within the Group of countries that will implement the new standard as early adopter[20], which implies that it will begin to exchange

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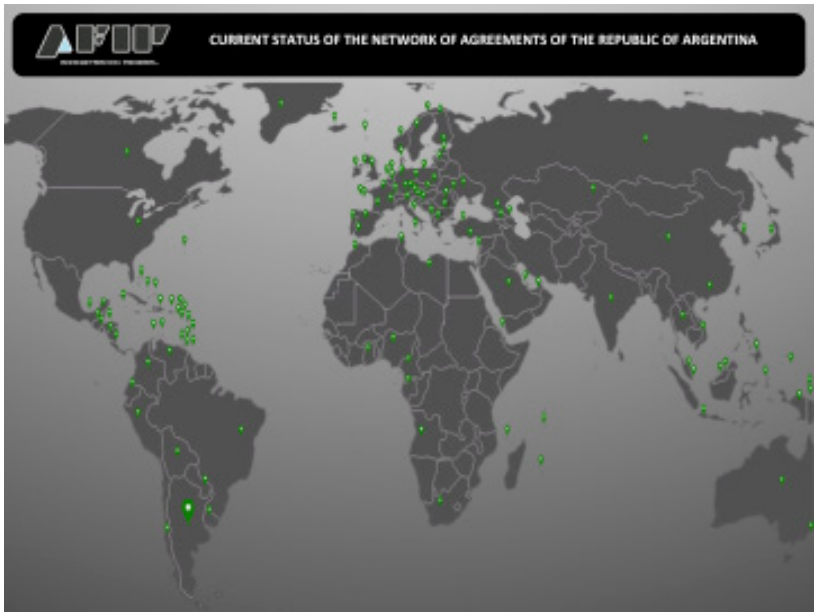
14. *See "The Global Forum on Transparency and Exchange of Information for Tax Purposes - Information Brief", in http://www.oecd.org/tax/transparency/Journalist's%20brief%20December%202012.pdf*
15. *See in this regard the Final communiqué of the meeting of Ministers of economy and Central Bank Governors of the G20, Moscow, 15-16 February 2013, paragraph 20.*
16. *Argentina joined the Multilateral Convention for mutual administrative assistance with tax purposes on November 3, 2011. The respective instrument of ratification was deposited on 13 September 2012. The Convention entered into force for Argentina January 1, 2013, and may have tax information of countries acceding to the Convention.*
17. *The TIEA signed April 23 in 2012 between Argentina and Uruguay deserves a specific note. This agreement entered into force on February 7, 2013 and its particularity is the credit method in order to avoid double taxation. This version or "Río de la Plata model" was negotiated on the basis to the model agreement exchange of information in tax matters elaborated by the OECD. However, it is a new format, which involves inserting into an information exchange agreement a clause from an agreement to avoid double taxation.*
18. *Standard for Automatic Exchange of Financial Account Information in Tax Matters.*
19. *United States Foreign Account Taxpayer Compliance Act.*
20. *Early Adopters.*

information under this modality from the year 2017. From then on, the Federal Administration of public revenues will have access to the bank accounts data of Argentines living abroad.

With joining this initiative, Argentina shows that it continues to be at the forefront of the struggle for international transparency and cooperation in tax matters.

Table 1
Agreements to avoid double taxation today



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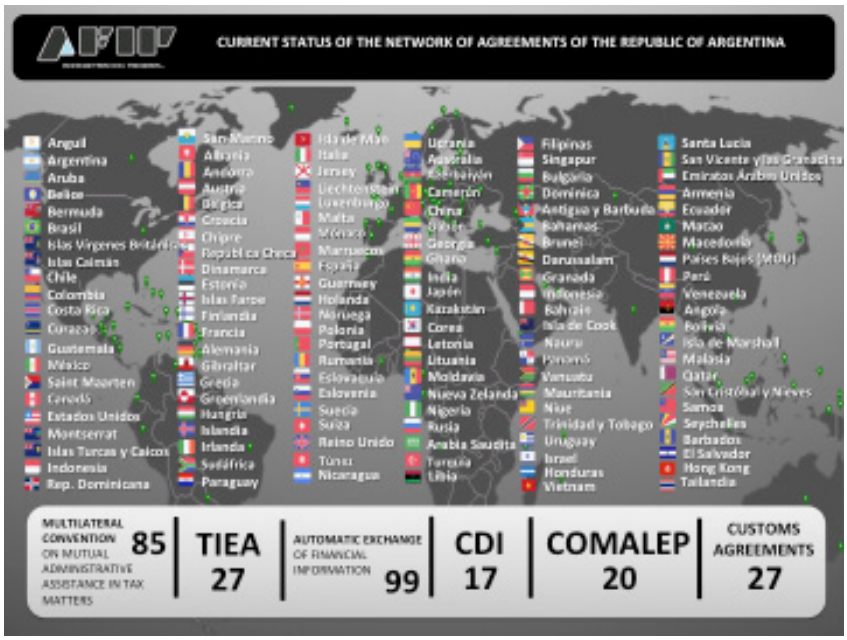

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6. CONCLUSIONS

We can see that the fight against international tax evasion is a difficult task that seems reaching higher levels of complexity as international business develop new forms of structuring. When international tax evasion maneuvers involve the application of agreements to avoid double taxation, with the sole or main purpose to achieve a double not taxation, the complexity of the tasks of tax administrations increase even more. They must properly protect the guarantees and rights of taxpayers and avoid violating the international commitments made by countries in the negotiation of tax treaties.

This complexity is well known by the multinational groups and their tax advisers responsible for the tax planning of their global business, situation that is exploited to the maximum to structure sophisticated tax engineering, pushing to limit the individual capacities of the tax administrations, which operate within their national jurisdiction boundaries.

In that sense, an efficient and almost indispensable solution in the tax reality that we manage in a global world lies in international cooperation and joint identification of problems. They challenge indiscriminately countries of different levels of development, and we need to coordinate the adoption of solutions as homogeneous as possible to the legal and administrative issues, which, with different nuances, are rather approximate.

The task is not simple, no doubt, but the magnitude of the problem of aggressive tax planning requires a response of equal magnitude by tax authorities. That response must be based on prevention, to hinder and prevent the development of schemes of fraud and abuse of tax agreements, but also in the design of exemplary sanctions for the most aggressive behaviors of harmful tax planning.

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THE BEPS ACTION PLAN AND THE BRAZILIAN REALITY

Paula Gonçalves Ferreira Santos

SYNOPSIS

This paper analyzes the BEPS (Base Erosion and Profit Shifting) action plan, its sphere of application and the difficulty of its implementation, especially in the developing Latin American countries. To put in context the difficulty for preventing the flight of capital in the Latin American countries, we are hereby presenting a tax plan implemented by two Brazilian companies and its consequences.

The Author: *Tax Auditor at the Secretariat of Federal Revenues of Brazil (RFB). She has a Postgraduate Degree in Constitutional Law from the Brazilian Institute of Public Law (IDP). Also completed a Specialized Course on Taxation at the Inter-American Center of Tax Administrations (CIAT) and is currently in the process of completing her Master's degree at the Catholic University of Brasilia (UCB).*

Contents

The world has undergone a series of changes in paradigm. The technological development and just to say it somehow, globalization are rapidy changing concepts and obsolete models. What is true today might perhaps not be true tomorrow, thereby leaving many experts anachronic, especially in the field of International Taxation.

Large multinational enterprises (MNEs) which should be the main corporate income taxpayers, threaten the integrity of revenues by means of the most varied tricks that erode the base and/or transfer the profit. It is no simple jam. The advantage obtained by these large enterprises that carry on business abroad and have a sophisticated tax *expertise*, makes competition with small enteprises operating mainly in the internal market, extremely unfair. In addition to creating competition problems these large enterprises likewise generate an inefficient allocation of resources, thereby deviating most investment decisions toward those with a lower rate of return before taxes, but which have a higher rate after taxes. Lastly, if the other taxpayers (thereafter including individuals) feel in some way at a disadvantage with the tax exemption resulting from the convenient use of the legal devices, which are only applied by those having sufficient resources to manipulate the system in their favor, it is only natural that the behavior be deviated from voluntary compliance – without disregarding the fact that the modern tax administration requires that such compliance be voluntary.[1]

The OECD (Organization for Economic Cooperation and Development) has been carrying out several studies that show how the tax practices of some multinational companies have become ever more aggressive through time, thereby creating serious equity and compliance problems. Thus, there is an ever clearer need for tax administrations to cooperate among themselves in the exchange of information, including the privileged one, and also in monitoring the effectiveness of the strategies.[2]

Besides the need to cooperate in order to guarantee the government's revenues and create more equitable conditions for the enterprises, there are still some other issues pending. There are some countries that act to make the tax system competitive. The purpose is to attract investments to the country at whatever the cost, even if that implies total tax disencumbrance. On the other hand, some countries, such as the South American ones, have problems to make their internal legislation compatible with the current international entrepreneurial situation, which turns out to be difficult when there is a legislative body and even a judicial body which disregard the problems faced abroad. There are many legal inconsistencies, but only to draw attention to one example, currently, there is no sense in the allegation of bank secrecy of the enterprises toward the tax authorities, especially if it is known that these enterprises have all the legal mechanisms to avoid the State.[3]

1. *OECD (2014), Plano de ação para o combate à erosão da base tributária e à transferência de lucros, OECD Publishing, fl. 10.*
2. *OECD (2014), Plano de ação para o combate à erosão da base tributária e à transferência de lucros, OECD Publishing, fl. 8.*
3. *The issue is to be resolved by the Federal Supreme Court (STF) within the framework of RE 601 314 / SP (which has had general repercussion since 2009).*

Ever greater attention is being paid to the government's loss of tax revenues from the enterprises, due to the plans that are focused on the transfer of profits to areas where there is a more favorable tax treatment, to the point of causing tax erosion. Such increasing attention and the inherent challenge of facing such a complex issue have led to the sensation that national and international rules regarding the taxation of crossborder benefits are violated and that only idiots pay taxes. Multinationals have been charged with avoiding taxes throughout the world, mainly in the developing countries, where tax revenues are essential for promoting long term progress.[4]

Accepting that these large enterprises, the multinationals, are immune to taxation, to seek the source of revenues in other taxpayers, cannot be an acceptable answer. Society, as a whole, expects from its government a fair and less regressive taxation system, something that is impossible when one must attribute the source of taxation to the consumption or income of taxpayers with less taxpaying capacity. Not to mention the fact that the new technologies and ways of avoiding taxes are appearing not only with respect to taxation of yields, given the confusion created with respect to taxation of electronic commerce.

In this sense, there is a need for a holistic approach to adequately deal with the erosion of the tax base and the transfer of benefits. Government actions must be integral and account for all the different aspects involved in the problem. One can no longer consider these dimensions in isolation, given that the multinationals, which are the large enterprises responsible for the use of innovative tax mechanisms may take advantage of the joint manipulation of these dimensions. Therefore, it may be said that the balance between taxation in the country of origin and taxation in the country of residence, the tax treatment of financial transactions within the entrepreneurial group, the adoption of measures for combatting evasion, including the legislation on the rules of foreign controlled companies and transfer pricing, among other aspects, must be dealt with at the world level, based on an in-depth analysis of the interaction of all these sensitive issues. The consequence is the need for coordination between the countries, which is essential in the implementation of any solution, even if different instruments are used to solve the problem.[5]

In sum, globalization has made the products and business models evolve, thereby creating conditions for the development of global strategies for maximizing benefits and minimizing expenditures and costs, including tax costs. Likewise, the rules on taxation of profits from international activities remained practically unchanged, for which reason the principles of the past continue to be applied to local as well as international tax regulations. The changes in business practices resulting from globalization and digitalization of the economy have led the authorities to wonder whether national and international regulations on the taxation of benefits kept the same pace as those changes. The cases of illegal abuses are the exception and not the rule and should not be seen as the main goal of recent times. The multinational companies that seek the erosion of the tax base and shifting of profits fulfill the legal requirements of the countries involved, but can manipulate the legal system in such a way as to evade the taxes. Governments are aware of the situation and admit that only international cooperation will be capable of reverting said legal framework.[6]

This article was divided into five parts. The first is the introduction which endeavors to give an idea of the problem to be considered by the BEPS

4. *OECD (2014), Plano de ação para o combate à erosão da base tributária e à transferência de lucros, OECD Publishing, fl. 17.*
5. *OECD (2014), Plano de ação para o combate à erosão da base tributária e à transferência de lucros, OECD Publishing, fl. 10.*
6. *OECD (2014), Plano de ação para o combate à erosão da base tributária e à transferência de lucros, OECD Publishing, fl. 31.*

action plan. The second part describes the BEPS plan and its scope of application. The third part shows how difficult it is to implement the BEPS plan, especially in the Latin American developing countries. The fourth one provides a tax plan carried out by two Brazilian companies and its consequences. The fifth part is the conclusion, where one may evidence the real effects of the application of the BEPS plan guidelines in the case analyzed in the fourth part of this study.

1. THE BEPS ACTION PLAN (BASE EROSION AND PROFIT SHIFTING)

The erosion of the tax base and profit shifting (BEPS) is a global problem requiring global solutions. BEPS deals with the planning strategies that take advantage of the gaps and insufficiencies in the tax regulations inorder to artificially transfer profits to low or null taxation locations, where there is little or no economic activity, which results in little or no corporate tax to be paid. The BEPS definition is of great importance for the developing countries due to its strong dependence on coporate taxes, especially those of multinational enterprises (MNEs).

The main objective of the structuring of the BEPS action plan (the acronym means base erosion and profit shifting) is to protect and restore the base used for calculating the corporate income tax, as stated in the subtitle of one of the parts of the action plan: "Establishing International Coherence of Corporate Income Taxation". [7]

Consisting of three main nuclei, considered fundamental for the international taxation reform, the BEPS action plan is based on: (I) the need to establish an international tax system with a paradigm in the cooperation data bases, instead of a paradigm based on competition; (II) the importance of adopting a systematic and integral approach for undertaking a substantial reform of the international tax system; and (III) the inevitability of completely accepting new solutions to problems that cannot be solved through the application of rules, unlike the traditional conservatism of the international tax system.[8]

The international tax system has to do – and it has always been so – in the first place with competition. Countries see themselves as competitors for investments and revenues. Cooperation actions between countries are limited by the development of competition, conquered by the elimination of market failures and the facilitation of free trade. These were the motivations behind the structuring of the international tax system and the evolution that has taken place in recent years. The orginal system was established for the real estate income from the brick and mortar economies. Therefore, it is based on the residence and source paradigm. All the countries tax their residents fundamentally based on the residence system and the nonresidents with physical presence in the country's territory, on the basis of the source system. The increased mobility of the production, labor and capital factors, together with the increase in intangible assets made this paradigm obsolete. Neither the developed or the developing countries are capable of increasing the revenues based on this paradigm.[9]

7. *Vann, R. J. (2014). Policy Forum: The Policy Underpinnings of the BEPS Project-Preserving the International Corporate Income Tax? Canadian Tax Journal, 62(2), 433-441.*
8. *Brauner, Y. (2014). What the BEPS. Fla. Tax Rev., 16, 59.*
9. *Brauner, Y. (2014). What the BEPS. Fla. Tax Rev., 16, fl. 10.*

In an attempt to reform the international tax system, fifteen specific actions are being carried out within the framework of the OECD/G-20. The G-20 joined the actions of the BEPS plan in order to try to make them compatible with the reality of the developing countries, given that such countries as China, Brazil, India, Indonesia, Russia and South Africa are part of the G-20, but not the OECD. The purpose of the project is to provide the governments the necessary national and international instruments for facing this objective. The first set of measures and reports were disseminated in September 2014. Together with the work to be carried out in 2015, it intends to give the countries the necessary tools to ensure that the profits generated by the economic activities are taxed in the place where they occur and where value is created. It will also afford them greater security by reducing controversies regarding the application of international tax regulations and the standardization of requisites. For the first time in the history of taxation, the G-20 countries that are not part of the OECD are involved on an equal footing.[10]

To achieve its objectives, the BEPS action plan proposes the adoption of 15 actions divided into five groups, each action in due course. In this sense, action 1 confirms the main difficulties which the digital economy faces for the application of the taxes (direct or indirect).[11]

The second action requires the neutralization of the effects of the instruments and hybrid entities generating double nontaxation, doble taxation or deferral. The hybrid instruments may be used in the case of double nontaxation, double taxation or deferral of the taxes. For example, through the creation of two deductions for a single financing operation, to the detriment of the corresponding income taxation, or undue application of the tax credit in relation to revenues from abroad and the corporate shares exemption system. The national regulations that allow taxpayers to select the tax system applicable to specific entities, whether national or foreign, may facilitate discrepancies through the hybrid instruments. Although it may be difficult to determine which country lost the tax revenues, since the legislation of every country involved has been respected, there is a reduction in the total amount of taxes paid by all the parties involved, which is detrimental to the competition, economic efficiency, transparency and equity.[12]

What is sought with this action is to develop model provisions that should be included in the agreements to avoid double taxation and recommendations in relation to the preparation of national rules for counteracting the effects (double nontaxation, double deduction and deferral of taxes) of hybrid instruments and entities. This may imply: (a) changes in the OECD's Tax Model Convention, to ensure that the hybrid instruments and entities (as well as the resident entities in the two countries) are not used for undue benefits that would be obtained by means of such agreements; (b) national legal provisions that prevent the exemption or non-accountability of payments deductible by the payer; (c) national laws that do not allow a deduction with respect to a payment that is not included in the calculation of the beneficiary's revenues (and is not subject to taxes by virtue of the regulations that govern controlled foreign corporations (CFC) or the like); (d) the national legal provisions that prevent a deduction with respect to a payment that is also deductible in another jurisdiction; and (e) if necessary, the coordination and orientation required for making a decision, if more than one country seeks to apply these rules to a transaction or structure.[13]

10. *OECD (November 20, 2014). About BEPS. Recovered from: http://www.oecd.org/tax/beps-about.htm*
11. *Jiménez, A. M., & Carrero, J. M. C. (2014). El Plan de Acción de la OCDE para eliminar la erosión de bases imponibles y el traslado de beneficios a otras jurisdicciones ("BEPS"): ¿el final, el principio del final o el final del principio? Quincena fiscal, (1), 88.*
12. *OECD (2014), Plano de ação para o combate à erosão da base tributária e à transferência de lucros, OECD Publishing, fl 15.*
13. *OECD (2014), Plano de ação para o combate à erosão da base tributária e à transferência de lucros, OECD Publishing, fl 15.*

The third action calls for strengthening the regulations that deal with the controlled foreign corporation (CFC), while action 4 of the plan calls for limiting the erosion of the tax base through the deduction of interest and other financial compensations. Then, action 5 urges that harmful tax practices be combatted with greater effectiveness, bearing in mind transparency and substance and action 6 prevents the undue use of agreements. In turn, action 7 deals with preventing the artificial avoidance of the condition of permanent establishment (PE). On the other hand, actions 8, 9 and 10 are aimed at guaranteeing that the results of transfer pricing be aligned with the creation of value. Thereafter, action 11 was created to establish methodologies for compiling and analyzing data on the tax base erosion and profit shifting phenomena and the actions to remedy them. Action 12 will require taxpayers to disclose their aggressive tax planning projects; action 13 will involve the review of transfer pricing documentation, while action 14 renders the controversy solution instruments more effective and finally, the purpose of action 15 is to develop a multilateral instrument.

A key point which must be dealt with through the use of the BEPS action plan is the issue of intangibles which have given way to various forms of tax planning in multinational enterprises due to their fluid nature. Intangibles are part of actions 8, 9 and 10. Within its scope of application one endeavors to: (a) provide a definition of intangible (with the economic profile, not strictly linked to the concept of rules present in article 12 of the OECD MOdel Convention); (b) align the benefits derived from the transfer of intangibles with the value chain of the group (attack against the "divorce" among them in order to adequately remunerate the various functions, the assets and risks related to the creation, development and maintenance of the intangible assets); (c) the development of transfer pricing rules or special measures for cases of difficult valuation; (d) update the guidelines regarding the agreement on distribution of costs.[14]

2. THE APPLICATION OF THE BEPS ACTION PLAN IN SOUTH AMERICAN COUNTRIES

The South American countries are considered as developing and thus, the difficulties that arise in the OECD studies in relation to the developing countries are applied to the South American ones.

It is important to admit that the risks faced by the developing countries with respect to BEPS, and the challenges faced when trying to mitigate them may differ in nature as well as in the scale of the challenges faced by the developing countries. This means that the actions of the BEPS plan for the developing countries may require specific emphasis as compared with the most appropriate ones for the advanced economies.[15]

There are criticisms due to the nonparticipation of all the actors involved in the phase of definition of the goal of the BEPS action plan. The G-20 countries that are not parto f the OECD, even though they are participating in the production phase of the actions, where not consulted when the BEPS plan goals were established and its actions were delimited. If these countries would have been included, there would probably be a more complete overview of the current

14. *Jiménez, A. M., & Carrero, J. M. C. (2014). El Plan de Acción de la OCDE para eliminar la erosión de bases imponibles y el traslado de beneficios a otras jurisdicciones ("BEPS"):¿el final, el principio del final o el final del principio?. Quincena fiscal, (1), 91.*
15. *OECD (to 2014), Report G20 Development Working Group on the impact of BEPS in Low Income Countries, Part I, OECD Publishing, fl 3.*

problemsand it would not seem as if a group of countries would have imposed goals and actions to the rest of the world. In any legislative-participative process it is essential for the actors to participate as of the initial definition of a specific policy and not wait to open the process until its execution or completion.[16]

Even though these countries were not called to participate in the dialogue during the first phase of the BEPS plan, their participation was possible with the support of the G-20 (Group of 20). The Group has associated itself with the OECD and endeavors to make the plan compatible with the realities of the developing countries. The initiative originated a report which describes BEPS in the developing countries.

The simplest answer to the base erosion and profit shifting problem undoubtedly would be the harmonization of the international tax system, in order that all the countries may have the same rate, in a standardized manner, divide the tax collected and share all the taxpayer information. However, any proposal that would oblige a state to fully harmonize its tax system with another state violates the principle that there should be multiple sovereign states with independent tax systems. This fact directly contradicts the assumption that complete harmonization would be ideal. But if harmonization is not in itself a valid objective of the system, should one pursue uniformity?[17]

Uniformity in the distribution of taxes collected would require agreement between several countries, but would solve the problem of the source or residence criterion in relation to taxation, since ultimately all the tax collected would be divided among the countries that participated in collecting the profit. However, the uniformity proposal would raise the issue as to whether it would be efficient to allocate the tax base to countries whose investment in research and development is well advanced, as opposed to the countries that could use the revenues to develop their own infrastructure. From this perspective, it would seem that the allocation of the tax base separately from the states that have not developed the infrastructure, is to be ineficiente from the standpoint of the rendering of public services. Regardless of the dominan function, the collection or division of taxes among the countries, the issue of the rendering of public services is much more difficult to respond, especially because it has not been disputed.[18]

In this line of thought it is important to mention that the countries that have developed the infrastructure and the technologies have comparative advantages vis-a-vis the developing countries. Large enterprises are organized naturally in these developed states and then they migrate to those that are in the development phase. Therefore, income tends to leave the countries with low infrastructure and development to the more developed countries, since developing countries are much more in need of the public services that may improve the quality of life of the population. However, the current infrastructure as that based on a standard distribution of the tax base, favors the more developed countries, since ultimately, they are the residence of the businesses that explore the resources and the developing markets.

The theory about remaining outside proposes that the more countries joining the BEPS system, the more profitable it is to be outside this system, ultimately causing greater damage to the system as a whole. The countries which on the basis of this argument decide to remain outside the BEPS plan do not respond appropriately

16. *Jiménez, A. M., & Carrero, J. M. C. (2014). El Plan de Acción de la OCDE para eliminar la erosión de bases imponibles y el traslado de beneficios a otras jurisdicciones ("BEPS"):¿ el final, el principio del final o el final del principio?. Quincena fiscal, (1), 88.*
17. *Vann, R. J. (2014). Policy Forum: The Policy Underpinnings of the BEPS Project-Preserving the International Corporate Income Tax?. Canadian Tax Journal, 62(2), 433-441.*
18. *Rosenzweig, A. H. (2014). Building a Framework for a Post-BEPS World. Tax Notes International, 74(12), 1077.*

to the cooperation attempts made based on the punishment. In simpler terms, perhaps punishment does not work with respect to the division of the tax revenues (in a way different from the tax collection function). Assuming that the theory of remaining outside were correct, the inclusion of the interests of the States that are not OECD members should be part of the considerations made in the articles on BEPS action – instead of dealing with them separately, as a second step- in order that the new system may be successful. Although it could seem that the adoption of the rules for sharing the tax revenues would be another ideal under the viewpoint of the OECD member States – most of them developed countries, success would be feasible i fone would consider the states with interests unrelated thereto.[19]

Without considering the division of the tax revenues collected, the tax base erosion and profit shifting (BEPS) creates impacts on the mobilization of internal resources in the developing countries. For some of the poorer countries which to a great extent depend on the tax revenues obtained from the multinational enterprises, BEPS has an especially significant effect. However, the impact of BEPS in the developing countries, goes beyond the revenues issue. BEPS, as previously mentioned, does away with the credibility of the tax system in the eyes of all the taxpayers. If the larger taxpayers manage to avoid their tax obligations, the trust and efficiency of the tax system are deteriorated.[20]

In its report, the OECD shows that the developing countries frequently are confronted with political and other conditions that affect their capability for facing base erosion and profit shifting, in particular[21]:

1. Some developing countries lack the necessary legislative measures for facing base erosion and profit shifting.
2. The legislative measures in the developing countries designed for facing BEPS are frequently hindered by the lack of information.
3. The developing countries are faced difficulties for structuring the necessary capacity for the application of very complex rules and challenging the multinational enterprises with experience and counseling.
4. The lack of legislation and gaps in skills for effectively facing the situation may allow for simpler, but potentially more aggressive tax evasion that is typically found in the developed economies.

The above description made the OECD identify the following fundamental issues regarding BEPS as those of greater relevance for the developing countries[22]:

1. The erosion of the calculation base caused by excessive payments to foreigners such as interest, charges for services, rental rates, management expenses, royalties and technical services.
2. The displacement of profits through a restructuring of the supply chain which, by means of a contract, transfers the related risks and benefits to subsidiaries in low taxation jurisdictions.
3. Significant difficulties for obtaining the necessary information to evaluate and consider issues related to BEPS and to apply its rules regarding transfer pricing.
4. The use of techniques for obtaining the benefits of a treaty for situations wherein said benefits were not intended.

19. *Rosenzweig, A. H. (2014). Building a Framework for a Post-BEPS World. Tax Notes International, 74(12). 1078.*
20. *OECD (2014), Report to G20 Development Working Group on the impact of BEPS in Low Income Countries, Part I, OECD Publishing, fl 3.*
21. *OECD (2014), Report to G20 Development Working Group on the impact of BEPS in Low Income Countries, Part I, OECD Publishing, fl 3.*
22. *OECD (2014), Report to G20 Development Working Group on the impact of BEPS in Low Income Countries, Part I, OECD Publishing, fl 4.*

5. Loss of revenue caused by the techniques used to avoid the payment of tax when the assets that are in the developing countries are sold.
6. In addition, the developing countries are frequently faced with a strong pressure to attract foreign investments by means of tax incentives which may erode the country's tax base, and whose benefit is not readily seen.

It is to be pointed out that tax planning by large multinational enterprises is rarely illegal. In some cases, it is simply a matter of exploring the undesired incompatibilities between the regulations of the different tax jurisdictions of the multinational entreprises. In other cases, evasion is possible because the principles developed at the international level have not followed the pace of global integration of the eonomy. Null or low taxation is not a cause of concern per se, but it does cause concern when combined with practices that artificially segregate the taxable income of the activities that generate it. In these cases, the concern arises when the revenues from crossborder activities are not taxed anywhere.[23]

The experience of the developing countries with BEPS and the struggle against BEPS may be diferente from that of the developed countries in six main areas[24]:

1. The nature of crossborder tax planning may differ between developed and developing countries.
2. The developing countries might not have the necessary legislative measures for facing BEPS.
3. Access to relevant information is at times difficult.
4. Need of will and political support for the effective measures to combat BEPS, with emphasis on regional consultations.
5. The structuring and maintenance of the capacity for applying the high complexity international standards that leave their application to your discretion.
6. The strong pressure on the developing countries to attract foreign investment may result in a competitive "race backward ".

Curiously enough, these differences also occur between developing countries, since to a great extent they differ in the level of institutional development and even the level of their market. There are no possible comparisons between China, Brazil, El Salvador and New Guinea. In fact, differences do not end there. As previously mentioned, many developing countries become attractive due to the legislation that grants privileges in relation to income taxation. Therefore, Panama, Bahamas, Mauritius, Barbados and Andorra must be treated differently from other developing countries vis-a-vis the objective of their tax system which is to attract enterprises to their territory.

23. OECD (to 2014), Report G20 Development Working Group on the impact of BEPS in Low Income Countries, Part I, OECD Publishing, fl 8.
24. OECD (to 2014), Report G20 Development Working Group on the impact of BEPS in Low Income Countries, Part I, OECD Publishing, fl 13.

3. A BRAZILIAN CASE

In Brazil, the specific economic sectors involved in international taxation are those that include the multinational enterprises, the agricultural and iron sectors, as well as the energy sector. In addition to these, the banking sector is also important. A case involving the banking sector will be described below.

On November 5, 2014, the ICIJ (International Consortium of Investigative Journalists), an NGO with headquarters in Washington, disseminated the files with information on 343 enterprises from various countries. They disclose how these enterprises have benefitted from Luxembourg's tax legislation to reduce the profit taxes.[25]

In the case of Brazil, two banks used their operations in Luxembourg to reduce the amount of revenues declared in their subsidiaries in tax havens. The benefit obtained by the Brazilian Banks abroad are taxed at the headquarters as well as at their subsidiaries. Therefore, since the Banks were capable of reducing the amount of revenues declared in Luxembourg, the base for calculating their profits was eroded in Brazil.

In Luxembourg, the Brazilian financial institutions received generous financial discounts at the time of consolidating their balances. Thus, lower amounts of profits were taxed. The benefit granted to Brazilian banks in Luxembourg is based on an agreement of recognition of tax goodwill. According to said tax good will agreement, the banks are authorized to include in their balances in Luxembourg what is known as intangible tax asset.

The benefits were granted as a result of a "concealed contribution" which the Brazilian financial institutions made to their subsidiaries in Luxembourg. These "nonmeasurable" expenses are described generically as advertising services offered, acquisition of customers, development of financial products, orientation given to Brazilian enterprises and individuals wishing to have accounts in Luxembourg, the exchange of the research work carried out by the parent company, offering knowledge and know-how to the risk management and compliance areas, among others.

The banks state that 95% of the customers and business they carry out in Luxembourg are derived from the efforts of their offices in Brazil.

In sum, the enterprises have provided themselves a service in Brazil. Then they will tell the government of Luxembourg that "the work" must be shown in the balance of the subsidiary in the tax haven as "intangible tax asset ". Thus, that is the reason for the reduction of revenues and payment of less taxes.

The value is recognized by the government according to the law of Luxembourg, as intangible assets, thereby rendering legitimate the procedure used by the enterprises.

The Brazilian legislation as regards the taxation of profits is well advanced and already has all the tools currently available for combatting double nontaxation. Thus the Brazilian law protects profits in these situations. The problem is that these situations are not always disclosed. It is very difficult for the tax authorities of a country to know the laws of the countries that shelter the subsidiaries of a national enterprise. For this reason, the BEPS action plan could be an alternative so that the country will not lose this type of revenue.

25. *RODRIGUES, Fernando. (17 de noviembre de 2014). Itaú e Bradesco economizam R$ 200 mi em impostos com operações em Luxemburgo. Recuperado de: http://www1.folha.uol.com.br/mercado/2014/11/1543572-itau-e-bradesco-economizam-r-200-mi-em-impostos-com-operacoes-em-luxemburgo.shtml. Acesso em 17 de novembro de 2014.*

Action number 2, under the BEPS action plan is the one that is focused on this type of stratagem, because it seeks the neutralization of the effects of the hybrid instruments. The *tax goodwill* used to reduce the profit in the subsidiary is a hybrid instrument, bearing in mind that the Brazilian law does not allow the use of these contributions to amortize the company's intangible benefit. Like in Brazil, said contributions are not set apart for being intangible, but rather a hybrid instrument classified differently by the legal systems of Brazil and Luxembourg.

Within this action, one intends to change the OECD Tax Convention Model, to guarantee that the hybrid instruments will not be used for undue benefits through this type of agreements. There is already a tax treaty signed between Brazil and Luxembourg, so it would be a matter of inserting a clause to ensure that this type of maneuver will not take place.

Nevertheless, such general terms involve a great complexity, considering that it is necessary to be aware of the treatment given to revenues in other tax systems and to determine the relationships between the diferente types of clauses in order to avoid the possible double taxation or conflicts that could arise from the interaction between them. Accordingly, at present there is a great need for coordination between the various international approaches to guarantee access to the international agreements and the friendly procedure or arbitration in case of conflict between the various regulations or tax authorities involved (to this end, one must coordinate this action wi the number 14 in order to improve the procedure for solving controversies).[26]

Another objective of action 2 is to modify the national legal provisions to avoid or reject the exemption or deduction with respect to a payment that is not included in the calculation of the revenues of the beneficiary or to prevent the deduction of a payment that is also deductible in another legislation. This is already happening in Brazil, however, as we have seen, it does not solve the problem, since the tax administration has no way of knowing all the details of every foreign law.

On the other hand, one could ask whether it would be sufficient to restore the withholding of taxes with respect to interest and rates, as suggested in the sixties, in the preparatory works of the OECD Model Convention, as a simple and much more effective way of eliminating this problem.[27]

26. *Jiménez, A. M., & Carrero, J. M. C. (2014). El Plan de Acción de la OCDE para eliminar la erosión de bases imponibles y el traslado de beneficios a otras jurisdicciones ("BEPS"):¿ el final, el principio del final o el final del principio?. Quincena fiscal, (1), 88.*
27. *Jiménez, A. M., & Carrero, J. M. C. (2014). El Plan de Acción de la OCDE para eliminar la erosión de bases imponibles y el traslado de beneficios a otras jurisdicciones ("BEPS"):¿ el final, el principio del final o el final del principio?. Quincena fiscal, (1), 88.*

4. CONCLUSIONS

The paper was introduced as a general overview of international taxation of income. The difficulty we have at present is how to tax revenues obtained by the large multinational enterprises, vis-a-vis tax planning that may erode the base for calculating the tax and transfer the profits.

Thereafter, the BEPS action plan was shown and how this initiative endeavors to face the problem of taxing the revenues of the large enterprises. The developing countries, including the South American ones, have a specific approach, bearing in mind that they did not have the opportunity of participating in the design of the plan, in spite of being actively present in carrying out the defined actions. Tax planning by two Brazilian banks in Luxembourg, recently published in the press, was chosen to analyze the applicability of the BEPS action plan in the developing countries.

The case study leads us to believe that the BEPS plan is not, in fact, a complete change of paradigm with respect to the offer and residence criteria. The proposed changes are more an attempt at solving the current situation than a new system of international taxation of income. Perhaps that was the way found to try to align the various countries in search for the taxation of income. A more audacious proposal would be much more difficult to put into practice, bearing in mind the different interests involved.

The final conclusion of this article is that there is still a lot to be seen and analyzed, including the praxis in the BEPS plan that is still being developed, for which reason there is no certainty about its effectiveness.

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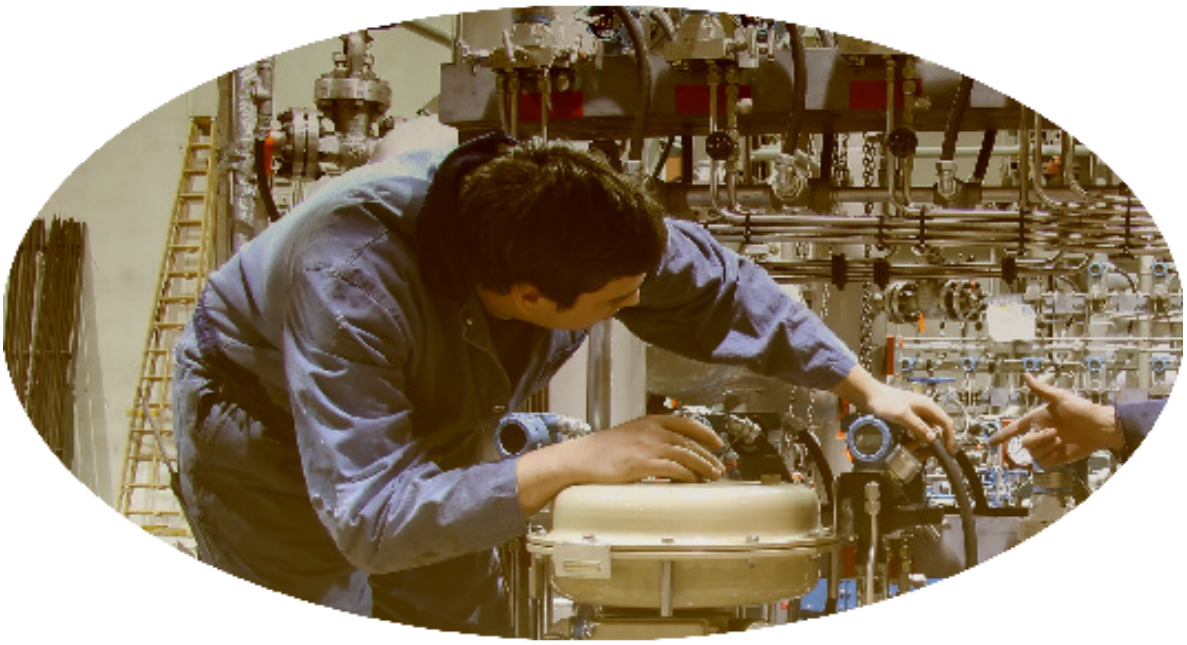
A NEW CONTROL AND SUPERVISION APPROACH TO THE EXPORT (MAQUILA) INDUSTRY IN MEXICO

Leopoldo Gutiérrez González and Luis De Jesús Beltrán Farías



SYNOPSIS

The 2013 reform eliminated the exemption of VAT and IEPS on temporary imports of some preferential customs systems; an amendment was made to articles 28-A of the LIVA and 15-A of the LIEPS, thereby defining as facilitation mechanisms the payment schemes via credit or the possibility of including the guarantee mechanism in enterprises of the financial sector, to avoid paying such taxes in cash. Tools were developed to find out online the statement of the credits and guaranteed amounts associated to the balances of the temporary imports pending return.

***The Authors: Leopoldo Gutiérrez González**, has a PhD. degree in Finance from Tulane University in the United States. He is currently Central Administrator of Model Development at SAT in Mexico. He worked at the IMF and World Bank in the implementation of risk models for decisionmaking. **Luis De Jesús Beltrán Farías**, has a Master's Degree in Economics from the Catholic University of Chile. He is currently Administrator of Model Development at SAT, with vast experience in the development of tax and customs risk models for decisionmaking.*

Content

This article analyzes the control model implemented since early 2015 by the Tax Administration Service for the surveillance of taxpayers who carry out temporary imports (Maquila), similar scheme to the Foreign Trade Zones in other countries.

It likewise presents a new surveillance approach based on a closed system, through which the taxpayers as well as the authority can see the same information and where the elements that comprise it are combined to produce a single output. This system allows the authority to permanently supervise the taxpayers and carry out electronic audits by means of the analysis of a deterministic tax account.

1. BACKGROUND

Since the sixties, the Mexican industrial policy has been aimed at promoting the export (Maquila) industry as an economic response to the high costs of labor in highly industrialized countries. Thus, Mexico has implemented several promotion programs with a view to facilitating foreign trade, creating sources of employment and promoting development and the transfer of technology in the country.

Since the creation of the Maquila in the sixties, the Mexican government has sought to develop a more competitive and dynamic industry, by allowing through foreign trade promotion programs the reduction of tariffs and the simplification of administrative procedures. With respect to this latter item, one may mention the creation of the Mexican Foreign Trade One-Stop Shop (VUCEM), which consists of a single portal that concentrates all procedures dealing with foreign trade of the different governmental entities, or else, allows the virtual transfer operation, whereby the companies that temporarily import merchandise for manufacturing products which in turn, shall be used and returned abroad by other companies, may carry out the virtual export operation, which results in the reduction of expenses in transportation, operations and the presentation of the goods before the customs offices.

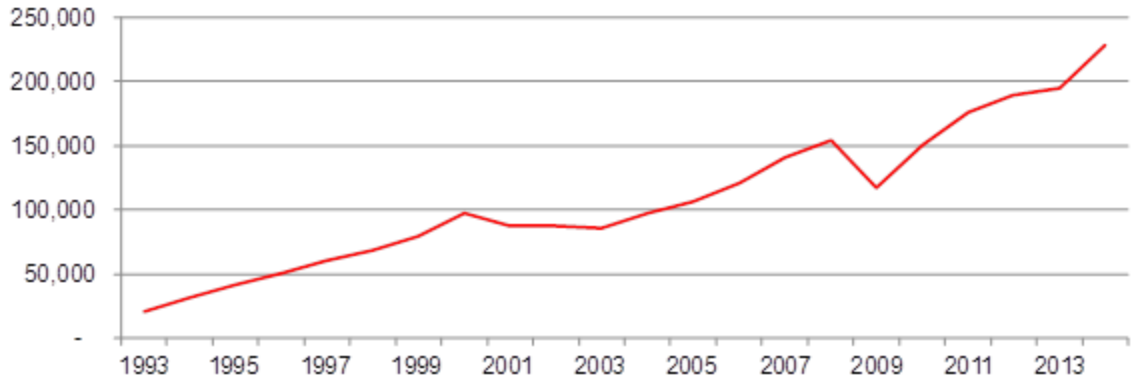
In addition, in 2006 Mexico implemented the Manufacturing Industry, Maquila and Export Services (IMMEX) program whereby producers of goods intended for export or companies providing services intended for export, temporarily import various goods to be used in the manufacturing of export products, without paying the General Import Tax (IGI), Value Added Tax (VAT), Special Tax on Production and Services (IEPS) and compensatory fees.

Somewhat similar to the IMMEX program, there are two other systems provided in the Mexican Customs Law known as the Strategic Examined Areas or the Fiscal Deposits of the Terminal

Automotive Industry, which in addition to the temporary import of goods and fixed asset, also afford the possibility of deferring payment of the taxes until the merchandise is returned, or else, nationalized.

Currently, there are approximately 6,700 businesses registered in the aforementioned programs, which in 2014 made imports for an approximate amount of 300 billion dollars, of which 75% of the amount corresponded to temporary imports. Since the signing of the North American Free Trade Agreement (NAFTA), the volume of temporary imports has been multiplied by 9, going from 25 billion dollars in 1993 to 225 billion dollars in 2013[1], which is equivalent to a potential collection of VAT associated to this item of 36 billion dollars, that in turn, represents the potential evasion if the appropriate customs destination of such imports were not controlled.

Graph 1
Evolution of temporary imports in Mexico
(millions of dollars)



Source: Public data from the National Statistics and Geography Institute of Mexico

2. 2013 FINANCE REFORM

Until 2014, the Value Added Tax Law in Mexico, exempted temporary imports made by maquila enterprises, provided that the temporarily imported goods were returned abroad. This scheme generated significant control problems for many years, since there were incentives for introducing in the country, goods for national sale purposes without complying with the payment of the corresponding taxes, as well as requesting the refund of VAT from temporarily imported inputs that had not been subjected to the payment of said tax.

This problem worsened in 2000, when the maquila businesses were given the administrative facility of transferring temporarily imported inputs to other businesses (virtual operation), thereby transferring the return operation to a company different from the one that originally imported the inputs.

1. *Public data from the National Statistics and Geography Institute of Mexico*

The system of exempting temporary imports was initially justified since the inputs coming from abroad to be transformed in our country, had as sole destination, their return to the country of origin or another country. Since the temporary imports did not enter the national market, it was technically and administratively correct to apply to them the VAT exemption. However, as time went by the customs facilities of the maquila system were rendered flexible and thus had an impact on the fiscal exemption system.

As a result of the foregoing, the finance reform of 2013 eliminated as of January 1st, 2015, the VAT exemption on the temporary introduction of goods in order to get rid of the distortions generated, simplify the tax administration and reinforce the instruments for identifying and combatting tax evasion and avoidance. Likewise, a certification system was developed for granting credits to compliant taxpayers which would make up for the 100% of VAT and IEPS in temporary imports, and settling said credits through verification of the return of the goods. Finally and in an alternate manner, a mechanism of commercial guarantees offered by businesses of the financial sector was created in order to take care of the temporary imports for those taxpayers who could not obtain the certification.

It is important to note that prior to the implementation of the finance reform, the controls carried out by the authority for supervising the return of temporary imports were based on field audits carried out in a reduced number of businesses, which in addition were complex and in conclusion, took long periods of time.

3. CERTIFICATION PROPOSAL

In late 2013, SAT initiated the implementation of the aforementioned reform and issued the requisites which the taxpayers had to fulfill in order to obtain the certification. In 2014 the process was begun for granting the aforementioned benefits and since its incorporation up to this date, 3,061 taxpayers have been certified and they have been granted credits for 75% of the total amount to be collected so far this year with respect to the payment of VAT and IEPS.

In order that the certification would be an integral facilitation mechanism, the authority established, in turn, three certification modalities: A, AA and AAA, by imposing compliance of a greater number of requisites to the latter, but also granting a greater number of benefits.

Certification under the A modality is based on compliance with nine requisites, among them that the businesses are up to date in compliance with their tax and customs obligations, that they have the control of inventories according to SAT's provisions, that the partners, shareholders and legal representatives are duly complying with their tax obligations, that the employees of the business are affiliated to the social security system, that the applicant is not in the risk lists published by SAT[2] and that the foreign trade staff be allowed to carry out supervision visits at all times. Additionally, special requisites were established for businesses of sensitive sectors (clothing, textiles, steel and shoes) aimed at guaranteeing a minimum of 12 months of operation of the business and the return of 80% of the temporarily imported merchandise.

On the other hand, obtaining the certification under the AA and AAA modalities is based on compliance with the aforementioned requisites plus compliance with additional requisites intended to supervise the taxpayer's productive

2. *According to articles 69 and 69-B of the Fiscal Code of the Federation.*

chain, wherein 40% and 70% of the suppliers, depending on the AA and AAA certification modality, respectively, must be up to date with their tax obligations and not be found within the risk lists published by SAT. Likewise, the businesses should not count on firm credits and inadmissible returns to aim at obtaining these certifications.

The main benefit granted by the certification system is the fiscal credit equivalent to 100% of the amount that should be paid by way of VAT and IEPS, when these result from the introduction to the national territory of goods under the temporary import customs systems. However, other benefits were included such as obtaining VAT refunds in periods of 20, 15 and 10 days, according to the A, AA and AAA modalities, respectively, the sending of letters of invitation, prior to carrying out the verification acts by the authorities in the AA and AAA modalities, and some customs facilities such as the customs dispatch for export through delivery service or the declaration of serial numbers in the requests for the AAA modality. All of them are aimed at facilitating foreign trade.

4. DEVELOPMENT OF THE CREDIT AND GUARANTEE ACCOUNTS CONTROL SYSTEM (SCCCYG)

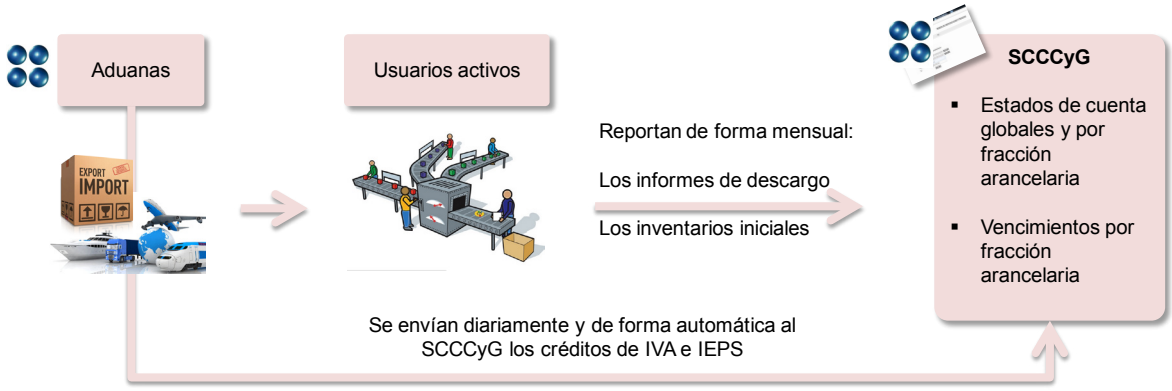
Prior to the 2013 finance reform, which eliminated the exemption of payment of VAT and IEPS on temporary imports and the systems for the payment of said taxes via fiscal credits and guarantees were approved, the Mexican customs regulation had Annex 24 which dealt with foreign trade, and which consisted of an automated system for the control of inventories of temporarily imported goods.

The system was developed so that through it, the businesses could control the pending return balances, in addition to facilitating the generation of reports that could ensure compliance with the information requirements established in the customs provisions and by the authority.

Annex 24 was implemented through third parties that offered the software to the taxpayers and which provided the information at the request of the authority. Actually, the Mexican authority did not have a standardized system at the national level that would allow the massive use of the updated information and strictly supervise the terms for returning the merchandise.

Derived from the above, there arose the need to develop a system for controlling the benefits granted in relation to the fiscal credits and guarantees, supervising in a timely manner the expiration of the terms for return. Thus, the Credit and Guarantee Accounts Control System (SCCCyG) was developed in 2014, for controlling online the credits and guarantee amounts related to the balances of the temporary imports pending return, from the universe of taxpayers that obtained the certification or with a system of approved guarantees. This system was developed according to the rules specifically prepared for said system: Annex 31 of the Foreign Trade General Rules.

Diagram 1
Diagram on the operation of the
Credit and Guarantee Accounts Control System



Source: SAT

The conceptual definition of the system was determined jointly with several associations (Mexican Association of Automotive Industry, National Association of Busses, Trucks and Truck Tractors Manufacturers and the National Council of the Maquila and Export Manufacturing Industry), some firms such as DELOITTE and Ernst & Young, as well as the Secretariat of Economy and the Secretariat of Finance and Public Credit of Mexico.

5. EFFICIENT USE OF THE INFORMATION

The system developed determines the credit and guarantee balances according to a mechanism of charges (initial inventory plus temporary imports) and discharges (returns, system changes, virtual transfers, destructions and donations) associated to every tariff fraction imported through said systems, controlling the legal terms for the return of temporary imports at commercial values.

Starting in 2015, 3 new tools were implemented in the operation which render active the SCCCyG and contribute to the preparation of the statement and thus, control the benefits of the systems of certification and guarantees given to the taxpayers:

1. **Loader of initial inventories and discharge reports**. Allows taxpayers to electronically send the information on discharges (exports, change of system, etc.).
2. **System viewer.** Allows for entering the credit and guarantees statement of account, as well as monitoring the signals of their suppliers' compliance with the tax obligations.
3. **Monitoring report on charges and payments.** Provides SAT a tool for evaluating the evolution of temporary imports subject to the benefit.

Since 2015, the SCCCyG is providing the taxpayer the following benefits:

- Provides the statement of account of the balance of credits and guarantees associated with temporary imports with the following characteristics:
    - Globally and by tariff fraction;
    - Daily updates of charges by type of system and type of good, and;
    - Fortnightly updates of discharges according to customs destination.
- Provides a system of alerts regarding the expiration of the legal terms established for the temporary import at the fraction level.
- Allows for monitoring the status of compliance of the suppliers according to the rules of permanence of the certification in their AA and AAA modalities, 40% and 70% of the suppliers, respectively.
- Provides the tools for:
    - The transmission (24 x 7) and validation of the discharge reports;
    - The transmission of the explosion of materials for the discharge of special fractions;
    - Consultation of the legal terms administered by the authority, and;
    - Obtaining the comments of daily operations.
    -

On the other hand, the system provides the control areas information by taxpayer on:

- The online inventory of temporary imports by tariff fraction subject to the benefit which may assist the auditor in determining his field examination strategy;
- The tariff fractions of greater risk according to the proximity of the expiration date for their return, as well as those in which the legal term has expired;
- The duration of the cycle of temporary imports and its evolution through time;
- The structure of customs destinations of temporary import which allows for establishing examination strategies for each of them (for example: request the justification of donations or destruction of said imports);
- Get to know the bill of materials associated to the final export and carry out comparative analyses at the industrial or economic activity level, and;
- Determine the structure of temporary imports subject to benefit, exempt, with zero rate paid in cash, as well as definitive imports in the certified and uncertified universes.

6. CONCLUSION

By the end of April 2015, the system developed had over 3,000 active businesses and granted credits of approximately 12.7 billion dollars. This amount represents the potential collection of VAT in case the imported goods are not returned on time abroad (from 6 to 60 months).

Likewise, the system has allowed the authority and the taxpayers a strict control of the discharges of their initial inventories and credits granted. During the first four months of the year, the taxpayers have reported discharges of 50% of initial inventories and 28% of inputs temporarily imported into Mexican territory.

Finally, this system obliges taxpayers to establish daily auditing control to supervise the daily figures shown in the system, and allows the authority to prioritize the tariff fractions that must be supervised (those with the lower amount of discharge).

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THE BEPS PLAN AND ITS INFLUENCE ON THE RULES INTRODUCED BY THE "ORGANIC LAW OF INCENTIVES TO PRODUCTION AND TAX FRAUD PREVENTION" IN THE ECUADOR

María Denisse Izquierdo Castro

SYNOPSIS

The purpose of this article is to expose and analyze internal rules introduced in Ecuador through the Organic Law of Incentives to Production and Tax Fraud Prevention, regarding the deduction of interest on loans between related parties. It also analyzes its effectiveness and consistency with the OECD Model Convention, to avoid the double taxation on cross-border transactions.

The Author: *Lawyer from the Catholic University of Santiago of Guayaquil. Master in Legal Business Practice from the Garrigues Study Center and the Antonio de Nebrija University in Madrid. Pursuing the Garrigues - Nebrija Ph.D in law. Professor of commercial and tax law of the career law at the Faculty of jurisprudence and, commercial law of the business engineering degree at the Faculty of Economics of the Catholic University of Santiago de Guayaquil. Associate of the law firm Izquierdo & Castro since 2010.*

Content

Globalization, economic transactions at the international level, and the interaction of various tax legislations (which did not take into account the fiscal impact of internal rules on cross-border transactions), have negatively affected taxpayers by allowing such operations to have a higher taxation and tax burden than those performed internally.

Seeking to promote foreign trade, the Organization Economic Cooperation and Development - from now on, OECD -, developed a model of Convention to avoid double taxation. This was to ensure that countries subscribe international treaties allowing that cross-border transactions would be taxed as much as internal operation are taxed, "eliminating double taxation, to minimize trade obstacles and difficulties to the sustained economic growth, at the same time affirming the sovereign right of each state to establish its own tax normative"[1].

However, if the signing of such agreements, in some cases, has fulfilled its purpose, it also has caused that in some situations the incomes arising from international transactions were not taxed in any of the contracting countries, leaving unprotected the tax sovereignty of those countries. I.e., in many cases, the double taxation disappeared, but replaced by a double exemption or taxation lower than the regular one.

Therefore, and at the request of the G20 Finance Ministers, the OECD has developed a "Plan of Action against Tax Base erosion and Profit Shifting" (BEPS). This Beps-plan, "1) identifies the actions necessary to mitigate the tax base erosion and the Profit Shifting, 2) establishes deadlines to implement these actions and 3) "identifies the necessary resources and methodology to implement these actions"[2].

The fourth action of the BEPS Plan indicates the need to "limit the tax base erosion by way of deductions on the interest and other financial charges"[3].

The purpose of this action is, precisely, that countries should include standards that prevent the tax base erosion by using expenses deductions in their internal legislation, since this plan's report has revealed that currently the use of debt between related entities, and with third parties, has allowed the excessive deduction of interests. As a solution to this problem, the OECD has pointed out that it is essential to establish limitations to deductions from excessive financial costs.

1. *Plan of action against the Tax Base Erosion and Profit shifting", page 11.*
2. *Plan of action against the Tax Base Erosion and Profit shifting", page 13.*
3. *Plan of action against the Tax Base Erosion and Profit shifting", page 20.*

Similarly, the Beps Plan says that, in order to enforce this action, "guidelines on transfer pricing must be established with respect to pricing of the related financial transactions"[4].

Since year 2008, and with the publication of the reform law for the tax equity in Ecuador, rules of organic nature regarding the application of the principle of full Competition limitations to deductions of expenses between related parties, were implemented for the first time in the country

However, these limitations have not had the expected application, as determined in the Taxation Law,-hereinafter LORTI. On the other hand, internal rules implemented to prevent tax base erosion through the deduction of expenses, were interpreted extensively by tax courts and by the Specialized Chamber of the National Court of Justice, extending such limitation to the virtual Elimination of the deduction of interest paid on loans between related parties.

In addition, and as if the judicial interpretation given to the limitations of financial expense deduction wasn't already harsh for taxable persons, on 29 December 2014, through the official Registry Annex 405, a measure called the law of incentives to production and prevention of Tax Fraud was published. Subsequently, its regulations establish a more severe tax regime for transactions between related parties.

Through this new regulation of tax law, as well as its rules of application are reformed, and introducing legal presumptions about the nature of loans between related parties, that entails not only the impossibility of deducting financial expenses generated between related parties, but taxation of the loan itself.

In short, recent legislative reforms generate an incorrect implementation of the Beps Plan and create a double taxation, contravening the principles promoted by the OECD.

This article aims to present and analyze the influence of **action No 4.** of the Beps Plan introduced in Ecuador's internal regulations, regarding the deduction of interest on loans between related parties, as well as its effectiveness and consistency with the Model Convention implemented by the OECD, to avoid the double taxation of Duties on cross-border transactions[6].

Therefore, we need to analyze the following: The internal measures with respect to the deduction of interest and financial charges paid abroad; the legislation on transfer pricing and internal measures implemented with respect to the deduction of interest and financial charges paid abroad to related parties. The deduction of financial expenses paid abroad according to the regulations for the application to the general law of taxation. Jurisprudential interpretation of the limitations on the deduction of expenses paid abroad. The reforms introduced by the law of incentives to production and prevention of Tax Fraud and its regulations; and its effects in both cases: when the company domiciled in Ecuador gives a loan to one of its related parties domiciled abroad, and in the cases in which the company domiciled in Ecuador receives a loan from them.

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4. Plan of action against the Tax Base Erosion and Profit shifting", page 20.

5. The deduction of interests with regard to external credits contracted by institutions of the financial system, or the deduction of financial costs of external loans by institutions of the financial system in favor of taxable persons resident in the Ecuador is not subject of this study.

(*)6. This study is not studying the deduction of interests with regard to external credits contracted by institutions of the financial system, nor the deduction of financial costs derived from external loans granted by institutions of the financial system in favor of taxable persons resident in Ecuador.

1. INTERNAL MEASURES REGARDING THE DEDUCTION OF INTEREST AND FINANCIAL CHARGES PAID ABROAD

The Organic Law on Internal Taxation provides that interest paid by taxpayers can be deducted from the tax base of the income tax, if they were product of debts incurred in order to run the business. This means, if they comply with the general rule, which provides that expenses and costs are deductible if they have been made for the purpose of obtaining, maintaining and/or improving the Ecuadorian source income that are not exempt.

In addition, when the interests and financial expenses are paid abroad, the rules provide that making the withholding at source is a prerequisite for their deduction, if what is paid constitutes for the beneficiary a taxable income in Ecuador[7]. Therefore, taxpayers resident in Ecuador shall act as withholding agent when paying the interests arising from the external credit granted[8].

Ever since the Reform Law for Tax Equality came into effect in Ecuador, limitations and additional requirements to the deduction of the financial expenses paid abroad have been established.

Nowadays, for deducting interest that are paid abroad, the established general rule regarding the credit must be followed: A) Registration of the external credit and its payments at the Central Bank[9]; and B) make the withholdings at the source of the income tax, over the paid interests.

The Central Bank Monetary Board, (whose functions are now exercised by the Policy Board of Financial and Monetary Regulation) has regulated the registration of such loans. It has pointed out that it is essential for the debtor to request this registration through the respective institutional form, within 45 calendar days from the date of disbursement. The request should enclose the following documents:

- "The representative instrument of credit that confirms the existence of the obligation and which must include the financial conditions, especially in term, currency, amount, interest rate, form of payment and destination;" "
- Affidavit, signed before a public notary or before a competent judge, by the legal representative of the company or by the individual who subscribed foreign credit, about the existence of the creditor and the obligation;
- Table of amortization or payments, as appropriate; and,
- Documents that demonstrate:
  - Accreditation to a bank account of the debtor in the country, through a transfer from abroad or a check drawn on an external Bank.
  - In the case of financial loans of foreign institutions to finance imports, copy of the single customs declaration accepted by the Ecuadorian Customs.
  - When the resources of foreign credit finance pre-lading operations, copy of the order document and the swift message of the transfer in favor of the foreign exporter.
  - When the lender pays obligations abroad on behalf of the national debtor, the transfer swift message of the resources in favor of the beneficiary will be required; the date of disbursement shall be deemed the date of such transfer; and,

7. *Article 13 of the Ley Orgánica de Régimen Tributario Interno.*
8. *Article 48 of the Ley Orgánica de Régimen Tributario Interno.*
9. *Article 10 of the Ley Orgánica de Régimen Tributario Interno.*

- "Whether it deals with compounded interests, written certification issued by the creditor stating date, period and amount of the capitalization of interests"[10].

In accordance to the LORTI law, the Monetary Board of the Central Bank have also decreed that "private debtors who have registered their external credits in Ecuador Central Bank will be required to register early cancellations and payments made to external creditors for contracted debt a maximum period of 45 days from the date of payment." Such payments shall be made through the Ecuadorian financial system"[11].

By all the documentation required for the registration of foreign credit, it practically forces the taxpayer to prove the existence of the loan, as a previous step to be able to deduce the interests that are paid. On the other hand, the obligation to register the external credit payments allows the Central Bank and the tax administration, to check its condition and the reality of the expenditure.

Finally, the deduction of financial expenses at the rate authorized by Board policy and monetary regulation and financial of the Central Bank has been also limited i.e., that only interest in which the part does not exceed these limits are deductible . This limitation means that in practice, interests are only deducted in the portion that does not exceed the market rate.

2. LEGISLATION IN THE FIELD OF TRANSFER PRICING AND INTERNAL MEASURES IMPLEMENTED WITH RESPECT TO THE DEDUCTION OF INTEREST AND FINANCIAL CHARGES PAID ABROAD TO RELATED PARTIES

With the publication of the reform law for the tax equity in Ecuador and by reforming the Organic Law of Taxation, rules of organic nature were introduced for the first time in the country, to regulate specifically the "transfer pricing", related parts, and related operations[13].

Under the reform previous mentioned, a section called "on transfer pricing" was added to the LORTI, whose first article stipulates that: "a transfer pricing regime is established to regulate for tax purposes the transactions between related parties, under the terms defined by this law, so that the payments between them are similar to those carried out between independent parties".

To apply this, the law has empowered the tax administration for carrying out fiscal adjustments when it does not comply with the principle of length, which provides that the taxable income that has not been subjected to taxation will be integrated to the tax base, when transactions between related parties have a price different from the market prices margins.

Consequently, the transfer-pricing regime corres-ponds to the implementation of standards that allow tax authorities to verify compliance with the arm's length principle, in transactions between related parties, i.e. at market price. The market price is the one in which, under normal conditions, independent parties would agree.

10. *Article 2 of the section second of the coding of the Central Bank Monetary Board regulations, called "External credits to the private Sector".*
11. *Article 3 section second of the codification of the Central Bank Monetary Board regulations, called "External credits to the private Sector".*
12. *Article 30 of the regulation for the application of tax law.*
13. *Until 2007, there were no rules of legal rank on the regulation of transfer pricing and the power of the tax administration on the matter. However, through the regulation for the application of the existing tax regime, those who could be considered as parts "related parties" had the obligation of the taxpayers to submit in annex of their tax return a comprehensive of transfer pricing report. They had to report their transactions with related parties it included the arm's length principle and established the criteria of comparability and methods for applying the arm's length principle.*

Therefore, only when it is verified that a transaction between related parties has been done at a price different from the market price, an adjustment can be made to modify the taxpayer's return and integrate in the tax base the difference between the declared value and the market value.

However, since in Ecuador it is only possible to deduce the interests to the extent that they do not exceed the rate authorized by the Policy and Financial and monetary Regulation[14] of the Central Bank[15], an adjustment of the amount of deductible interest does not seem possible nor necessary.

In addition to the limitations established to the deduction of expenses according to the interest rate agreed, conditions relating to the percentage of debt among related parties have also been imposed; for this reason, it is essential to analyze the guidelines set out in our legislation to determine the related parties.

The regulation states that parties are considered as related when there is:

1. **Participation in capital, control or administration:** "Individuals or companies domiciled or not in Ecuador, if one of them participate directly or indirectly in the direction, management, control or capital of the other. Or if a third party, individual or registered society or not in the Ecuador, participate directly or indirectly in their management, administration, control or capital"[16]. The regulations for the application of the Tax Law (LORTI) indicates the minimum percentages of participation that should exist for considering as related parties the individuals or entities in the scope of this description[17];

2. **Foreign tax regime:** "Taxable persons carrying out transactions with companies established or located in a tax jurisdiction of lower taxation or in tax havens"[18].

   Through the NAC-DGERCGC15-00000052 resolution, published in the official Registry Supplement No. 430 on 03 February 2015, the service of internal revenue - from now on, SRI -issued "rules establishing tax havens, preferential tax regimes and regimes or jurisdictions of lower taxation. The list of jurisdictions deemed to be tax havens (87 total) was issued, and the criteria under which a jurisdiction of lower taxation would have the same treatment as a tax haven[22].

3. **Volume of transactions between the parties:** "When an individual or Corporation, resident or not in Ecuador, perform 50% or more of their sales or purchases of goods, services, or other areas of operations, with an individual or company, domiciled or

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14. This causes the deductible interests are always those derived from the market rate.

15. He is currently the Board policy and monetary regulation and financial of the central bank which exercises the functions which, at the time held the Monetary Board and the Board of Directors of the Central Bank.

16. Article not numbered of the Ley Orgánica de Régimen Tributario Interno.

17, Article 4.-related parties-in order to establish related parties, more than the mentioned in the law, the tax administration in order to establish some kind of bonding by percentage of capital or share of transactions, will take into account, inter alia, the following cases:"

1. When an individual or company is owning directly or indirectly 25% or more of the share capital or equity in another society.

2. Societies in which the same partners, shareholders or their spouses, or their relatives up to the fourth degree of consanguinity or second of affinity, participate directly or indirectly in at least 25% of the share capital or own funds maintain commercial transactions, provide services or are in a relationship of dependency.

3. When an individual or company be owner directly or indirectly 25% or more of the share capital or equity, in two or more companies (...)

18. Non-numbered article of the Ley Orgánica de Régimen Tributario Interno.

19. Central tax administration, which corresponds to the income tax, is exercised by the internal revenue service.

20. Article 2 of the resolution. NAC-DGERCGC15-00000052 of the SRI.

21. "Article 4.-lower taxation jurisdiction-will have the same treatment of tax haven jurisdictions whose effective rate of income tax or taxes identical or analogous nature is less than a sixty percent (60%) with the corresponding in the Ecuador on pensions of the same nature in accordance with the internal tax system Act" ", during the last fiscal period, as appropriate".

not in the country. For the consideration of related parties under this paragraph, the tax administration shall notify the taxable person, which, if applicable, could demonstrate that there is no relationship by board, management, control or capital"[22].

With this rule, a link is established according to the trade relations of taxable entities or persons, our legislation is here distinct from the OECD regarding related parties, according to their guide for transfer pricing; and, although it is possible to demonstrate that there is no corporate bonding, the burden of proof is reverted without reasonable justification.

4. **Designation of the active subject:** Those subjects determined by the tax administration as related, because there is not a restrictive list. The standard provides that "to establish the existence of some kind of relationship or link between taxpayers, the tax administration will be considering the shareholding or other corporate rights over the companies' assets, the holders of capital, the effective management of the business, the distribution of profits, the proportion of transactions between such taxpayers, the mechanisms of prices used in such operations" thus leaving open the possibility that the active subject determine other cases in which the parties could be considered as related; and,

5. **By presumption:** Those parties that the SRI presume related. The provision allows that a presumption is established when a transaction between two individuals is not performed at market value, pointing out that "the tax administration may establish a presumption of related parties when transactions carried out do not conform to the arm's length principle".

In conclusion, to determine who may be considered related parties is left at the Administration's criteria.

To allow that the active subject may consider by presumption, without any kind of pre-set parameters in the law, that certain taxable subjects are related parties means that, through administrative acts and without control, essential elements of the tax can be determined. This is in contravention with the principle of legal reserve and the principle of regulated acts governing the performance of the public service.

The Constitutional Court, in resolution 18, published in the official supplement 743 from July 11, 2012, issues the decision 018-12-SIN-CC, in case No. 0008-10-IN, and referring to the principle of legality, expresses the following:

"(…) To say that there should be no tax without law means that only the law can establish the tax obligation and therefore, only the law should define what are the assumptions and elements of the tax relationship. When elements and assumptions are considered, I would mean that it is the law that should define the taxable relation in its objective meaning and the subjective sphere, i.e. taxable persons from the obligation that will be born. It must be the law that set the object and the amount of the provision, i.e. the criteria with which the taxable income should be assessed to apply the tax in a certain amount and it is the law that should define this amount".

(…) Regarding this, the doctrine is accurate to point out that in cases in which the law itself contemplates that legislation must be completed by a secondary source, "the law should provide with enough determination the limits within the secondary source can be used, so that the tax can be determined "in accordance with the law"." "Blank checks" are not admissible but regulation must intervene to determine

22. *Numeral quarter of article 4 of the regulations for the application of tax law.*

"terms of subordination, development and complementarity. Generally, the secondary source is referred to in the decision to apply or not a tax previously regulated by the law, to establish or modify an amount. In this case, this amount must be pre-determined within precise boundaries that can be controlled (…)"

It is clear that according to the criteria of the constitutional court itself, the regulation allowing the internal revenue service to "presume" or "determine" (without preset parameters) who are related parties, could be unconstitutional. It enable the tax administration to implement a regime of discretion, despite the fact that, according to our legal system, acts and performances by public institutions and public officers are essentially regulated[23], in the exercise of their powers.

This discretionary power granted to the administration creates a troubling legal uncertainty and the lack of "clear game rules" involves the creation of a legal system in which the transfer pricing regime could be applied to "any", even to independent parties, under assumptions as those listed previously.

As I mentioned earlier, this is an important issue when establishing financial expenses can be deducted from the taxable income tax since article 10 of the LORTI fixed greater limitations and requirements for the deduction of interest, when these are result of foreign loans subscribed between related parties, have the following:

"(…) To be deductible interest paid on foreign loans granted directly or indirectly by related parties, the total amount of these may not be greater than 300% with respect to the heritage of societies. As regards individuals, the total amount of foreign loans shall not be greater than 60% with respect to their total assets.

Interest paid with respect to the excess of indicated relationships, will not be deductible (...)

Therefore, it is possible to deduct expenses paid abroad if the credit and payments are recorded in the Central Bank but with two limitations. First, according to the amount of interest to the only deductible portion of expenses not to exceed the rate authorized by the Board on policy and monetary regulation and financial of the Central Bank. The second, regarding the volume of debt, if the loans granted by the related parties domiciled abroad exceed 300% of the assets or the 60 percent of assets, according to the case, the interest paid on the surplus will not be deductible.

Requirements and limitations set forth to deductions of interest and financial charges prevent the existence of an "excessive financial expenditure" that erodes the income tax base.

23. Mandatory resolution No. 2 (R.O. 678; 25-IX-78).

3. THE DEDUCTION OF EXTERNAL EXPENSES PAID ABROAD ACCORDING TO THE ORGANIC LAW OF TAXATION REGULATIONS

As previously noted, the tax law establishes limitations with respect to the deduction of expenses paid to related parties abroad.

However, the regulations for the enforcement of the internal tax regime, the regular that provision, amended as indicated in the article previously cited and extends the restriction of the deduction to the total "external debt", by stipulating as follows:

"Art 30..-Deduction for abroad payments"
(II) Interest on external loans - (...) in addition, for credits from abroad, with related parties, the following conditions must be met:

- For corporations, interests generated by their credits from abroad will be deductible, if the ratio of total external debt does not exceed 300% of the assets.

- For individuals who are subject to submit accounting, interests generated by their credits from abroad will be deductible, if the ratio of total external debt does not exceed 60% of total assets.

- For foreign branches, interest from loans from abroad will be deductible, where the ratio of total external indebtedness and the assigned assets does not exceed 300%. Credits received from the parent company will not be considered as external credits

When the debt ratios indicated above exceed these limits at the time of the credit registration at the Central Bank, the portion of expenses generated on the excess of the corresponding relationship, without prejudice to withholdings at source of income over the total of the interest tax, shall not be deductible.

Taxable persons shall make the corresponding reassessment of tax, without prejudice to the determinative Faculty of the tax administration when the debt ratio is modified.

External debt is the total of debts incurred with external individuals and external legal entities (...) "."

Therefore, the limitation regarding the value of the external credit ceases to be only for loans between related parties and through this regulation, becomes a general limitation to the deduction of interest on any external loan.

The above contravenes the principle of legal reserve, which specifies, "The tax laws will determine the taxable object, the active and passive subjects, the amount of the tax or how to set it, the exemptions and deductions"[24].

24. *Article 4 of the current tax code.*

4. JURISPRUDENTIAL INTERPRETATION OF THE LIMITATIONS ON THE DEDUCTION OF EXPENSES PAID ABROAD

As noted above, the application regulation of the tax law differs from the provisions of the law. Therefore, it would have been convenient that the tax appeal district courts, as well as the Specialized National Courts of Ecuador, implement only the limitations provided in the law and not those of the regulation, in order to respect the guiding principles of the Ecuadorian tax regime[25], enshrined in the tax code and the Constitution.

However, when applying this regulation the courts did not decide on the legality of limitations on deductions established through regulation.

On the contrary, they have given the transfer pricing regulation and deduction of expenses between related parties, a broad interpretation that has caused legal uncertainty and generates a double taxation.

This way, the Tax Court of the National Court of Justice of Ecuador, when resolving the case N° 271-2010, within the record 271, published in the official registry supplement 271 on 13 February 2015, statutes on the deduction of interest arising from a loan between related parties, and says:

"(…) Over interests and commissions abroad for USD $ 43.770.069,22, the judgment rightly apply article 17 of the tax code, which provides for the principle of economic reality. The statement points out that the conflict goes back to establish whether the values registered by the company under the concept of loans are such, or if indeed they are a provision of funds, as argued by the tax administration. As the object of the litigation, the obligation of the administration of Justice is to determine the true economic essence behind the pretended loan agreements on which the expenditures of interest were submitted (...).

(…) The sentence acknowledges that no one has an obligation to choose the most burdensome way for his or her interests and that it is possible to choose legal forms that tax may be more beneficial from a tax point of view. But it emphasizes that the conduct of the taxpayer should circumvent the obligation through the use of inadequate legal forms: otherwise this would lead to the abuse of the right, which is can be corrected through the application of the principle of economic reality or prevalence of economic substance over legal forms.(…)

(…) As for the capitalization item, the tax administration argues that, when the funding comes from a related company, a provision of funds or capital contribution that must be registered in the accounts as a capital increase and not as a loan that generate costs by concept of interests. It points out that the tax administration does not object that the Ecuadorian related company need and receive funding from the economic group to which it belongs. The objection of the internal revenue service is that if the economic group injects liquidity into their company, linked to the rotation of operations, that funding should be part of the normal corporate and accounting mechanisms as a capital that increases its assets. This increase will be paid to the group through dividends or profits. However, for reducing the base tax and to avoid the payment of 25% of income tax on utilities, they have held a loan agreement; presenting the funding between

25. *The tax regime is governed by the principles of legality, generality, equality, proportionality, non-retroactivity, progressiveness, efficiency, administrative simplicity, equity, transparency and revenue adequacy.*
Article 5 of the existing tax code.
Article 300 of the Constitution of Ecuador.

related companies as a loan results in a transfer of taxable bases towards other tax jurisdictions, with the consequent revenue loss to the State of residence of the borrower company. The judgement points out that the Administration has described the so-called loan and interest paid as a simulation and argues that it is not a credit operation, but a provision of funds of the economic group in favor of its subsidiary in the Ecuador, and should be regarded as a capital increase.

(…) (C) In relation to the legal problem of the item of external interests and commissions, since the related companies could not benefit from the respective deduction, this tribunal observes that the appreciation of the Court A, with respect to the figure of Provision of funds, is correct.

(D) In regard to the legal problem of the deduction of interest and financial costs from external credits to benefit from the deduction of interest and financial costs from foreign loans, the taxpayer must strictly comply with what the laws establish on the matter. (…) The Court in its A-quo judgment confirms that we deal with a figure of inter-company funding, and from previous decisions issued by this room on the principle of economic reality; this specialized room believes that there has been no misapplication, or wrong application of the concerned articles. The Court A has implemented provisions of the laws and has acted in accordance with law (...) "."

Similarly, the tax section of the National Court of Justice has issued a similar judgement, to resolve the case No. 226-2009, through record 226, published in the official registry supplement 368 on November 23, 2012. In this case, the court ratifies the item by which the SRI denied the financial charges paid between related parties, considering that related party transactions were not the granting of a credit but an increase in capital, which led the paid interests to be considered as dividends, which are not deductible.

To substantiate its action, the mentioned Court said the following:

"(…) SECOND.- the multinational company S.A, provided capital under the figure of loan to the plaintiff of this judgement, which thereby could deduct interest. This results in a lower tax base. The Administration, on the case under discussion, has not qualified it as circumvention, but as simulation. It is possible to qualify the intention of legal persons involved in a business, as well as real economic relations that exist between the parties regardless of legal forms that use. It is not a case of economy of choice; from the expert reports, it is inferred that it was not a loan but a provision of funds and that it has engaged in improper assessment of the test.

(…) SEVENTH.- It is not acceptable mentioning issues inherent to the economic options, to the permissible circumvention, and even less to standards issued after the case became object of discrepancy, which would induce a different understanding of the transcribed case. From the exposed considerations, having infringed the article 17 second subsection of the tax code, the present Tax Chamber of the National Court is acting on behalf of the sovereign people of Ecuador, by the authority of the Constitution and the laws of the Republic. The court quashes the judgment of 31 March 2009 issued by the second Chamber of the District Court of the Fraud No. 1 and recognizes the legitimacy of the contested Resolution (...) "."

In this regard, it is important to analyze the performance of the tax administration in these judgements. This approach runs counter to the provisions of the transfer-pricing regime and distorts the purpose and scope of the principle of Arm's Length. Based on this principle, as a rule, only adjustments can be performed when an operation is not performed at market value, in order to correct the difference, and integrate the adjustment to the tax base.

In other words, the Arm's Length principle allows the active subject to perform acts of determination to verify that transactions between related parties are made at market price. This can be conceptualized it in the following way: " Arm's Length Principle: for tax purposes, this means principle by which, when the established or imposed conditions between related parties in their commercial or financial transactions differ from what would have been stipulated or between independent parties, their utilities will be taxed. At least those utilities that would have been obtained by one of the parties if those conditions did not exist, but that have not been obtained because of these conditions"[26].

The OECD Model Convention, in orden to avoid double taxation also enshrines the principle of Arm's Length, by providing in article 9. "(when)... two (related) companies, in their commercial or financial relations, are united by accepted or imposed conditions. If these differ from those that would be agreed by independent companies, the benefits that would have been obtained by one of the companies if there were no such conditions, and that in fact have not been conducted because of them, can be included in the profits of that enterprise and be taxed accordingly".

This article has been established as the indispensable foundation of bilateral tax agreements between OECD member countries and among a growing number of non-members, such as Ecuador.

However, the arm's length principle has not, in Ecuador, the effect of limiting or preventing double taxation, applying the transfer-pricing regime in cases in which there has been no difference between the market value and the agreed inter-company transactions.

This application of the cited articles is away from the OECD itself has given. In the report and comments to the model of Convention to avoid double taxation, it says, "the provisions of this section only apply when agreed or imposed special conditions between the two companies; the rectification of the accounting of the companies is not admissible if the operations between them occurred in conditions of Arm's Length"[27].

Accordingly, it has also been recognized by doctrine that "for the national provisions to allow adjustments of benefits when there are interconnections between societies, or influence, in corporate laws, the adjustments established by article 9 Mod. CDI may be practiced only when such interconnections are the cause of special conditions made or imposed, as well as consistent with the Arm´s Length principle, therefore interconnection under corporate legislation is not sufficient to modify the accounts"[28].

This correction between the value of the transaction and the market modifies the allocation of taxable profits within a multinational group for tax purposes, and it is known as the primary adjustment[29]. Therefore, it is only when the tax administration finds that the transactions recorded in the accounts of the taxable subject reflect that they are not based on the principle of Arm's Length, that the correction may take place.

However, the primary adjustment does not alter the fact that the surplus of utility corresponding

26. *Internal tax regime Organic Act.*
27. *Page 191 of the 8th ed. of the abridged publication entitled 'Tax on income and Heritage Convention model'. This abridged version includes the text of the Model Tax Convention as it read on July 22, 2010, but without historical notes, detailed list of tax agreements concluded between the countries members of the OECD and reports, which are included in volume II of the integral version, are not reproduced in this version.*
28. *Vogel, Klaus, "On Double Taxation Conventions", Ed.Kluwer Law, London, 1998, p. 525.*
29. *"The primary adjustment is the adjustment of the taxable profits of a company by a tax administration of a first jurisdiction pursuant to the application of the principle of arm's length to operations in which an associate of a second tax jurisdiction is involved."*

to the adjustment is not compatible with the result that would have been obtained if the related operations had been carried out under conditions of Arm's Length. To make the profit sharing correctly, a secondary adjustment takes place, whereby the surplus utility resulting from the primary adjustment is treated as if it had been transferred, in one way or another, and, consequently, was subject to taxation.

The secondary adjustment, as sustained Calderón Carrero and Martín Jiménez, "arises usually in relation to the tax qualification of excessive income contained in the accounts of a related entity. At least in relation to what would have proceeded and paid under conditions of Arm's Length in accordance with the primary adjustment by the tax authorities of a particular country. Therefore, the secondary adjustment would be done by the tax authorities of a given State, eventually only over the person or related entity has received a benefit in excess pursuant to a primary adjustment by a tax administration. For a secondary adjustment to apply there must be a discrepancy or difference between the taxable income attributable to the related parties in accordance with a primary adjustment and income or cash flow derived from the linked operation that was originally performed"[30].

Consequently, the secondary adjustment is the one resulting from the application of a tax to a secondary operation[31] and this usually takes the form of alleged dividends, alleged contributions of own assets or loans.

However, in the analyzed cases, the tax administration ignored the interest paid to foreign taxable persons, which should result in a secondary adjustment. To do so, the administration bases its performance on article 17, which provides that "when the taxable event consist of a legal act, it will be qualified according to its true essence and legal nature, whatever the chosen form or name used by stakeholders. When the taxable event is determined according to economic concepts, the criterion to qualify them takes into account situations or economic relations that actually exist or are established by interested parties, irrespective of the legal forms that are used".

In other words, the active subject, without making a primary adjustment in which to determine the existence of the market values, comes to consider loans between related parties as not adhering to the economic reality; that they are operations that have been conducted only in order to erode the tax base. In addition, it concludes that the capital between related parties can only be injected through corporate schemes, thus making a secondary adjustment on the total value of transactions, despite not demonstrating or discussing if they meet or not with the principle of Arm's Length.

Therefore, based on the "economic reality", the SRI arrives to conclude, in general, that in the case of related parties, there may not be lending and therefore financial expenses (all of them) derived from such credits are denied. They establish the tax base for the income tax and deny the deduction. Even if the loan and payments of principal and interest have been registered on the Central Bank of Ecuador, their existence and conditions has been verified, as well as the volume of debt that represent these loans, and which interests have been deduced only to the extent that they do not exceed the rate authorized by the Central Bank.

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30. Calderón Carrero, Manuel José and Martín Jiménez, Adolfo, "Los ajustes secundarios en la Nueva regulación de las Operaciones Vinculadas" " revista de Contabilidad y Tributación, núm. 316, 47/2009, julio 2009, pág. 37 y 38.

31. The glossary of the guidelines of the OECD points out, a secondary operation is an alleged operation that comes from certain countries under its domestic law, after having proposed a primary setting in order to achieve an effective sharing of benefits compatible with this primary setting. Secondary operations can take the form of dividends alleged, alleged contributions of capital or of alleged loans.

Worse that the criterion of the active subject, is that this opinion was received by the appeal tax courts and the National Court while obviously the tax administration does not apply correctly the provisions relating to the deduction of expenses paid abroad or transfer pricing regulations.

As a result, the courts ratify dictated administrative acts against the regulations that expressly allow the deduction of expenses between related parties, for cases in which the requirements are met, and with the above-mentioned limitations.

On the other hand, it is essential to analyze that it is possible to avoid double taxation for the multinational group, if a correlative adjustment is made[32]. This correlative correction consists in adjusting downward the tax debt, made by the tax administration of the second jurisdiction, so that the allocation of profits between the two tax authorities are compatible with the primary adjustment for the SRI and there is no double taxation[33].

I.e. when a primary adjustment raise the tax debt of the company resident in a Contracting State, the other State could adjust accordingly, downward, on the assessment of income that should be charged in accordance with the principle of Arm's Length[34].

However, if another jurisdiction is not in agreement with the adjustment made by the Ecuadorian tax administration, it will not be forced to make a correlative adjustment and the multinational group will be taxed twice for that part of the benefits[35].

The OECD itself, in comments to paragraph 2 of article 9 of the Model Convention to avoid Double Taxation, considers this request. It points out that the State to whom a correlative adjustment is required must comply with it only if "it considers that the benefits adjustment amount reflects accurately the benefits that would have been obtained had the operation occurred at arm's length".

The same guidelines of the Model Convention to avoid double taxation provide that correlative adjustments are not imperatives, which evidences that tax administrations are not obliged to reach an agreement within the friendly procedure[36]. No tax administration should perform a correlate adjustment except if it the primary adjustment is considered justified, both in principle and in regards to the amount.

However, in the Ecuadorian case, the possibility of deducting financial expenses generated by the external lending between related companies is denied to the taxpayers. Regardless that a primary adjustment was made or the violation of the principle of Arm's Length are determined, the tax administration of the second jurisdiction where the foreign related company is located will hardly admit the criterion of SRI and the National Courts, because that would imply that all the operation tribute only in Ecuador.

Finally, it is essential to emphasize that this interpretation and application of the rules of transfer and prices of the provisions relating to the deduction of the expenses to be repeated, become mandatory application[37] and create a double taxation. This double tax burden is

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32. According to OECD guidelines glossary, the correlative adjustment is the adjustment of the tax debt of the related company established in a second fiscal jurisdiction. It is made by the tax administration of that jurisdiction to take into account the primary adjustment made by the tax administration of the first jurisdiction, to obtain a consistent distribution of benefits between the two countries.

33. See paragraph 4.32 of the OECD guidelines.

34. García Prats, Fco. A. "Article 9 MC OECD partners" Monograph of Ruiz Garcia, José Ramón, Calderón Carrero, Manuel José "Comments to the conventions to avoid double taxation". 2004, Cit. Pág. 559.

35. Paragraph 12 of the OECD guidelines.

36. Article 25 OECD Model Convention to avoid double taxation.

37. Article 182 of the Judicial Organic Code, which provides that when a criterion has been ratified three or more times by the national court of Justice, it becomes a mandatory jurisprudential precedent. In this case two judgements have been quoted as example.

generated when the returns received by the foreign company is added to taxable income taxed in the country of residence; and when to be considered as non-deductible expenses does not lessen the tax base from income tax, resulting in a greater charge tax for cross-border operations.

Double taxation is contrary to the concept and the aim of the transfer-pricing regime, since its purpose is to tax transactions between related parties, the same way as transactions between independent parties, to create a level playing field in the market, not a disadvantage to related parties.

5. REFORMS INTRODUCED BY THE LAW OF INCENTIVES FOR THE PRODUCTION AND PREVENTION OF TAX EVASION AND THEIR REGULATION

As If the interpretation of the administration of Justice, denying the deduction of the interest paid on parts related overseas was not a negative enough measure that affects the tax base and severely hurts the economy of multinational groups, on December 29, 2014 was published in the official registry supplement 405, the law of incentives for production and Tax Fraud Prevention. Its purpose is to create greater controls and tax for this type of transaction.

This Act amended article 37 of the LORTI, introducing the following provision: "(...) when a company grants financial loans to its partners, shareholders, participants or beneficiaries, or any of its related parties non-commercial loans[38], this operation will be considered as an early dividend payment and, therefore, the company must perform the corresponding withholding to the corporate rate for the transaction amount. Such withholdings shall be declared and paid the month following the transfer within the time limits provided for in the regulation and shall constitute a tax credit for the society in its Declaration of the tax income (...) "."

Thus, by law, loans between related parties are considered pre-payments of dividends, so that, from the entry into force of this standard, no longer discussion regarding the deductibility of the expenses generated as result of external loans between related parties, due to the legal presumption does not support evidence to the contrary.

Such an arrangement can produce various and complex effects and conflicts, depending on whether the taxable person which taxed in Ecuador is the lender or the borrower, which will be examined below.

5.1. When the company domiciled in Ecuador provides a loan to one of its related parties domiciled abroad

In this case, the taxpayer grants one of their related parties domiciled abroad a loan but, under this rule, the total value of the capital will be considered as an early payment of dividends, which brings the following consequences:

- **Accounting effects:** The capital sent abroad is considered, for tax purposes, a delivery of dividends but from an accounting point of view, it is not possible to take such presumption. The principle of economic over legal form[39], in virtue of which required that transactions and operations are recorded for accounting purposes according to its financial nature, is of mandatory application in the Ecuador, to be enshrined in the International's financial reporting standards (IFRS) and in article 17 of the organic tax code.

38. *The law does not define what "commercial loans".*
39. *"Economic reality Prima on the form of transactions". IFRS 1.*

- This entails a serious conflict when it comes to recording accounted for the transaction, since if it is recorded as an pre-payment of dividends the economic reality of the taxable person would be not reflecting.

- **Tax effects for the resident company in Ecuador (lender):**

  Withholding at the source of the income tax: To consider the loaned capital as a dividend, forces the lender to make withholdings over the 22% of the total amount of the credit granted to the company or foreign individual.

  Therefore, and pursuant to IFRS, it would appear that the correct approach would be to register in the item "accounts receivable" the total value of the loan (including withholdings) with credit to "banks" and "withholding at the source". Pursuant to the statutory provision designated, a tax adjustment would occur in the following month, involving a reclassification and change seats and items[40]; since, at the time of making the monthly statement as a withholding agent, the dividends that were delivered in advance must be taken into account and the withholdings at source must be paid to the Treasury.

  However, it should be noted that if at accounting level, the operation has to be registered as it , i.e., as a loan, the withholdings at source for income tax lost its economic justification, since it would have to be done even if the operation does not generate a taxable income, or a utility for the foreign borrower.

  Tax remittance on foreign currency: Under the qualification of *"early dividend",* the society that gives the loan will have to pay the tax remittance on currency[41], - hereinafter ISD-, on the value of the capital sent abroad as credit granted.

  The law says that "payments made abroad, as dividends distributed by national or foreign companies domiciled in Ecuador, after the payment of the income tax, in favor of other foreign corporations or individuals not resident in Ecuadorare exempt of the ISD. Except if the company or the individual - as appropriate - is not domiciled in tax havens or jurisdictions of lower taxation"[42].

  However, to be considered a "pre-payment of dividend", the loan is not exempt from the ISD, and 5% on the amount that is transferred abroad must be paid (from US$ 1000.00)[43], implying an operating cost for the lender.

- **Tax effects for the related party domiciled abroad (borrower):**

  Income tax withholding at source: The law provides that the withholdings can be used as tax credit[44] of the income tax, by the taxpayer, but in practice, this will not be possible.

  Withholdings made in Ecuador alone could be used as tax credit[45] abroad only when they were carried out on an income that is also taxed in the foreign jurisdiction and the capital received under the loan is not a taxable income. Therefore, the foreign company should be considered the value retained as an operating cost.

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40. What causes a "double accounting", which is forced the taxpayer under article 37 of the LORTI, because when it comes to declaring the fiscal adjustment do not modify only values, but also items and ledger accounts.

41. "Art 155..-creation of the tax out of currency.-create tax remittance (ISD) on the value of the operations and currency transactions carried out abroad, with or without involvement of the institutions belonging to the financial system". Reform law for tax equity in the Ecuador. Article 156 of the Reform Law for tax equity in Ecuador.

42. Article 159 of the Reform law for tax equity in Ecuador.

43. Article 160 of the reform law for tax equity in the Ecuador.

44. Article 38 of the law of tax.

45. There are jurisdictions where the values paid as tax income in Ecuador, are not recognized as tax credits, but a "deduction for double international taxation" is applied, as in the case of Spain.

In short, the foreign company will pay a 22% income tax in the country, on a value that does not represent any profit[46].

Payment of the credit granted: The legal presumption on the loan brings serious doubts as to the tax treatment of its cancellation. What is the tax treatment to be given to the capital that pays the foreign company to the taxpayer?

The standard says that "granting" loans to related parties shall be considered as pre-payment of dividends for tax effects, therefore, is outside the scope of this legal presumption the cancellation or payment of the loan granted to the foreign company.

However, we have to take into account that that this currency input can be only understood as corresponding to the payment of the loan which is granted if, as stated by IFRS, this was recorded as a liability, an account receivable, pursuant to the principle of economic reality.

However, if on the other hand, under the legal presumption the loan to a related party must be registered in the accounts as "pre-payment of dividends", currencies that enter the country for their cancellation would not have an accounting justification that ensures they will not be taxed again.

On financial yields, there seems to be no impact, they would be taxed at 22% in Ecuador, and would be deductible for the foreign company.

Finally, it is concluded that the granting of a loan by the taxable person to one of their related parties domiciled in the foreign tax in the following way:

- 22% for income tax on the total value of credit granted, paid through the respective withholding;
- 5% on concept of currency tax (ISD), on the value of the capital sent abroad; and,
- 22% as income tax on interest received under the loan.

5.2. When the company domiciled in Ecuador receives a loan from one of its related parties domiciled abroad

The reform introduced by the Internal Organic Tax Law does not clarify when the qualification of loans between related parties is applicable. In the case that these were granted by taxable persons resident in Ecuador, in favor of a company or individual resident abroad, or if it is also applicable in cases where the resident company in the country is the beneficiary of the credit.

However, the phrasing of the provision leaves the door open: It may be applicable also in cases in which the taxable person resident in Ecuador is the one who receive the loan. This is according to this present interpretation by the internal revenue service and the courts for transfer pricing rules and provisions relating to the deduction of expenses between related parties (without any express rule on the matter). It seems logical that the scope of article 37 of the LORTI will include operations under which foreign companies made loans in favor of individuals resident in Ecuador.

In this case, the consequences are different from those mentioned above. They are analyzed below:

46. However, the cost, by virtue of agreement between the parties, can be assumed by the lender.

Accounting effects: The legal presumption in which a credit is considered an early delivery of dividends for tax purposes, cannot not be registered. This happens because it is not possible to assume this presumption, since it contravenes the principle of economic reality already mentioned previously. In addition, it is not possible to register this credit as a dividend, because then the financial statements would not reflect the real situation of the taxable person, by accounting as an utility that in practice has no material or economic existence.

Therefore, the total value of the credit would be recorded in the 'banks' account charged to the item "payable accounts ", in spite of the subsequent fiscal adjustment. This involves a reclassification of transaction ; since when making the return, the value of the loan received will be considered as a dividend and income taxable to be added to the taxable income of the income tax of the taxpayer, determining an unreal utility.

- **Tax effects for the resident company in Ecuador:**

Income tax on credit: The effect of considering the value of the loan as a pre-payment of dividends is that received capital should be considered a taxable income and therefore, its value must be added to the tax base from income tax, taxed at 22%.

Non-deductible expenses: On the other hand, financial expenses incurred pursuant to the received loan will not be deductible since are not really considered as an interest, in the absence of a cause that justifies them, increasing the tax base for the calculation of the income tax.

Let us remember that this was not so, even if loans between related parties were not recognized as credits, these were not considered utilities but contribution to equity. I.e., it was not taxed as capital; it was not considered a taxable income, even if it did not allow the deduction of the financial expenses generated by the credit.

Tax on remittance of currencies: The loan being granted to a related party, the taxable person will have to pay the tax on currency remittance at the time the payment of capital and interest on the loan that was awarded will take place.

The law says that payments made abroad will be exempt from this remittance tax, by concept of amortization of principal and accrued interest on certain loans. But "the institutions of the national financial system and payments related to loans granted by financial institutions established or domiciled in tax havens or related parties or, in general, lower taxation jurisdictions"[49], are not included in the exemption. So this type of credit operations are not exempted.

Therefore, 5% of the sum transferred abroad will be paid (principal and interest), which will constitute an operating cost to the taxpayer.

Labor effects on the resident company in Ecuador: While it is true that consideration of a loan as early payment of dividends have serious tax effects, the tax debt increase would not be the unique economic burden that would affect the borrower.

The labor code in its article 97 provides that "the employer or company will recognize for the benefit of their workers fifteen per cent (15%) of the cash profits (...)".

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47. *"Economic reality prevails over the form of transactions". IFRS 1. Organic tax code Article 17.*
48. *What causes a "double counting", which is forced the taxpayer under article 37 of the LORTI, because when it comes to declaring the fiscal adjustment do not modify only values, but also items and ledger accounts.*
49. *Article 159 of the Ley Reforming tax equity in the Ecuador.*

Article 104 ibid points out that "for the determination of the annual profits of the respective companies, the returns or payments that are made for the payment of the tax income will be taken as basis ".

Consequently, in our legal system, workers are entitled to receive a percentage of profits. This is calculated on the value declared by the employer in respect of income tax; consider a credit as a pre-payment of dividend, which increases the tax base also imply that from the capital of the loan in question, 15% will be paid additionally to the workers.

Payment of the loan granted: As I have mentioned before, article 37 of LORTI establishes the legal presumption under which loans are considered dividends shall be applicable when "credit is granted" to a related party transactions, so it is assumed that its cancellation is outside the scope of the standard.

However, when the interest generated under the loan is paid the taxable person will have to perform the income tax withholding at source of 22%, but the transnational company will be entitled to use this value as a tax credit.

- **Tax effects for the related party domiciled abroad:** In this case, the foreign company will not be affected, since granting the loan in favor of the national society would not generate direct taxation.

  As noted previously, they will have to apply the financial income tax withholdings at source of 22% (as it was the case even before the tax reform). However, they will be entitled to use its value as a tax credit, in greater or lesser extent, depending on the national legislation of their country and the agreement to avoid double taxation, if any.

Finally, we can conclude that the granting of a loan by a foreign society, in favor of one of its related parties resident in the Ecuador, would have the following tax effects:

- 22% of income tax on the total value of the credit, since being pre-paid dividends the taxable person shall add it to the tax base;

- 22% on the interest that is paid by virtue of the loan, since the tax may not be deducted as expenses or financial costs, when determining the taxable base in the respective return;

- 5% tax on the remittance of currencies , on the principal and interest, which will be paid by the Ecuadorian company when they pay the respective debt and financial expenses; and,

- 15% on the value of the loan, in concept of workers benefits.

- 22% on the financial performance received by the related company resident abroad, through the withholding the taxable person in Ecuador must carry out. However, according to the legal provisions of the country of residence of the foreign company, could be entitled to apply for the deduction or tax credit for the income tax withheld in Ecuador.

6. CONCLUSIONS

The requirements and limitations to the deduction of interest and financial charges prevent the deductibility of an “excessive financial expenditure” that erode the tax base for the income tax, in accordance with the Fourth Action of the BEPS Plan. In addition, these internal measures avoid that double taxation conventions could be used by multinational companies to create a double exemption, and achieve the taxation of operation according to the Arm’s Length Principle, in alignment with the criteria issued by the OECD.

However, this measure was not considered sufficient to prevent the erosion the tax base and, at the end of the year 2014, the organic law of incentives for the production and prevention of tax fraud and its implementation regulations were published. This way, the organic tax law was reformed, and it was stated that when a company grant non-commercial loans to any of its related parties, this operation would be considered as pre-payment of dividends.

Thus, under this legal presumption, against which there is no proof to the contrary, the granting of a loan by a company domiciled in the Ecuador, to one of the related parties domiciled abroad will be taxed as follows: 22% as income tax on the total value of credit granted, paid through the respective withholdings. 5% tax currency remittance on the value of the capital sent abroad; and 22% as income tax, on the interests that are paid under the loan.

In the other case, i.e. when the company domiciled in Ecuador receives a loan from one related party domiciled abroad, the tax burden is even greater. It is taxed as follows: 22% tax on the total value of credit, 22% on the interest that is paid by virtue of the loan, since they may not be deducted as expenses, and their value will add to the tax base during the tax adjustment. There will be 5% tax currency remittance on the principal and interest, when cancelling the respective debt; 15% on the value of the loan, in concept of utility of the workers; and 22% on the financial performance perceived by the foreign society, through the withholding that the taxable person in Ecuador must carry out.

From the above, it can be concluded that reforms implemented through the law of incentives to production and prevention of the tax fraud, which consider the loans between related parties as pre-payment of dividends, drift away from to the Fourth action of the Beps Plan. This is because it does not eliminate the double exemption, and does not prevent the tax base erosion, but it creates a double tax burden, which seriously impairs the transactions between related parties and, as observed, generates serious economic consequences for the country, since it prevents investment in Ecuador from being economically favorable.

In addition, these reforms are contrary to the ninth article of the OECD Model Double Taxation Convention, and distort the purpose and scope of the Arm’s Length Principle and transfer pricing regime, since they modify the legal nature of transactions between related parties, even performed at market value.

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THE IMPORTANCE OF APPLIED PSYCHOLOGY TO OBTAIN THE OPTIMAL SOLUTION IN AUDIT PROCEDURES

João Araújo Marques

SYNOPSIS

Emotional intelligence is considered increasingly relevant in everyday life, especially in the prevention and management of conflicts. In tax examination, it is very important to learn techniques about the control of emotions as a means of promoting voluntary compliance.

This paper summarizes the state of the art in the field of applied psychology, by applying to the forensic context some of the conclusions of the observed works. An empirical case on the management of emotions is presented in the research.

The Author: *Is tax auditor in the field of the fight against abusive tax planning, producing scientific dissemination in this field, as a speaker in tax administration conferences or in higher education. He has a degree in taxation and two post-graduates in tax law and facial expression of emotions; he taught a second edition module and published an article in the Handbook of facial expression of emotion. Currently, in preparing his doctoral thesis in criminology, his field studies deal with ethics in the tax legal relationship and ways to fight against abusive tax planning.*

Content

Today, being tax auditor requires the mastery of a set of multidisciplinary knowledge, law, not only the tax law, but also administrative, civil, commercial and criminal law. Computer science, resulting from a strong investment in information technology, has created a new range of tools at the service of the audit. Applied Mathematics, which are essential for the application of indirect methods of assessment scientifically valid, and therefore less susceptible to the shortcomings that may lead to the annulment of the tax assessment and management of interpersonal relationship with taxpayers.

The approach taken by the tax authorities in computer applications implied the creation of crosses to a dimension never seen before, as it was the case in Portugal and the implementation of the e-*billing system,* which entered into force at the beginning of 2013, as part of a series of invoices emission control measures. To get an idea of the magnitude of this project, around 400 million invoices are registered every month, which are crossed to each other and to other databases.

The controls performed by these tools produce standardized results, working with a double effect. Either the resulting differences are derived from transactions with risk of evasion, and must be worked with a focus on its correctness, preferably on a voluntary basis, or the differences are purely administrative and may originate from the selection of software tools or errors caused by negligence in the fulfillment of an obligation by the taxpayer.

The volume of information produced calls for a highly elevated and specialized, organizational dynamics, which can lead to paradigm changes in the tax authorities' operations procedures. The vision of the tax auditor as someone who deeply analyzes the accounts of taxpayers, document by document, is obsolete, since this type of analysis can be done mostly through information crosses. Hence, the external audit tends to be a more valuable resource for the detection and analysis of situations of high risk of non-compliance, which approximates the tax audit to the judicial authorities and the criminal investigation, or transactions that may produce large illegitimate tax advantages, in the case of abusive tax planning.

Along with the constant changes, tax audit techniques have evolved over time, covering forensic techniques common to other types of investigation, in particular the criminal investigation, with special emphasis on techniques of interpersonal contact with the taxpayer in different contexts, either a stagecoach's collection of elements or a hearing as part of a criminal investigation procedure.

The conduct of this relationship is, apart from any requirement of specific expertise, the key issue to determine the path that must lead to a peaceful, positive and ethical tax legal relationship.

Here there is still a long way to go, since management of the interpersonal relationship with the taxpayer depends mostly on the individual approach intrinsic to each auditor, which seeks to optimize it through his sensitivity and experience.

The need to develop the ability to optimize interpersonal relationships, as the essential condition for the success of the investigation, has led to the development of new scientific fields of study, and to the revitalization of others such as criminology, which has emerged as an increasingly important study area. In addition, the development of knowledge derived from the techniques of practical psychology contributes decisively to providing auditors with a better perception of the emotional context surrounding each particular situation. They may apply techniques of emotion modelling, either on themselves or on the other party, to ensure the best possible results for each process.

1. PROBLEMS INHERENT TO THE NATURE OF THE INVESTIGATION PROCEDURES

The audit procedure, even without being criminal investigation, requires the implementation of investigation activities, which leads to the need to know some of the main risks associated with this type of procedures.

One of the most important issues associated with the operating mode of the investigators, including the tax auditors, refers to the risk of the election of the first hypothesis that seems to be quite good and not carefully identify all possible scenarios and determine the more consistent with the evidence, an effect called *satisficing* (Heuer, 1999). For example, a computer system has detected a particular company is engaged in the importation of goods, but this company does not declare these acquisitions and consequently does not record the income sales of these goods. When their executives are investigated, they deny having knowledge of these operations, filing a complaint to the police against unknown for identity theft. From the proceedings carried out in the investigation, it appears that the goods were sent by express mail to an address completely alien to the company address. The persons who acquired the goods and then sold them on the internet or through a network of resellers were identified and all unrelated to the management of the company. Even if all the tests are going in the same direction, it is important not to exclude the possibility that those who manage the company can have a stake in the existing scheme. In fact, it is only by keeping open all possibilities that you can see the facts from different perspectives and carry out all necessary measures to overcome a possible initial error of analysis.

Another very important problem has to do with the judgment on the quantity and quality of available information, which determines the volume and type of measures necessary to complete the audit. In particular, the development of the application of “Johari window” self-knowledge model to the criminal investigation (Tong, Bryant, and Horvath, 2009) deserves special interest. Throughout auditing procedures to be held, a set of information is obtained, and the auditor has to consider the different variables related to the information. An auditor collects information that happens to be known, being aware of that information. There may be information unknown to the auditor, and he does not know that it exists; there are also situations in which the auditor knows that there is more information, which is unknown, but that he can obtain from those who know, through the interrogation. There is an even worse scenario, in which the auditor believes to know certain information, assuming it as truth,

when in fact this information is not useful and can even be detrimental to the development of the investigation.

To know the existence of such problems is the first step so that these dangers are not a risk to the success of the audit procedure.

2. LIE DETECTION

In principle, an audit procedure is aimed at the discovery of the material truth, and inevitably, we consider that the taxpayer may have an interest in not cooperating in this proceeding and that the lie is a variable to take into account.

Therefore, in the context of a criminal investigation, various instruments are used, such as the Reality Monitoring Criteria that is used in the context of the research to deepen if a story is true or elaborated, involving other aspects beyond the clarity of statements, their liveliness and whether or not they are vague or unclear. In addition, the truth is sought through perception information, by detailing memories of physical and visual sensations; spatial information, taking into account specific details; temporal information, hourly location and order of events. The feelings of the party that is investigated, how did he or she felt; the reconstruction of history, by different orders of events, associating them with the emotions felt in each of them; the realism of the story; cognitive analysis of the questioned facts.

The development of techniques for detecting lies has been a challenge for many application areas of psychology. Although their developments have a strong scientific support, we do not intend to present the technique of lie detection as an easy, automatic and indiscriminate application. The first condition is at the same time the individual' idiosyncrasy for the regulation of emotion, as there are people who lie very easily, without showing it clearly on their face or behavior. Usual stereotypes associated with the lie, such as avoiding eye contact and the systematic presentation of signs of nervousness, are not in themselves conclusive, since there is a symbiotic relationship between these signs and lying. If it is true that any person showing these signs could be a sigh that he is lying, it is no less true that the absence of these indicators does not mean at all that the individual is not lying.

The scientific development in the facial expression of emotion argues that the analysis of facial expression, through methods and techniques with scientific evidence, can be an asset for the detection of lies (Freitas-Magalhães, 2011). Since the face shows expressions that are the result of involuntary muscle movements revealing a mismatch between what is really felt and what is intended to be expressed. This is because the brain cannot explain two expressions simultaneously, since the true expression first appears on the face, completely escaping the control of the individual, and only then, even if it is in microseconds, appears the expression that the individual intends to present as true.

According to this line of research, founded by Paul Ekman, in the face, lying is reflected in a decrease of head movements, increase of pressure of lips, including biting and licking the lips, more the jaw movements and micro negative expressions, which are translated in general, in a face of less pleasant aspect. Analysis of the eyes movements may be decisive in the detection of lies. The indicators are the intensity of the gaze, the dilation of the pupil due to the contraction of the muscle of the iris dilator, associated with obvious emotion of contempt, the incidence of look, more evasive, the inclination of the gaze, to below and above , and the laterality of the gaze, especially looking at profile. When a deviation of gaze occurs during the development of a lie, then might be followed by a look of toward the interlocutor, to assess whether the attempt at deceiving was successful.

Another important aspect is the identification of a smile as true or false; this is very important in the detection of lies, since the smile is a weapon easily used for deception. A smile is in its nature the expression of positive emotions, but when it is used artificially, it seeks precisely to show a sense of comfort that in reality does not exist. It may hide the effective absence of emotion or the existence of negative emotions, trying to make believe that the individual feels a positive emotion that it is not true. A real and genuine smile is associated, among others, with the muscle *orbicularis oculi* that surrounds the eye cavity and plays a decisive role in the closure of the eyelids, joining the appearance of wrinkles on the outside of the lower eyelid that arises directly and they are real features of the smile. For example, for a better understanding of the function and the movement of the muscle *orbicularis oculi*as, which is responsible for the wrinkles of expression known as Crow's feet, which are evident in the face in situations of true smile, closely linked to the positive emotions of joy. It also allows understanding how it is possible to analyze the facial expression of emotion as a reliable scientific instrument because the analysis of these movements allows determining how genuine a smile is. In a feigned smile, the Crow's feet do not appear, the cheeks do not rise and the eyes become less tight. A true smile uses more muscles and upper eyelid bends a little on the eyes.

The relation of coherence between the verbal and non-verbal language serves as a valuable indicator of the validation of the truth or lying. A prime example would be an individual saying a yes while shaking the head negatively, or vice versa.

Another factor worthy of special attention in relation to the taxpayer, is the correct perception, not only of what is said, the language, but also as how it is said, the paralanguage, namely tone of voice, fluency, pauses and the speed of the speech. The lie may also be revealed in the speech when the intonation of the voice does not match what the individual says, for example, when the force of what is said is not consistent with the strength of what is said. Variations in the intensity, frequency and volume of the speech are also relevant when they are uncoordinated with variations in the produced language, whose fluidity tends to be lower in the lie, making the speech more slowly and with greater vocal tension and the voice can sounds more acute. There is also a biological for this explanation since who lies may have the vocal cords more stretched than normal, causing the thinner, weaker voice. Thus, by way of compensation, it is also common that the lie is associated with a tone of voice in crescendo, which may be subliminally associated with the aspect that if is spoken at a higher pitch it spreads more belief that what is said is true. A little illustrative and little detailed speech with the repetition of words and expressions is also connected also to lie , in order to avoid inconsistencies that may be prohibited of verbal language, but can be detected in the facial expression. The pauses also deserve attention, which increase in number and are increasingly longer when lying. They can also cause the emission of sounds like sighs, (observed by Castle, 2011), dryness in the mouth, which can cause choking or swallowing dry, and producing gestures, such as the fast hiding of the mouth with the hand, which expresses the conflict of the brain between the true emotion to express and having to represent a falsely constructed expression. You can even include the touch of the nose, because in moments of tension occurs an increased sensitivity of the nasal mucosa, one shoulder and rises slightly.

There is almost a consensual view that nonverbal communication plays a very important role in the discovery of a lie. Thus, to understand the message really conveyed, and not the one that the person pretends to convey, analysis of gestures, posture and movements of the body, the distance at which it is placed, and its variations, as well as the face and the movement of the eyes are all elements that cannot be neglected.

3. THE IMPORTANCE OF EMOTIONAL PERCEPTION IN THE EXAMINATION - ROLE OF THE TAX AUDITOR

The paradigm of evolution in the fight against fraud and tax evasion has focused mainly on the development of the techniques of digital information, with very positive results. Nevertheless, it is equally important that the level of development of the interpersonal relations between the representatives of the tax administrations and taxpayers evolve in such a way that whenever possible, decisions between the parties are taken under a logic of common interest, a concept often devalued. It seems paradoxical indeed, that a line of common interest can lead to the optimal solution: the tax authorities apply a quick and effective justice, and the taxpayer receives the lowest possible penalty.

In this regard, the tax auditor set the ethical level of the relationship to be established with the taxpayer or their representatives. This is why it is important that tax auditor obtain better understanding of context information available, and more than finding or detecting any lie, he should be able to assess the emotional state of the taxpayer. After this first approximation, which should enable us to understand the motivations of taxpayers over how to deal with the procedure of audit, the auditor should be prepared to use modeling techniques of emotional behavior in order to bring to the taxpayer to a more assertive and beneficial behavior. This is not only for the examination, but also for themselves as there may be a correction of the fraudulent behavior.

Take, for example, that the first contact, the auditor detects that the taxpayer is in a State of anger. The examination can then adapt to obtain from the suspect an emotional experience that serves better the procedure of auditing. In the sense of an evolution towards a framework in which predominates a more positive emotion, using strategies that lead to a decrease of the anger felt by the taxpayer. Alternatively, if that was the best way, manage research in order to exploit this anger, to obtain the desired information or evidence that the information transmitted is not true. The management of the power relations that we will see in the next chapter deserves special attention.

Similarly, if the auditor perceives emotions more complex and difficult to identify in the taxpayer, such as shame or guilt, he can establish strategies that correct the evasive behavior, promoting a more positive emotional state, which in the modelling of these emotions can often be achieved in a subliminal relatively simple way. This has very positive results in terms of voluntary regulation of this taxpayer to obtain optimal solutions, with benefits for both parties, which initially are not seen as possible in the relations of this type.

Emotional perception is a key part for audit procedures to become quicker and more efficient, since a proper perception of the emotional context can be molded to obtain an effective remedy to the breach, allowing seeing clearly and objectively the inherent reasons and benefits associated with this regularization. In fact, the real possibility of molding the emotional framework brings a great ethical responsibility for the tax auditor. The taxpayer cannot stay doubtful about the accuracy of the correction, i.e. it must be made clear that the rectification is inevitable, this being a condition for the use of such strategies. The establishment of a new emotional context requires that solutions be presented, safe and fair for that taxpayer to regularize his tax situation, and at the same time immediately identify the benefits of voluntary regularization, clearly establishing a parallel with the penalties to which he is exposed if he does not regularize his tax situation.

Therefore, a focus on molding of the emotional state should therefore be carefully used when there is no absolute firmness in the regulation to carry out, very common situation when there are no sufficient elements for direct evaluation of the tax situation of the taxpayer. In these cases, the this type of techniques should only be used for obtaining elements that allow to perform a logic of quantification of breaches, reserving the presentation of the values for a time in which solid foundations to support this quantification. There are situations in which it is tempting to reach an agreement with the taxpayer, when the relationship cost-benefit of the procedure is pondered by the auditor; he can conclude that the development of further proceedings, depending on the expected result, will be uneconomic. Taxpayers also have, a more or less developed perception of the emotional framework that surrounds them, and some confusion can arise in the proceedings, which distort the concept of promotion of voluntary adjustments, with the possibility of negotiation of the acceptable taxation values.

This subversion is very risky, mainly at the level of the perception of the power relationship between the role of the tax auditor and the role of the taxpayer, which may result in the taxpayer not perceiving in a clear and objective manner that he committed illegalities, and that these breaches are legally punishable. He could therefore understand these situations as a better alternative for the fulfillment of his legal obligations, if the value agreed was inferior to what would be obtained, if the taxpayer had fulfilled his tax obligations.

4. MANAGING THE POWER RELATIONSHIP

In an audit procedure, the tax legal relationship is governed by an unbalanced power ratio between the authorities and taxpayers, only returning to balance at the facilities of the administrative or judicial complaints procedure. In fact, the prerogatives of the tax audit compel certain behaviors from the taxpayer. If they do not show them, in addition to not preventing enforced collection, they face the corresponding sanctions.

The legal principles of the Portuguese tax system defines that the audit proceedings must be appropriate and proportional to the objective, that taxpayers must have an approach of cooperation for the pursuit of the truth, and that there is a reduction of sanctions for taxpayers who regularize their faults.

In theory, both parts of the investigation have a common interest in achieving optimum solutions, avoiding unnecessary legal disputes, so the procedure should be conducted in a fair and efficient way, ensuring a correct determination of the facts and promoting the voluntary adjustment of delinquent taxpayers.

In carrying out the proceedings, the auditor has a psychological power advantage over taxpayers. This must consciously be limited, if it can be guaranteed with reasonable certainty that the investigation will be able to produce the discovery of the material truth and, if necessary, collect the evidence that lead to repair effectively the detected breach, even without the cooperation of the taxpayer.

This unbalanced power relationship can cause two problems: On the one hand, the auditor can abuse of this advantage. On the other hand, the taxpayer may perceive that the auditor could not use the relationship of power in its favor, either by the excessive display of power, or by an inability to exercise legal prerogatives conferred on him by this psychological advantage. The principle of proportionality requires, legally, the management of the power relationship, so the auditor must oppose proceedings for which there

is no basis, as for example, to create a scenario of apprehension all the assets, or widespread lifting of banking secrecy, when there are no facts that would justify the legal application of these measures.

This logic of power does not follow a hierarchical logic of power associated with the status but rather a power legally assigned to an auditor that will be close to a taxpayer. The taxpayer is confronted with a situation in which he did not want to be, but that cannot prevent, and where, of course, he knows that he will be in a subordinate position. What should not be confused with the absolute control, since the authority vested by law, also has its well-defined limits.

The management of power relations has received much attention in the application of psychology. One of these studies (hunting, Tiedens, & Lee, 2011) refers to the implicit or explicit forms of power. They have their different effects on people, especially if the explicit forms of demonstration of power, such as the best office or the best parking, were beneficial to the Organization studied, or, if these signals should be controlled in such a way that everyone knew who held the power. Without the need for its explicit visibility, giving everyone a similar treatment to help people with power to resist the negative stereotypes, such as authoritarianism, insensitivity and even cruelty of certain specific situations. The authors conclude that when the explicit demonstration of power contribute to people with more power to remember the expectations that the Organization has upon them, these are beneficial, leading to these people to resist to the negative power stereotypes.

While the study is not defined for a tax audit context, dealing with unbalanced power relations, it is interesting to note that, in fact it is not about having power but about knowing how to use it. For example, a cordial and correct identification at the beginning of the procedure, with the strong demonstration of identification card, can have the dual effect. On the one hand, the auditor can make use of that Act to remind its mission as an agent in the service of the public interest. On the other hand, the taxpayer sees certainly defined his place in power ratio, offering the possibility to keep the ratio of power less unbalanced as possible through their collaboration.

This simple initial gesture may be decisive to establish, therefore, a perception of ethics that will be predictable during the audit process. In this relationship, in which both know that they are at different stages of the levels of power, it is very important for the auditor to use this power in the most appropriate manner, depending on the emotion expressed by the taxpayer.

Hence, to obtain a more effective regulation of emotions involved in a given context, the auditor must take into account that an exaggerated demonstration of power, without full control of the situation, may result in contempt or ridicule of the taxpayer. This can lead to the auditor being affected by the emotion of anger, leading to the temptation to show that he has real power, showing it disproportionately and thus destroying the possibility of achieving an optimal solution, creating a conflict between the tax authority and the taxpayer.

Above all, the auditor must have the power to lead specific procedures and this requires the ability to make decisions in a systematic way. When decision are taken by someone who feels angry, there is evidence (Lerner & Tiedens, 2006) that in such cases, impulsive decisions may be taken and less likely that the angry person stop to think and carefully analyze the situation. The authors of this work conclude with a word of Aristotle, who taught that those who make decisions influenced by anger might have difficulty at deciding at the right time, for the right reason and in the right way.

Once more, the psychology offers important lessons for the contemporary tax auditor: A demonstration of power out of time or excessive can lead to an unwanted emotional experience, distorting the assessment of the situation, causing major problems and hindering the

ability to assess in an objective and rational way. A position higher on the scale of power, can lead to an excess of unwanted confidence, a false sense of control and a wrong evaluation of the behavior of the taxpayer, situations that create a high risk that the procedure ends with unintended results.

Of course, this does not mean that an auditor should never express anger, either by facial expression or by his behavior but it means that any emotional state of wrath of the auditor should be controlled and can be acceptable only in specific circumstances. A state of anger as modeling tool must be always absolutely controlled; otherwise, the auditor is dominated by this emotional state. About the impact of the use of an expression of anger in the context of negotiations, there is also evidence (Sinaceur & Tiedens, 2006) that the expressions of anger can be advantageous in the context of the negotiations, but only if the recipients believe that there are no valid alternatives. This study confirms that these strategies should be used with caution, recalling other studies showing that expressing an emotion can lead to a stimulus that disclose what is actually felt. It should be noted that the strategy of expressing emotions might ultimately result in a sensory experience of anger, which, as demonstrated, may condition any type of cooperation of the taxpayer.

Thus, regardless that the relationship of power naturally is unbalanced, the use of expressions of anger by the tax auditor should be limited to situations in which they have absolute control over the situation or when the only way in which the taxpayer secure their own interests is through effective collaboration. For example, this strategy can be used in cases of fraud investigation, when one of the involved taxpayer is caught and there is clear proof of his guilt, but there is no sufficient evidence to accuse other people involved, due to lack of clear answers and omission of facts, is that trapped taxpayer possesses.

In conclusion, the correct use of the advantage in an unbalanced power relationship is a very useful tool to provide mutual satisfaction situations, but only if managed carefully, because the excessive demonstration of power can lead to negative results. In fact, the emotion of anger modeling strategies can contribute to a reduction of conflicts and disputes, helping to promote more fair, effective and efficient audits.

5. RECOGNIZING AND MODELING EMOTIONS

The ability to recognize an emotional framework and model the emotions perceived, is almost another dimension of power. It is not assigned by the law but by how the taxpayer will react to the first contact with the auditor, which can be seen to increase its sphere of power based on its ability to recognize the emotional state of the investigation, for example If the taxpayer seems to feel guilty, distressed or simply embarrassed.

Hence, to defend the importance of a better understanding of the area of control of emotions, i.e., the capacity that an auditor has, within a framework of tax audit, to influence the emotions he feels, when he feels them and how these emotions are experienced. This ability to regulate emotions can be decisive for the development of an audit procedure, and it is important to understand that an essential condition is to get out of the emotional context, since being affected by different emotions, although in similar scenarios, the experience can be radically different.

This phenomenon is known as a cognitive alteration (Gross, 2008), in which through the ability to alter the way in which the interlocutor thinks the situation or the way in that the interlocutor

thinks of the situation or how the demands of such a situation is handled, the emotional context can be significantly altered. Adapting the author's example when an auditor is questioning a taxpayer, his first reaction might be to release a bit of frustration. Rather than consider this behavior as a personal attack, probably resulting in a context where anger could reign, it can cause a cognitive change to establish strategies that allow understanding why the taxpayer feels threatened or concerned about their situation.

Avoiding in the first place that the dominant emotion is anger, it is possible to define a more favorable emotional context, since different ways to address the investigation are open, transforming a somewhat negative environment in a new emotional framework, which may lead to more collaboration by the taxpayer.

Such an approach should not be seen as a sign of weakness against the need to demonstrate the effectiveness of the power of the auditor. It is rather a way of ensuring that the audit is carried without relying heavily on this unbalanced power relationship, especially because the show of power can lead to unwanted results as we have seen before.

6. CASE STUDY - EMOTIONAL CONTROL IN THE TAX AUDIT CONTEXT

To strengthen the importance of these issues, a case study is presented, taken from a true story in the context of a tax audit of a taxpayer whose collected evidence pointed as having led and implemented a tax fraud scheme.

After a few months of intensive research, evidence was gathered that this taxpayer had created a fraudulent scheme. He had simulated carrying out an activity in another country of the European Union, without considering himself as subject to tax in Portugal. He had declared all his VAT transactions as intra-union purchases, without supporting the payment of taxes in the national territory or paying in another country, or the intra-union transactions, considering that the goods and services were from another country, exempting the customer from the economic tax burden.

It was understood, after obtaining all the evidence, that it was time to question the taxpayer and confront him with the facts. This case study seeks to portray the emotional framework involving this procedure and the changes that were introduced on basis of the objective that had been recommended for this activity - obtaining the optimal solution. Like any empirical study in the area of emotion, this case study presents the usual weaknesses of an image provided by the tax auditor, depending on what was his emotional picture perception and the modeling strategies that he sought to use. Therefore, this case study must be seen as a way of demonstrating the advantages of being able to identify emotions and strategies of modeling other emotions, different from the perceived, with the presentation of scientific data that support the strategy adopted.

Arriving at the appointment, the taxpayer was accompanied by an attorney and started with a neutral expression, but his behavior was weak and half-hearted and his hands were sweaty. He seemed trying to figure out all the information already obtained in the audit and how serious was his problem, trying not to show any emotion.

However, he was caught lying in the first question. He was then warned that the situation could only worsen with this type of behavior. At that time, the taxpayer paused, swallowed, and seemed to experience shame. In seconds, his speech became entangled by a mental blocking and he immediately lowered his look, avoiding eye contact. He closed his mouth, almost as if to

bite the lip, and then fixed his eyes on a distant point. Finally, he placed his hands on the face, almost as if he were trying to hide, in order then to re-establish contact, showing a strange smile.

This was the perceived emotional context seconds after having been confronted with the fact of being lying. To be able to introduce emotional modeling strategies is essential to be able to identify the predominant emotion in a particular context, which sometimes is an extremely complex task, especially when it is necessary to know the data that identify an emotion to the detriment of another.

In this case in study, the first impulse was to consider that the taxpayer was ashamed of being caught lying. Was he actually shameful? Could it not be the expression of other emotion, such as guilt?

The ability to give a correct answer to these questions can provide a significant advantage to the investigation. It allows the auditor to introduce techniques for driving the procedure towards an optimal solution for the tax authority. It allows repairing the infraction and reducing the possibility of conflict, but also offering the best possible solution for the taxpayer giving legal avenues available for the regularization and guidance so that he can benefit from reduced sentences if it collaborates with the tax authority. Either shame or guilt, these emotions may lead the individual to try to correct the reason that led to them. However, there is a very significant difference; Shame is characterized by a submissive and passive reaction in the way to repair the breach. Guilt is characterized by motivating a more proactive behavior in the individual (Xu, Begue, & Shankland, 2011), sometimes taking him to take a role of great activity and effort to overcome the flaw that led him to feel that emotion.

Another very important aspect, regarding shame, is that the auditor should be able to determine if the shame felt by the taxpayer is due simply to the fact of having been captured, regardless the fact of having violated the law. This has consequences at the time of introducing emotional regulation strategies, if the reason for shame lies mainly in the fact of having violated the law, repair solutions can be offered immediately. By contrast, if the taxpayer feels embarrassed only for having been caught, the following strategy must be carefully prepared, as it is predictable that once his feeling of shame is over, in this case the presence of the auditor, he may totally changes the way of reacting to the problem, and can move easily away from any commitment.

This shows the importance of a good recognition of the emotional framework to define the strategy to follow, since different emotions tend to lead to different behaviors. If the dominant emotion is guilt, the likelihood that the taxpayer wants to work to regularize his breaches is much greater than if the taxpayer feels only ashamed because here he will assume a role more submissive and dependent on external stimuli. Then, it is fundamental to remember that shame depends on an approach, and tends to diminish and even disappear. Therefore, it is also essential to identify the approach of shame, since this is the feeling the taxpayer wants to eliminate.

The transition between the emotional images is also very difficult to perceive. In this case, it began by detecting signs of shame, resulting from the fact of having been caught lying. In the following moments, it was important to realize if the perceived shame was only due to this situation and if a wider emotional context including the feeling of guilt was involved.

This ambiguity is due to the antecedents of each of these emotions. In general, the shame is associated with small and innocuous violations of social norms, and is determined by the judgment that the individual thinks others may make about this behavior, and the potential damage that this situation can create in their social status. By contrast, guilt is typically present in situations in

which the individual inflicts damage to others, including the breach of obligations and lying, which makes the individual to react immediately to repair the error (Keltner & Buswell, 1997).

On the other hand, there is scientific evidence that shame can be recognized in different cultures (Tracy, Robins, & Schriber, 2009); to assess guilt there is no pattern of behavior. A set of signs is associated to shame, allowing its recognition in facial expressions, body language and behavior. There is even evidence pointing to the existence of a sequence in the demonstration of the state of shame (Keltner & Buswell, 1997). These include avoiding eye contact, a movement in the lower part of the face for a smile, a feigned smile, identifiable by the movement of lifting the corner of the mouth, but without lifting the cheeks and the appearance of expression lines outside the eyes, which are only produced in spontaneous smiles. A new movement in the lower part of the face occurs for the control of the smile. Then, the head moves downward and there is a lifting of hands to the face in nearly a quarter of the cases.

As described in the case study, the taxpayer showed a behavior compatible with shame, but not eliminating the guilt, which does not have a specific representation. However, the antecedents of emotion were more consistent with guilt. Therefore, it was necessary to refine the perception of emotional part that was actually concerned.

According to the research project “Research Project on the Social Psychology of Embarrassment at the School of Psychology” of the University of St. Andrews, there are three essential ingredients for shame. They are defined be the process of drawing unwanted attention to ourselves, because of a fact attributed to us: Existence of an audience; making a negative impression, and a violation of rules take place.

In the study of this case, the existence of an audience should be seen in two scenarios: On the one hand, the audience, made up of the tax auditor and the lawyer, who presented himself as a childhood friend of his mother, who was surprised by the severity of the situation. On the other hand, the presence of the lawyer, who was not of his trust, but of his mother´s trust, could mean a potential risk of dissemination of information, increasing the risk of existence of a future audience, within the perimeter of intimacy and comfort. This second aspect, combined with the fact of having been caught lying on the first question, caused an unwanted attention due to the surprise shown by his lawyer, who ceased being a potential support to become an unwanted audience. It was not only in that situation, it was also a risk factor, since at least his mother would now know in depth the gravity of the situation.

In a context of audit, catching the taxpayer in an obvious lie, when he did not expect it, offers a significant advantage in the strengthening of the relationship of power that by nature is already unbalanced. It allows the auditor to experience different approaches, with a less immediate risk of conflicts, if the emotional conditions can be controlled in order to maintain this advantage.

However, it is essential to be able to distinguish the implications on the assumption of a certain emotion, shame or guilt, to the detriment of another. We must determine if the emotion felt by the taxpayer derives from having violated law, i.e. the criminal aspect, or is derived from the fact of having been captured, the discovery of an ineptitude, with implications related to the social aspect.

The knowledge taken from the works and studies in the area of the psychology has shown that all the ingredients were associated with a feeling of shame, which associated with facial expressions and body movements of the taxpayer made to admit an emotional picture of shame and not of guilt. It was notorious that this emotional picture emerged when the taxpayer becomes aware that the scheme that he had used had been detected, that the auditor was already fully aware of the facts of the case. Moreover, that the lawyer who had come reluctantly with

him began to realize that this could be a set of serious behaviors, and that the presence of this lawyer could jeopardize his own social status. Shortly after showing facial signs associated with shame, the taxpayer assumed a submissive stance, as he is expected of this emotion.

The first consequence of this framework is to take into account that it is unlikely that the taxpayer autonomously define strategies to repair the breaches, which would be a feature of guilt, knowing that any possibility to fix these problems by the taxpayer will require tighter control by the auditor. We must also understand two different situations: The practice of the crime itself, which leads to future consequences, and the fact that the taxpayer has been caught, which was the central theme of the revelation of emotion. This could bring immediate consequences in terms of social relations, since the scene in question carries the present risk of proliferation of information through the attorney. More than this role, he assumed the role of someone sent by the mother. This certainly could seriously harm his image, before not only his inner circle, his family and friends, but also before his close social group, because he lived in a small town, where everyone learns from everyone and feels free to create his own judgment about an event in particular.

The auditor must then try to create strategies that lead to this submissive behavior that becomes a proactive behavior directed to solve the real problem, the tax violation. This can be achieved if the taxpayer is aware that it is still possible to control the immediate consequences associated with social damage, refocusing the attention of taxpayers in the regularization of the legal problem.

In this case, after concluding that it was an emotional context in which the shame predominated, focusing on the fact that the taxpayer had been caught, the first strategy was to try to model the emotion of the taxpayer, giving him the opportunity to remove one of the focuses of the emotion. Therefore, the taxpayer was asked if he intended to continue with the investigation in the presence of the lawyer. The lawyer participated in his internal relationships and had a social status in their community that the taxpayer could not reach, by which everything that he could disclose would have a much deeper impact amid its proximity, than whatever the taxpayer could respond, within that environment.

The goal was then to reduce the presence of shame and try to focus the attention of the taxpayer on the best resolution of his criminal problem, by removing from the equation the risk concerned immediately to the taxpayer, i.e., social risk who ran if that lawyer knew the true extent of the problem under investigation. This concern is presented as “spotlight effect”, since people tend to overestimate how their behaviors are valued by others (Gilovich, Medvec, & Savitsky, 2000). It made the taxpayer realize that the judgment of others about their actions does not depend directly on the fact of having been captured, but directly of their conduct in these circumstances, with consequences that will be reflected on the penalty to be imposed if subjected to greater scrutiny by their close pair group.

This strategy proved to be very successful, because while the taxpayer was in a submissive position intrinsic to the dominant emotion for him, granting this opportunity was a signal that might still be possible to solve the real problem, releasing him from that irrational concern of endangering their social status. Actually, it was made clear that now that he was alone, ha had no need to worry about the presence of a third party who did not represent a potential solution for the taxpayer, but rather a potential problem. This drastically reduced the risk of dissemination of the problems he had in hand, reinforcing that he was given one last chance to deal with offences he had committed, and that the assumption of a commitment to repair these faults could have exactly the opposite effect, since it would reveal a brand a positive character.

The decision to conduct of the procedure is thus following scientific evidence (Darby & Harris, 2010) that when someone feels embarrassed, according to this emotion he tends to exhibit very specific behavioral standards. He turns to look in the eyes of his partners, which may suggest that the person who felt this emotion soon after seeks information that will allow to perceive the reaction of his interlocutor to outline a strategy to choose the shape of the most successful recovery. At this time, the tax auditor should be aware of these situations and understand that this type of reaction is perfectly natural, maintaining the necessary caution, because there is also scientific evidence (Keltner & Anderson, 2000) which warns that the manifestation of this kind of emotion can create greater empathy with their partners. This simultaneously create a higher probability to excuse the breaches of the other , so shame can, from this perspective, almost serve as a means to facilitate the resolution of problems, because it can trigger a positive reaction at others for their benefit. It must not be forgotten that if the shame is the dominant emotion, it is important to identify it to clarify that the presence of this emotion is real, and not a strategy of the taxpayer opting for a role of subordination only to please and fool the one who is in a dominant position.

In the event that the auditor has these concepts in mind, the interrogation can be oriented to make it look that they can contribute data to the resolution of the cause of shame, making this taxpayer - being in a position of submission - someone grateful for the provision of a solution. This would increase the chances that the investigation not only success with a greater chance of obtaining the cooperation of the taxpayer, but also that he really works to rectify the errors that have been identified.

However, we should never forget, in relation to the case study, that the relief offered to the taxpayer, by retiring him from the audience he did not like, is directed to the subsequent resolution of the tax problem. It is not a form of giving an easy way out of a problem, especially when this is unrelated to the investigation.

Another very interesting research line is related to the application of emotion in psychotherapy (Greenberg, 2010) that follows the conceptual line of Spinoza that emotions cannot be suppressed or eliminated, with the exception of an opposite emotion that is still stronger. It presents five principles to consider when working on emotions: The perception of emotion; the emotional context and the expression of emotion; the emotion regulation; the reflection of the emotion, and the transformation of emotion. This last one is considered the fundamental principle for changing emotional, since the transformation of an emotion may only occur when it is replaced by another, more suited to achieve the purposes. Adapting these teachings to the specific context of the tax audit, it is a fact that there are strategies that can be adopted in order to promote a change in the emotional context.

The second strategy, trying to adapt the teaching of Greenberg, is based on the premise that the research would have more chance of success if we could model the emotion of shame, changing it into a feeling of guilt. Because the feeling of shame is almost ephemeral, so its effect would probably end during the investigation, and inevitably another emotional state surges. It was crucial to strengthen the need to provide the taxpayer with an absolute awareness that voluntary regularization was the optimal situation. That would be achieved if the emotional state to shape in this context were the emotion of guilt, which would offer further guarantees of success. Because as discussed, the guilt not only infuses a greater and more enduring need to address the approach to emotion, but also brings a dynamic impulse which implies that the individual carries out this need in acts and effective efforts to repair the breach.

The implementation of such a strategy, in the case under study, and given that the taxpayer showed much concern about its status in social

trustworthiness, began with the explanation of the functioning of the investigation process and the inevitability of investigating people who had close with him. Moreover, that, in the end, the process will probably end in an indictment under the terms of a court.

It is also at this time the system of sanctions should be clearly explained, stressing that this kind of consequences is not only much worse than any social condemnation, but also not avoid, by contrast, since if applicable imprisonment this social condemnation would reach levels far beyond what the taxpayer now feared widespread. Now, it mattered little if it had been captured, because he had indeed violated the law, and that it was in the solution of this problem the taxpayer should be centered.

At this stage, it is also important to address the General principles of the tax system, the purpose it serves and its essential importance for the society in general. This focus on the origin is a valuable tool for the modeling of a sense of guilt, if there is no doubt, for the auditor or taxpayer, that he is guilty.

However, this is only a first step in the implementation of a third strategy, which seeks a context of positive emotions. Therefore, it should always be reinforced that there are alternative ways within the existing legal framework, with minor penalties, and that the optimal solution depends on the taxpayer´s choice. In addition to this rational approach, an emotional approach was used in order to induce a positive expectation of the result, centered on the option for the taxpayer can achieve this optimal solution. It must be taken into account, as he has been said, that this type of strategy requires a maximum ethical level; unrealistic scenarios, unlikely or beyond the control of the auditor, should never be presented.

Presenting the worst-case scenario and the best scenario should always be in mind this need, since the tax auditor should focus, in these circumstances, on the basic principles of the tax system and the emotional context, and must be particularly strict, because creating false expectations in the taxpayer can have disastrous consequences.

The combination of these three strategies for the transformation of the emotion of shame into guilt and, from this last one, into a context in which the positive emotions predominate made possible that the first consultation became the key moment for the resolution of the tax audit. It managed to reach the optimal solution in which all the breaches are regularized and the fines paid by the taxpayer, minimizing any social consequence and, in accordance with the law, avoiding criminal charges that could result in imprisonment.

7. CONCLUSIONS

The tax audit is an extremely complex and demanding activity that requires a great effort by the auditors. They must be attentive to a set of problems related to the investigation.

The psychology area offers approaches distinct from those usually considered, with breakthroughs in areas such as the detection of lies, able to identify a set of behaviors and facial expressions that help to understand if the taxpayer is lying or telling the truth.

In spite the fact that the auditor is an unbalanced power relationship, he or she must be cautious when showing power. The control of anger by the auditor, and the disclosure or attenuation of this emotion, when perceived by the taxpayer, is a strategy of emotion modeling that must be used with extreme caution, because it can bring disastrous consequences.

This work also is intended to draw attention to the evidence that a tax audit can be performed better by the auditor, if he or she manages to perceive the dominant emotion and implement strategies for controlling the emotional perception as a key instrument to achieve successfully optimum solutions in audit procedures.

The empirical presentation presented through the case study shows that if the auditor detects shame as dominant emotional perception, strategies aimed at shaping this sentiment toward guilt would be an intermediate step for a more positive and favorable emotional context. To impart justice through the total repair of the breach and the corresponding fines, and at the same time, in view of the taxpayer´s effort for such repair, guarantee him or her the lowest possible penalty.

Therefore, it is concluded that knowledge of the emotional context and modeling capacity are important tools for the contemporary tax auditor, to achieve optimal solutions in the context of the tax audit, in a more recurrent and effective way.

Therefore, the tax authorities need to think about the need to introduce a significant training component in the area of emotion, not only through an increase in the theoretical training, but also with practical actions of simulation of emotional contexts, training tax auditors in the use of a potentially powerful tool to obtain optimal solutions.

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THE EVOLUTION IN THE ROLE OF EXCISE TAX STAMPS FOR SPECIFIC CONSUMPTION GOODS

Nicola Sudán

SYNOPSIS

This article examines the evolving components and expanding role and growth of excise tax stamps. What were once unsecured little pieces of paper for tax collection purposes, are now transforming into high-tech encrypted, multi-layered devices, which perform not only a tax collection function, but also the functions of product authentication and track and trace. This evolution has a lot to do with increasing requirements for more robust stamps to fight illicit trade, as well as looming international regulations such as the WHO FCTC Protocol, which has put the spotlight on tobacco tax stamps as potential carriers of the track and trace technology imposed by the Protocol.

The Author: *Is the editor of Reconnaissance International's monthly newsletter Tax Stamp News™, as well as director of the annual Tax Stamp Forum™, and principal researcher and writer of Tax Stamps: A Technical Study and Market Report (on which this article is based). Prior to that, she had marketing roles in both the security printing/authentication industry and the tobacco industry.*

Content

More tax stamps are produced every year than any other security-printed item except banknotes. Known by a variety of names (excise stamps, duty stamps, tax seals, banderoles), these are the "weapon of choice" for many governments around the world to secure the valuable revenue derived from customs and excise duty on tobacco and alcohol, acting both as a record of payment and a barrier to the distribution of illicit products, whether in the form of contraband or counterfeits.

Every year, about 170 billion tax stamps are used in over 80 countries. The combined forces of population and consumption growth continue to push these figures up, but other factors in the growth of tax stamps include their adoption by new countries, and the extension of existing stamp programmes to new products.

Increasingly, the key functions of any tax stamp, whatever form it takes, is to provide fiscal verification (ie. that tax has been paid), as well as supply chain visibility and product authentication.

As a result, the demands of tax stamps have become considerably more complex and one of the most striking advances is the extent to which traditional stamps are being replaced by programmes combining such stamps with advanced track and trace technology, monitoring and audit systems.

Because tax stamps offer these additional benefits – which are important in the fight against the growing global problem of illicit trade – the issue of tax stamp use has now become the subject of international policy. The WHO Framework Convention on Tobacco Control (FCTC) and its Protocol to Eliminate Illicit Trade on Tobacco Products is likely to have a significant impact on the shape of tax stamp programmes of the future.

1. THE ROLE OF TAX STAMPS IN RECOVERING EXCISE TAXES AND FIGHTING ILLICIT TRADE

1.1. Why use tax stamps?

The combination of high consumption levels and high excise tax rates continues to feed the demand for illicit products. Excise tax stamps have been in use for over 200 years; but it was only 20 years ago, when global trade began to appear and border controls came down, that many countries started using them for the first time, especially in Eastern Europe and the Former Soviet Union. The stamps gave governments an immediate solution to regain control over the goods – mainly cigarettes and spirits – being sold in their territory; they provided visible proof that excise taxes had been paid, and allowed counterfeits to be distinguished from genuine products. Without this control, the surge in illicit trade that resulted from the politico-economic turbulence of the 1990s would have continued unchecked.

Tax stamps are not the only approach for addressing tax recovery and illicit trade; however, as a key element used in combination with other measures such as strengthened enforcement, tax stamps have led to good results for governments and other stakeholders, results which have in turn driven their continued growth and technological development.

Consumption levels are key drivers of tax stamp programmes. For example, the global consumption of spirits increased by 27% between 2005 and 2010, reflected by a corresponding increase in spirits tax stamps. Although it may seem strange, regions such as North and Latin America boast some of the most sophisticated tax stamp and track and trace systems in the world, even though cigarette consumption in these areas has decreased substantially over the last 20 years. This is because excise tax continues to raise significant revenues for governments – as long as there are systems in place to secure and enhance those revenues. And although excise tax as a percentage of total tax revenue has also been in general decline over the years, it still represents an average of almost 8% of total taxation, in OECD member countries.

1.2. Additional taxable products

While tobacco and spirits continue to be the main product groups subject to so-called "sin taxes", an increasing number of other products are also being brought within the scope of tax stamp programmes. Several countries have now extended their programmes to include not only beer and wine, but also soft drinks and mineral water. In a few countries, the scope has been broadened even further – covering such commodities as CDs and books, mobile phones, luxury foods, and even detergents and engine oils. Such products may or may not carry traditional stamps. But what binds them together with tobacco and alcohol products are the unique markings they carry allied to a system for monitoring, auditing and enforcement of tax collection purposes.

The increasing range of taxable products and efforts to collect the tax leads us to perhaps the greatest change of all over the past ten years – namely the financial tsunami which hit the global economy in 2008. The repercussions of this meltdown on national economies cannot be underestimated and has led to a much sharper focus on improved tax collection as one tool in securing debt and deficit reduction around the world.

1.3. How tax stamps curb illicit trade

Some 10% of cigarettes smoked in Europe are counterfeit or contraband, creating serious health concerns for citizens and major financial headaches for industry and governments. There are four kinds of illicit trade that occur at each stage of the supply chain, right up to the retailer, and the combined use of tax stamps, track and trace systems, licensing and enhanced enforcement is the most effective way to address each kind.

1.3.1. Legal products distributed domestically

This type of illicit trade is characterised by deliberate manufacturer production overruns. It can be minimised with tax stamps and licensing requirements, along with adequate enforcement. Given this, enhanced tax stamps, particularly those with track and trace mechanisms, are important to maintain an accurate and objective measure of what has been produced by each manufacturer.

This has been demonstrated in Brazil, where tracking mechanisms are built into all production machines, giving taxation authorities real-time updates of how much of each product is being produced, and the respective tax amount.

At the retail level, both legal and illegal products might be sold at discounted prices in the formal and informal retail sector. A good example of this is the way tax-exempt cigarettes are sold on Canadian First Nation reserves. Often the

cigarettes are legally manufactured but illegally sold tax-exempt to non-eligible consumers.

Furthermore, stamps and track and trace markings allow tax-exempt and tax-paid products to be differentiated when on the shelf, and help ensure that markets regulated by quotas are not being oversupplied.

1.3.2. Legal products distributed cross-border

This type of illicit trade refers to "returning exports", where products are manufactured within one jurisdiction, exported to a neighbouring jurisdiction (in order to avoid domestic taxes), and subsequently smuggled back into the original jurisdiction and sold at a lower price. This was the case for Canada in the early 1990s, Brazil, and the UK.

Track and trace mechanisms can reliably reveal the export practices of a manufacturer to whom the product is being shipped. The ability to trace a product to a particular site or retailer allows enforcement officials to gather information on common distribution routes and practices and the role that manufacturers play in the smuggling network. Tax stamps have moderate potential here, given that they do not always disclose the place of manufacture or distribution points, unless enhanced with a tracking code.

At the retail level, tax stamps are especially effective, as they can ensure that products smuggled in from lower-taxed jurisdictions are not sold in the formal retail market in higher-taxed jurisdictions. However, tax markings are limited to protecting only the formal retail sector, and do not address informal sales of cigarettes.

1.3.3. Illegal products distributed cross-border

This pertains to illegal tobacco products (counterfeit or produced by an unlicensed manufacturer) that are distributed throughout more than one jurisdiction. Smuggling through large-scale shipments of counterfeit products is a burgeoning global threat. The distribution of counterfeit cigarettes from producers in China, Eastern Europe and some parts of Latin America has become a major source of contraband in many countries, and requires different policy solutions than those aimed at legitimate producers.

Domestic policymakers have jurisdiction over the retail sector; protecting the retail level from illegal brands requires a comprehensive licensing regime with adequate inspection and enhanced tax stamps to ensure that illicit products do not enter the legitimate supply chain.

The emphasis on enhanced-security tax stamps is important because of the relative ease with which smuggling operations are able to counterfeit generic tax markings. As such, enhanced tax markings have high potential for ensuring that illicit products do not permeate the retail sector.

1.3.4. Illegal products distributed domestically

This addresses illegal tobacco products (without a license or registration) that are distributed within one jurisdiction. Here it is assumed that the manufacturer is purposely avoiding a legal responsibility to acquire a license. An example of this would be illicit manufacturers operating in Canada without a license on First Nation reserves.

At the retail level, licensing, enhanced tax stamps, and enhanced enforcement all have high potential for addressing contraband activities. The ability to successfully identify contraband product through enhanced tax stamps, coupled with the financial risks of losing a retail license, can have a profound effect upon retailers' willingness to engage in illicit trade.

1.3.5. Stamps must be high-security

Tax stamps and marks are considered to be effective in the face of all types of illicit trade,

and are a “high potential” solution, as they allow easier product identification and authentication. However, simple stamps – as opposed to high security stamps – are considered rarely useful in addressing contraband; counterfeit versions can be created within a matter of weeks, if not days, depending on demand. Adding covert markings to tax stamps ensures that goods can be identified as counterfeit by officials, even though counterfeit brands might look authentic. Tracking and tracing is also considered a high potential solution, as it allows real-time monitoring of tobacco product manufacture and better supply chain control.

2. A GROWING MARKET

The market for tobacco and alcohol tax stamps is growing, due to a combination of population/consumption growth in countries that already use them, the extension of programmes from one product group to another and more countries adopting tax stamps for the first time. In 1990, the annual volume of cigarette and spirits stamps was estimated at over 49 billion stamps (2 billion for spirits and 47 billion for cigarettes). At the end of 2005, these figures were 13.5 billion and 122 billion respectively. In 2010 these figures had ballooned to almost 23 billion for alcohol and over 127 billion for cigarettes (an increase of 68% and 4.5% respectively). The latter is in spite of the fact that global cigarette consumption is now declining. Projected volumes for 2015 are 35.5 billion for spirits and almost 135 billion for cigarettes, a further increase versus 2010 of 55% and 6% respectively.

Taken collectively, tax stamp usage has grown by almost 11% from 135.5 billion in 2005 to 150 billion in 2010. In 1990, fewer than 20 countries were using tax stamps. By 2005, this number had grown to 73. As of 2011, over 80 countries were using them for alcohol, tobacco, or both. Of these, 18 used them for cigarettes alone, nine for alcohol alone, and 54 for both (vs. 46 in 2005). From 2011, cigarette tax stamps were in use in over 70 countries and alcohol stamps in over 60.

Most countries which adopt a programme for one product (usually cigarettes) will often introduce a second programme to include both cigarettes and alcohol. This explains in part the significantly greater increase in alcohol stamp usage compared with cigarette stamps.

Although the actual number of countries using tax stamp programmes for the first time has not increased significantly during the past few years, there has been a lot of activity around upgrading and extending existing programmes.

2.1. Tax stamp usage in Latin America and the Caribbean

Latin America and the Caribbean account for almost 14% of the world’s spirits tax stamps and 7% of cigarettes. At least 12 countries use tax stamps – for tobacco only, alcohol only or both – which means that the majority of countries in the region do not use stamps at all. In contrast to most other regions in the world, more countries in this region use stamps for alcohol than they do for cigarettes.

In Latin America, no countries have introduced tax stamps within the last few years, although a number of countries have extended their existing tax stamp programmes to other products and made them more sophisticated. Brazil, in particular, has become a worldwide reference for those countries thinking of upgrading their systems.

3. THE ANATOMY OF THE MODERN TAX STAMP

The tax stamp has evolved over past decades, from a simple printed item without security (for tax collection purposes only), to a complex, multi-layered security device with integrated production monitoring, track and trace, and authentication capability.

3.1. Little banknotes

The vast majority of tax stamps remain paper-based, with aspects common to banknotes, passports and other government security documents in terms of production processes and security features. There are a number of characteristics of tax stamps, however, that do not apply to banknotes and that restrict the kind of features that can be used to make them. These are:

- Their size (or lack thereof) – this imposes limits on the size and number of security features, especiallʃy overt ones, which must compete with functional features such as product information and numbering for space on the stamp;

- The method of applying them to products – most stamps are applied on high-speed automated bottling and packing lines and, as such, need to be lightweight and flexible, yet robust. This limits the suitable substrates on which they can be produced as well as the features they can carry;

- Their 'one-sidedness' – since tax stamps are affixed, for the main part, to bottles, cans or packs, they can only be viewed or examined from one side.

Despite these constraints, tax stamps – just like banknotes – require the highest levels of security that aid different stakeholders in authenticating the product and the stamp. These features are typically divided into four levels: overt, semi-covert, covert and forensic:

- **Level 1** – overt features – are those that can be seen without the aid of special tools or lights and require the minimum of training to be effective. Such features are designed to enable the general public (ie. consumers) to identify if the product is genuine or not;

- **Level 2** – semi-covert features – are those that require simple, sometimes commercially available – tools to view them, such as ultra-violet (UV) lights, magnifiers and lenses. The examiner needs to know where the features are and how to examine them and they are not normally made known to the general public. They are typically designed for retailers, manufacturers and other members of the supply chain, as well as for officials during routine inspections;

- **Level 3** – covert, or hidden, features – are viewed with sophisticated hand-held tools that are only available to enforcement authorities. The general public and supply chain members usually do not know about these features;

- **Level 4** – forensic features – are reserved for special departments or officials. Special tools or laboratories are likely to be required to reveal their presence and their characteristics. The presence and nature of such features is generally kept a closely guarded secret and they are typically used after a raid to provide definitive proof of the authenticity of a product. Such data can be used, if necessary as evidence in a court of law.

Today's tax stamps are more than likely to incorporate all four levels. They are also likely to incorporate a code or number that enables the item to be tracked so that enforcement officers, manufacturers and distributors can determine the origin and destination of the products, and

all stages in between. Given the lack of "real estate" on which to incorporate security features and functional elements, it is fortunate that each component of a tax stamp is able to carry security features.

The main component is a substrate, usually paper. The paper carries markings indicative of tax-paid status, which are a mixture of fixed and variable print. The fixed print is common to all the stamps in a particular jurisdiction and indicates the location of the tax authority and the product to which the stamp is attached. The variable print is usually a serial number that allows the stamp to be traced back to the time and place of its application.

On the other side of the substrate can be an adhesive that holds the stamp to the product. All three elements – the print, the substrate and the adhesive – are candidates for security technology. Add to this the possibility of incorporating applied and embedded features such as holograms and taggants, and the gamut of security techniques is suddenly wider than one would suppose for such a tiny piece of paper.

3.2. Security in the paper

The majority of tax stamps are produced on security paper. Paper is regarded as secure if it is produced under certain conditions and contains particular elements. Security paper is custom-made by specialist manufacturers for each application and contains features that are complex to apply, integrate or create, and which are not only specific to the security market but unique to each customer. The paper is invariably UV dull, enabling the application or integration of UV features that are a key security element for value documents. It is also typically – for tax stamps – around 40-70 gsm, a weight that is not routinely available for commercial papers.

The main paper-based security features for tax stamps are security fibres and dots, but security threads and watermarks can also be used.

3.3. Security in the printing

Several printing processes are used to produce tax stamps. Their value lies not so much in the technologies themselves, but in the design elements and security features that they can produce, as well as their scarcity and cost, both of which provide a significant barrier to counterfeiting.

The three key security print processes for tax stamps are offset, intaglio and, for numbering or encoding, inkjet print. In addition, silkscreen print processes are often used for applying security features such as colour-shifting motifs.

3.4. Applied security

3.4.1. Holograms

It has been 15 years since they were first used, but holograms are still an extremely relevant and important authentication device for government tax stamps. Indeed the market for tax stamp holograms is the second largest after banknotes, according to the International Hologram Manufacturers Association. The term "hologram" is a generic one for optical devices that display complex images and patterns through the phenomenon of diffraction. The visual effects vary widely and include three dimensional images, kinetic geometric designs or patterns, multi-channel images (in which one image, or part of the image, switches to another) and short animation sequences.

As security features, holograms cannot be copied by conventional reprographic means (copiers or scanners and printers), nor can their effects be reproduced or simulated by conventional printing or finishing techniques. They are complex and complicated to originate and manufacture and even the most determined forgers are unlikely to reproduce copies that are totally accurate.

3.4.2. Security Inks

The prime function of ink is to impart visible images to paper, films or other printable surfaces through the creation of very small dots and lines. A wide variety of additional security features can be provided through components added to the ink, with a range of optical, chemical and physical properties that offer overt and covert authentication.

Within the field of overt security inks that do not require special illumination or reading devices are optically active inks. These exhibit different effects according to the angle of observation or illumination. They include colour-shifting inks that change from one visible colour to another or, in the case of iridescent or pearlescent inks, from one colour to clear.

One of the most secure optically active inks for tax stamps is *SICPA OASIS*® from SICPA, with its dual-authentication security features based on liquid crystal technology. SICPA OASIS has an overt colour-shift for easy authentication by the public, and a semi-covert light-polarisation feature for retailers and inspectors that requires the aid of a small credit card-sized validator or specialised light source. The validator consists of two types of polarising filters that reveal different colours or effects from the same ink. For instance, through the right-hand filter, the ink may appear bright, while through the left filter it may appear black.

SICPA OASIS is used on tax stamps in, among others, California, Ecuador and Massachusetts. Another optically active security ink is thermochromic ink, which changes colour when heated, reverting to its original colour when the heat source is removed.

The most common inks for creating semi-covert features in general, and tax stamps in particular, are luminescent inks. This is a collective term for inks that change colour and/or exhibit distinct visible characteristics under different sources of illumination and at different wavelengths.

Although fluorescent inks are a highly popular security feature for tax stamps, they are not particularly secure, in their simplest form, because they are easily obtainable. Therefore, bi-fluorescent inks can be used for increased security – as is the case for Ireland's cigarette tax stamps – which fluoresce in two different colours at two different wavelengths.

3.4.3. Taggants

Taggants – also known as covert forensic markers – are now a staple of the document and product protection industry, having achieved rapid growth in recent years, in large part due to their anonymity, versatility and flexibility. There are now over 50 companies supplying taggants (compared with around 30 in 2006).

Taggants are molecular or microscopic particles. They can be organic or inorganic in composition and exhibit specific and unique physical, biological, chemical or spectroscopic properties, which are typically read and authenticated using matching assay kits or hand-held detectors.

In their simplest form, taggants provide a simple yes/no authentication by their presence or absence, detected by a handheld reader. Increasingly, however, the underlying technologies provide innumerable variants within the taggants that allow a batch to be assigned to specific departments within an organisation, or over different product lines or production batches.

Taggants are used in trace quantities and are only verifiable by trained inspectors with dedicated equipment. Their presence is, therefore, considered proof that a product is authentic (or, in their absence, that it is a fake) and can be used as evidence to this effect in courts of law.

Taggants can be applied to tax stamps in a number of ways – although generally incorporated in the inks, they can also be embedded in the paper pulp or fibres, the holograms or even the adhesives. And, whereas holograms are the principal overt security features, taggants have become the

most generally accepted technique for covert and forensic identification and authentication for tax stamps.

3.5. Serialisation and track and trace technologies

All of the previously discussed technologies operate on the premise that they confer authentication, of both themselves and the items they are attached to, through their physical security and resistance to counterfeiting. These physical authentication technologies are, however, increasingly being combined with a range of options for assigning a unique digital code to an item (a process called serialisation), and then the ability to track that code (and the item attached to it) at various points throughout its travels along the supply chain (a process called track and trace). There is a common misconception that authentication and serialisation are interchangeable. However serialisation, in itself, authenticates nothing, and needs to be combined with other technologies and systems architectures.

A wide range of different technologies are available to generate and assign serial codes – from simple printed alphanumeric sequences to complex covert codes based on unique and proprietary technologies that are difficult to generate, detect or manipulate by anyone other than those authorised to do so.

Almost all of the world's tax stamps now carry at least an alphanumeric serial number, and a growing number of countries are starting to combine this number with a secure barcode – either visible or invisible, 1D or 2D, smartphone-readable or only readable with a proprietary scanner. The codes are typically recorded in a central database and combined with specific information about the product that code is applied to. The concept behind many of these systems is that once the product is in the market, the original product data can be supplemented by information added in the field about its location and distribution. Theoretically, when the system works as intended, a digital picture of the product's progression through the marketplace, called a "pedigree", will be available any time the digital code is entered into the database.

As can be imagined, the process of developing, deploying, managing and utilising the information generated by what can be billions of individual codes can be a huge and expensive challenge. But the promise of these systems is that when properly implemented and used, they can deliver highly useful patterns of information as to the path of genuine items in the marketplace and serve as early warning systems of fraudulent activity.

Another practical challenge to implementing serialisation and track and trace is exactly how the codes are printed and read on what can be a very small area. Tax stamps share this problem with pharmaceutical labels, another product area where serialisation and pedigree are used. A method which is gaining popularity in this regard is the two-dimensional barcode which can carry a great deal of information in a small space. There are a number of 2D barcode symbologies available and many are being tested.

In Brazil, in addition to the tax stamp programmes used for tobacco and alcohol, all cold beverages are marked with a unique 2D barcode, printed directly on the beverage containers during production, thereby circumventing the need for a paper stamp. The codes are ordered and paid for in a similar way to traditional tax stamp systems, but the delivery process is different. The codes are generated by a central database owned and controlled by Receita Federal do Brasil and Casa da Moeda do Brasil (CMB), and uploaded to the master server of each beverage plant, for subsequent transmission to all production lines. On the production lines, each container is marked with its unique code, which is then scanned and activated, and transmitted back to the central database, together with an image of the container to which

it has been applied. This gives the Receita Federal immediate visibility into what has been produced and by whom, and provides valuable information that they can cross-check against declared production figures.

Although a number of countries now have the systems in place to implement a full-blown track and trace programme, many have not actually done so, only making use of the administrative, production monitoring and authentication capabilities of their tax stamp programme, and are yet to maximise its track and trace capabilities. This currently means that once the product leaves the factory it falls "off the radar", until it is eventually picked up again through inspector audits and investigations.

3.5.1. Radio frequency identification (RFID) tags

Essentially, RFID does not itself allow for the tracking of a product, but the ability of RFID devices to be read automatically, individually or together, by radio waves, at a distance measured in centimetres or even metres from the product itself, and without requiring line of sight, opens up the potential for the quick and easy tracking of many products which are targets of counterfeiters and/or diverters.

The latest microchip technology results in substantially higher performance than conventional printed electronics while dramatically reducing circuit size and cost. In practice, this means that tiny chips and electronic devices can be fabricated on a flexible substrate, like paper, in a process more akin to printing than the conventional way of building up silicon chips in a vertical sense. This ultra-thin technology has now opened the door for applying RFID to tax stamps.

3.6. What is the optimum tax-paid mark?

Today, the general consensus over what constitutes an optimum tax-paid mark on excise products is that a combination of different elements is required. These elements include overt and covert security features for authentication, and unique serialisation codes for track and trace. Whether or not these elements should be carried on a tax stamp or directly printed on the product packaging remains, however, a point of contention.

4. HOW WILL TAX STAMPS BE AFFECTED BY INTERNATIONAL STANDARDS AND REGULATIONS?

Since fiscal policy is determined and implemented at the national level (and, in some cases, the state/provincial level as well), there are no international regulations governing tax stamps. Each country, in other words, is "doing its own thing".

Increasingly, however, tax stamps offer a secondary benefit as product authentication devices, and a third benefit as carriers of unique identifying codes for track and trace – benefits that are important in the fight against the growing global problem of illicit trade. Consequently the issue of tax stamp use is gaining international attention and in recent years has become the subject of international policy.

This is particularly the case in the tobacco industry, where the FCTC (Framework Convention on Tobacco Control) and its Protocol to Eliminate Illicit Trade in Tobacco Products is likely to have a significant impact on the shape of tax stamp programmes of the future.

The Protocol is essentially a law enforcement protocol wrapped up in a health treaty and, over the past few years, it has been extremely contentious. The objectives of one of its key

requirements – a global track and trace system for cigarettes – needs to be established within five years of the Protocol's adoption, with each party ensuring that cigarette packages bear unique identification markings containing essential information regarding the products.

4.1. Tax stamp volumes could increase

Implementation of the FCTC Protocol may lead to much more widespread adoption of tax stamps for cigarettes. Those ratifying countries that already have tax stamp programmes in place will most likely want to combine these programmes with their track and trace obligations under the Protocol. It is also likely that these obligations will tip some new countries into adopting tax stamps for the first time, versus countries that decide to use direct marking schemes along the lines of the tobacco industry's Codentify™ system.

4.2. Towards a tax stamp standard

And now work is underway towards the drafting of ISO 19998, the new international standard for the content, security and issuance of excise tax stamps. This standard, together with the FCTC Protocol – and other regulations such as the EU Tobacco Products Directive – will lead the drive towards internationally agreed frameworks around which governments and industry can work together to standardise technologies for tax stamps and product track and trace.

5. CONCLUSIONS

The factors discussed in this review will all have a positive impact on tax stamps over the next five years. How large this impact will be in the context of the FCTC Protocol is hard to tell and, in any case, only eight countries – of which two are Nicaragua and Uruguay – have so far adopted it (a minimum of 40 adoptions are required for the Protocol to enter into force).

In the meantime, the need to protect revenues and deter illicit trade continues and the tax stamp market is predicted to grow accordingly, from 150 billion in 2010 to just under 170 billion this year – an increase of over 13%. Cigarette stamps will grow in volume terms by just under 6% to 135 billion. Tax stamp usage will decline, however, in Latin America (by 6.5%), and in North America (by almost 11%).

Tax stamps for alcohol will grow by 55% to over 35 billion, the growth coming primarily from Africa and Asia. Volumes are predicted to remain more or less static in Latin America.

Tax stamps have a relatively young history, but a demonstrably successful one. For all the reasons outlined in this review, they are likely to remain the weapon of choice for revenue authorities for many years to come.

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THE SINGLE TAX ACCOUNT AS BUSINESS INTELLIGENCE TOOL FOR ADMINISTRATIVE AND JUDICIAL COLLECTION

General Treasury Team of the Republic of Chile

SYPNOSIS

This document describes the Single Tax Account (STA) system and explains how this tool serves the purpose of ensuring tax compliance. The use of the STA files renders possible the optimization of the enforced collection work and promotes the design of policies for the collection of delinquent debts. In Chile, this task is carried out by the General Treasury of the Republic (GTR), entity which together with the Internal Revenue Service (IRS) and the National Customs Service (NCS), are part of the tax administration.

***The Authors**. The document was prepared with the contribution made by the Operations Division and the Collection and Bankruptcy Division of the General Treasury of the Republic. The following officials contributed to the editing of the document: C**laudia Pérez Ciudad**, Public Administrator, Collection Control Executive, Operations Division. **David Chanampe Pizarro**, Bachelor's Degree in Juridical Sciences, Management Control Analyst, Collection and Bankruptcy Division. **Hugo Moreno Martínez**, Public Administrator, Examination Analyst of the Expenditure Section, Operations Division. **Carlos Ríos Rebeco**, Economist, Adviser, General Treasury of the Republic. **Hernán Frigolett Cordova**, Economist, General Treasury of the Republic.*

Content

The General Treasury of the Republic (hereinafter GTR) is an institution which, together with the Internal Revenue Service (IRS) and the National Customs Service (NCS) is part of the Tax Administration of Chile.

The GTR dates back to the times of the Conquest, following Cristopher Columbus' arrival to America in 1492. The GTR is the historical inheritance of the continuous task of handling and management of the Fiscal Funds which begins with the establishment of the Chilean political organization through the appointment of Gerónimo de Alderete as first Treasurer in 1541. The Treasury function goes beyond the constitution of the Republic of Chile as an independent nation in the early XIX century and subsists until this day.

It should be noted that the configuration of the GTR as it exists today began in the early 60s. As a result of a series of social and institutional changes that took place in those years, significant restructurings occurred in various public entities, among them the GTR, which was granted the powers and authorities that delimit its sphere of action with the citizens.

Thus, the GTR is at present the institution in charge of "collecting taxes and other fiscal revenues, as well as the preservation and custody of the funds collected, revenue stamps and other securities managed by the Service."[1]

The collection process ends when the funds enter the national treasury in a spontaneous manner through the payments made by the taxpayers. However, total compliance level at one hundred per cent is not always observed, since some of the taxpayers postpone the payment of their obligations, thereby originating the collection function through valid collection actions from the legal standpoint and in keeping with the guidelines that direct the State's administration.

In this context, the GTR must carry out the enforced collection, whether administrative or judicial of:

- Delinquent taxes, with their interest and sanctions.
- The fines applied by administrative authorities.
- Fiscal credits considered as tax by the law for purposes of their collection.
- Other executive credits or of any nature which correspond to tax revenues.

In spite of the above, the General Treasury does not enjoy full powers for the collection of fiscal credits and must deal with existing legal limitations that restrict the service's action. By way of example, these limitations are related to:

- Deficiencies in existing powers to render effective money garnishments.
- Legal restrictions to speed up the seizure or sale of goods.
- Lack of legal powers related to the modernization and proximity to citizens.
- Confusing rules that tend to be interpreted in various ways by the courts.
- Existence of rules that are contrary to the rights of the citizens or which are not applicable.

In view of this situation, the Treasury faced two options: wait for the regulations to change or

1. *Decree with Force of Law n°1 of 1994de 1994 sets the adapted, coordinated, systematized and updated text of the organic law of the treasury service.*

decide to innovate in spheres related to strategic management and information technologies to comply with the mandate of recovering the delinquent debt. It is worth noting that in Chile, the delinquent debt amounts to over US$ 5.500 Million, which is equivalent to 2.1% of the GDP.

Under this context, the Treasury promoted the implementation of an information system whose benefits have exceeded the expectations. This system is the Single Tax Account (STA), which includes the information that has allowed the institution to comply with the functions provided by the law and in particular, to better manage the delinquent debt.

The document consists of 4 sections. The first section is set aside for this brief introduction. The second section describes the STA, its origin, development and outstanding positive effects in management. The third section shows the collection model in force at the GTR which is based on the STA. Finally, the fourth section includes the main conclusions.

1. THE SINGLE TAX ACCOUNT (STA)

1.1. Background

Historically, the Tax Administration of Chile has endeavored to maintain a permanent and controlled record of the tax life of the taxpayers, in order to protect the fiscal interest and public resources. It is for this reason and for the purpose of rendering transparent the information of each of the citizens subject to tax that some main elements have been established, where a relevant component is the STA.

An essential event lay the bases for structuring the system. In 1969, by means of a Decree with Force of Law No. 3 of January 29, a mechanism was established for the unique identification of each taxpayer. The Single Tax List (STL) was determined as the identity number. In the case of individuals, the Civil Registry and National Identification Service must provide the identification number. In the case of corporations, the tax administration is in charging of granting a particular number, although it is created under the same parameters of the STL.

The main advantage of counting on an STL, as single identification number, is that it allows for clearly tracing all the tax activities of an individual through a single number.

In addition, this single identification number is used in all procedures of the State's administration and in the relationship which every citizen establishes as individual, in different processes of his life (economic, health, education, and housing), thereby allowing all individuals more expeditious, effective and precise procedures and greater order.

Some of the objectives that were taken into account for creating this mechanism are:

- Establish a system that for identifying all of the country's taxpayers and maintaining tax compliance control aimed at its improvement.
- Through adequate identification of the taxpayers they may receive better assistance in their relations with the Internal Revenue Service and the GTR, since the administrative procedures are thus simplified and improved.
- Achieve greater tax fairness through the control of taxpayers who do not duly comply with the obligations provided by the laws, which would additionally increase collection.

It is thus, through the aforementioned Decree that the preliminary steps are taken for the creation of the STA System which is currently available at the GTR. Said Decree is the one that determines that the GTR must schedule the accounting and administrative measures it may deem convenient to adapt its tax collection and payment accounting methods to the Single Tax List (STL), so that every taxpayer may have an STA, identified with his STL number. The STL must be implemented according to its schedule, its objective being to account for the charges and payments of the named person, individually determine the balances owed and facilitate control of the taxes and taxpayer assistance.

In addition, it is determined that the aforementioned STA may serve for making partial tax payments to the Treasuries, to pay installments on credit notes or specific income orders, according to article 50 of the Tax Code.

Subsequently, it is provided by means of the State's Financial Administration Law, Decree-Law N° 1.263, of 1975, expanded and updated by article 13 of Law N°19.041, that the GTR, through the STA must register all transactions involving charges, settlements, payments, installments, refunds, elimination and settlement of debts which affect the taxpayers and other public sector debtors. Likewise, the disbursements of any nature which the GTR may pay to taxpayers or other Treasury creditors must be incorporated.

It is for this reason that the GTR has developed a System that registers all transactions of the taxpayers' tax life, thus giving way to the STA, by building a powerful data base that allows the link with the different GTR business processes and enabling it to take over all the functions entrusted by the laws and authorities.

It is important to point out that all the information registered in the STA System is obtained from information in the forms that are related to the different transactions and which has been structured in the form of a code – contents, for which reason it registers only the code with its respective contents or amount. Thus, any data added, which is not registered after a code, is not entered and will not be recorded in the STA System. The form entered in the System will create a current account or will constitute a transaction of a current account if the original form already existed in the computerized system.

In this way it is possible to trace all the movements of the tax life of the taxpayers, by keeping a complete record of the entire tax background, thereby allowing that all of the Treasury's business processes may be carried out efficiently.

On the other hand, it must be borne in mind that the amounts recorded in the STA affect the accounting records of the Fiscal Accounting Plan, which is used as basis of various reports for the economic authority, as well as for other Services. The codes used for recording the amounts to be paid are called account codes, since they correspond to the accounts determined by the Government of Chile's Budget Directorate, either to enter or pay amounts.

1.2. Structure

The STA bases its structure on the taxpayers, each of which constitutes a single account, where all the tax information generated throughout his accounting life is recorded. Its structure is based on a hierarchical type model, which differentiates between the Account, Transaction and Item levels.

The information is entered in the system through forms which constitute an Account. A separate account is created for each of them, which must include the identification through the STL or RoI (Real Estate identification), form number, page number and expiration period, which is known as "Cut Key".

The Movements reflect all the transactions that may affect a form registered in a taxpayer's STA, such as Charge, Payment, exemptions, etc.

Finally the Item – Code corresponds to the detail of all the codes included in the form, dealing with identification as well as tax and totalizer codes. The codes used to enter the amounts to be paid are called account codes and correspond to the accounts determined by the Budget Directorate, either to enter or pay amounts. This information serves as the Accounting basis and subsequently generates various reports for the economic authority as well as for other Services.

The entry of a specific taxpayer's form to the STA (either through STL or RoI) implies the creation of a current account for said form. Therefore, the same taxpayer may have as many current accounts as entry forms are recorded in the STA. The forms that originate a current account at STA are such forms as Previous Charge, Simultaneous Filing and Payment, Payment and Disbursements.

The process begins by sending the information from the so-called Transferring Services, which send 99% online to our system. In 2014, eleven and a half million forms were received from these services, which include the payment obligations and modifications of movements.

After the obligation has been generated, it is paid by the taxpayers. It should be noted that in addition to these obligations, there are simultaneous returns that are paid directly through the existing collection channels[2].

The Treasury has virtual and face-to-face channels, such as banking branches, branches of its own offices, payment via web, automatic payments from a current account, etc. To this end, agreements were entered into with banking entities and in support of the banking business, which describe in detail the procedures, commitments and obligations, terms, etc., which each entity will acquire with the GTR.

In 2014, over 28 million transactions were received, of which 80% of the payments were received virtually, which, on the one hand, reduces the risks of error in loading the information, and optimizes the times and process. Currently, there are several means of payments: cash, check, promissory note, banking cards, commercial cards and discount from current account and debit cards. The use of the means of payment depends on the payment channel

In the face-to-face payments the forms include an identifier which corresponds to a special bar code known as ID "Identification Code", whose structure includes a series of elements which will allow the IRAS to validate the payment made through the cashier and subsequently notify the GTR for its registration in the STA System. On the other hand, in the case of electronic payments, the payment may be single or multiple through the use of purchase "trolleys".

Much in the same way as the tax information is sent from different channels, likewise, on the third day, (except for self-owned branches) the remittances are deposited in current accounts, there being individual accounts for each participating institution, which thus allows a strict and timely control of the monies collected, which, once entered in these subsidiary revenue current accounts are transferred to the Single Fiscal Account (SFA)[3].

2. *For example, the value added tax VAT, is of the simultaneous filing and payment type.*
3. *The Single Fiscal Account is where fiscal resources are administered. DL 1263; Article 32: "All of the Public Sector's revenues, except for those expressly excluded by law, must be deposited in a current account called Single Fiscal Account of the State Bank. For such purposes, the aforementioned current account will be subdivided into a main account, maintained by the General Treasury of the Republic and in subsidiary accounts, intended for the different Services. The holders of the subsidiary accounts may draw up to the amount of the respective deposits without being able to overdraw".*

For every form entering our system there are systemic validations that allow for detecting errors at different levels:

- **Interface:** The control is aimed at detecting inconsistencies in accuracy, completeness and data comparison.
- **Data control in loading in STA:** The controls are aimed at the consistency of the accounts and information, accounts without obligation, STI and/or zero folio, etc.
- **Regularizations:** Where normative compliance is verified, annulments of obligations, etc.
- **Products:** The controls are aimed at orders of magnitude, completeness and deviations.

An important element for the entry of new forms of movements, in addition to consistency and accuracy of the information included is the timeliness with which it is registered in the system. In the case of obligations, 99% is entered at the time it is sent, given that the necessary links have been generated in order that it may be sent online and visualized in real time.

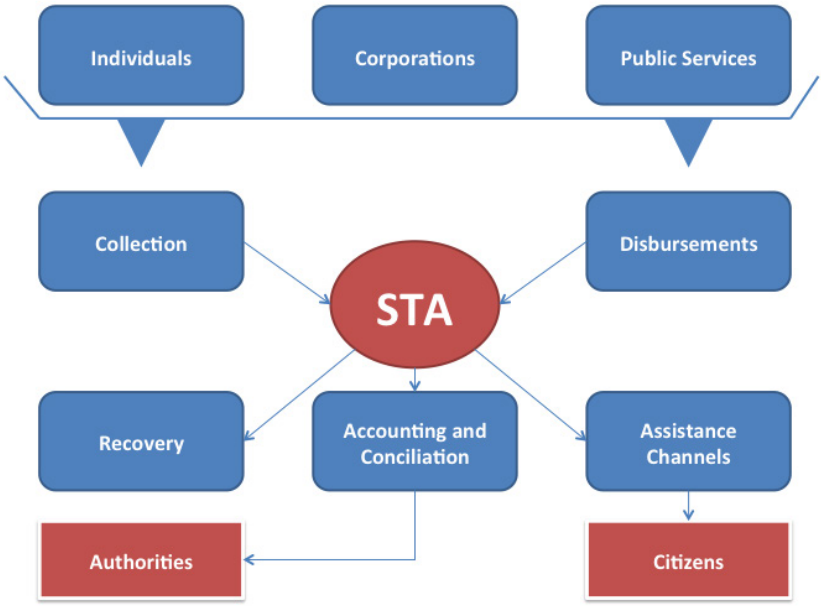
In the case of forms that are collected, 85% enter the system online and the great majority of those remaining in a term not greater than 2 days, since, even though the processes are automated, it is necessary to agree on the online link.

Whether a result of that generated in the STA, as well as through the generation of such items as bonuses, subsidies, etc., when disbursements are made they are also registered in the Single Account through forms, thereby generating current accounts.

The update of personal data in the STA is carried out massively through the annual Income Tax Filing process held in April of every year, with the background information declared by each taxpayer through the Form determined for such purpose and thus establishing the tax domicile that will be used for all tax activities in which the taxpayers will be involved.

In addition to the taxpayers' own products, the STA generates information for the country's accounting records as well as for generating the Collection process.

Graph 1
STA System



1.3. Corporate use of the STA

Below is a description of the main advantages and achievements related to the implementation and development of the STA system.

1.3.1. Assistance channels

The GTR has five channels to assist taxpayers and citizens in general: Face-to-face assistance; Web assistance, Call Center; and assistance modules in our offices as well as in other sites with which agreements have been established. In each of them it is possible to obtain products from our STA, either to find out about debts, whether delinquent or not; balances in favor, tax information in general from the single account, as well as products required for related procedures: debt certificates; payment certificates; receipt notices (payment forms). In 2014, over a million and a half persons required at least one product requested through face-to-face channels.

In order to request products from the single account itself, it is necessary to count on access codes, the foregoing for the purpose of safeguarding the confidentiality of the information, in addition to the security mechanisms of our own systems.

Within the GTR business processes, in the sphere of distribution, the disbursements which correspond to the tax obligations which the Treasury generally pays to the taxpayers, are registered in the STA, thus allowing the careful control of the taxpayers' tax life.

The process of disbursements to taxpayers is carried out in other Systems developed, but its relationship with the STA is permanent and relevant, given the definition in force which states that all movements related to the taxpayer's tax life must be recorded in the STA. Therefore, every disbursement made generates a Form that becomes part of the STA as of that moment.

Additionally, the disbursements process has other binding elements with the STA System, such as the relationship associated to the compensation of the fiscal debt which takes place at the time of generating the disbursements to the taxpayers. As part of the regulatory definitions in force, in general, if a taxpayer is a debtor of the Treasury

at the time of approval of a disbursement, either a tax refund or some other related item, the disbursements process consults the STA to identify the debts in force and in cases where it exists, it makes the respective compensation of the amount owed, with the disbursement being made for the balance that remains in favor of the taxpayer, in the event that there may be any balance.

The foregoing interaction allows for increasing the levels of debt collection and recovery by the Government, thereby providing resources for the development of public policies, affording greater opportunity in the collection process and in the recovery in particular.

1.3.2. In Accounting

The forms registered in the STA, under the logic of development of the codes which each form has, allows for establishing the relationship with Fiscal Accounting and the application of the accounting movements, where every code having a value or amount associated to collection or disbursements has an effect in the respective budgetary account. In this way it is possible to structure the budgetary accounting and at the same time, clearly identify the budgetary exercise for each year. That way the control of the Treasury's resources and the Nation's budgetary execution have the necessary protection. This background information is then used in preparing the necessary Execution and Management Reports that account for the appropriate exercise of the Public Treasury's fiscal resources administration function.

1.3.3. In the recovery processes

Upon conclusion of the collection process the different movements are reflected in the STA. These movements may correspond to the obligations, whether charges, transfers, modifications, etc., from the transferring services and to the payments of the different forms. These may show accounts payable, either because there are charges without payment or without their counterbalancing item, as well as in cases of payments of a lower amount than that actually due.

This is thus the beginning of the process whereby it is sought that the debtor pay the delinquent taxes or fiscal credits, according to the powers which the Law attributes to the GTR; that is, the mission to administratively and compulsorily collect the tax obligations and credits from the Public Sector which have not been paid within the respective expiration terms.

Every month, a Debit Balance report is generated, which describes in detail the monthly status of the delinquent portfolio. The Debit Balance of the month of December/January is used to prepare the Delinquent Portfolio Certificate that will be in force during the year and will serve as basis for determining Recovery collection goals.

2. THE RECOVERY MODEL

This section includes the GTR's Recovery Model. In the first place, general background information, as well as from the improvement process developed in recent years is delivered, to then show in detail the administrative and judicial recovery models.

Recovery: general aspects, improvements and challenges

2.1. The recovery cycle

With the Delinquent Debtor Balance and the debtor's data as main inputs of the recovery support systems, one sets up the recovery systems that will provide significant support to the Recovery Process.

Until 2008, recovery was carried out at the Regional or Provincial Treasuries using as main input the information from STA, it being perhaps the main and almost only collection indicator.

The structure consisted of working teams formed by Attorneys, Tax Collectors, Supervisors and a Head of Recovery for every Regional or Provincial Treasury. Each office distributed its workload according to geographical criteria and by type of tax; however, there was no centralized strategic definition, but rather definitions were oriented toward the mere result.

In 2009, the Treasury's total portfolio amounted to US$ 3,542 million distributed in a total of 822,810 claims corresponding to 487,624 taxpayers. The Treasuries managed every type of taxpayers and lacked standardized methods to generate collection action, without differentiating the nature of the debt, type of taxpayer, geographical area, economic activity, whether it was a corporation or individual, etc.

Since there was a large number of claims to collect, the focus of attention was dispelled, because it was known that a debtor could have more than one case or claim and such claims were not examined by only one attorney; rather, they could be handled by 2 or more attorneys, it being understood that the workload was distributed according to collective claims.

2.1.1. Project for strengthening the 2009 recovery

To implement the project for strengthening recovery, the design of the practical application was determined jointly with each of the treasuries, in keeping with that provided in the strengthening project. It considers four main aspects:

- **The model for allocating the portfolio and for determining the operational collection units (OCU) to be established in each Treasury**

To determine the composition of these units, a review was made of the proposals submitted by each treasury and adjustments were made at the central level, which had been agreed at the local level and which mainly considered two aspects: on the one hand, the competencies and strengths of the human resources available in each regional entity, and on the other, the composition of each treasury's portfolio, in order to achieve homogeneity in management.

The allocation model considers the distribution of the portfolio among the different OCUs, by balancing the workload through different criteria that allow for supporting the recovery strategy determined.

Allocation was made by distinguishing between the tax and territorial portfolios, since they represent different universes from the standpoint of the composition of the portfolio and from the standpoint of the recovery process. On their part, every treasury expressed the convenience of distinguishing between this type of portfolio and setting up special units for such purposes.

Distribution of the tax portfolio workload

One of the weaknesses of the judicial recovery carried out in the country's offices was the separated treatment through different collection strategies for each of the claims associated with a debtor. This led to a non-integral analysis of a taxpayer which implied, for example, duplicity of tasks for locating the debtor ad search for properties, disparity in the actions of each process (claims) of a same debtor, payment negotiations or agreements that are not integral, partial execution of the means for collection and finally, closing of collection cycles in nonfinite time frames.

In view of the above, a workload distribution was established for each operational collection unit, by consolidating all the cases (claims) in a judicial collection process by debtor. That is, a single operational collection unit will be in charge of a debtor and will consolidate all collection claims in process.

This working method has the following advantages:

- Accumulation of claims by debtors and managed by a single unit, which results in economy of scale (several processes of different claims for the same debtor all at once) and procedural economy (the same incidents by debtor are processed all at once).
- Integral negotiation of payment agreements.
- User assistance by a single unit (OCU).
- Better knowledge of debtors being subjected to collection.

In spite of the advantages an inconvenience was visualized, which is related to the handling of the files, since previously, the cases (claims) of a debtor were distributed in different files, which rendered difficult the collection process. To overcome such complication (which did not constitute a weakness per se, but rather a difficulty not comparable with the benefits resulting from the integrated work by taxpayer), it has been determined that separate files be consolidated in a single case.

Distribution of the territorial portfolio workload

As in the case of tax debtors, the processes are kept collectively in files, except that in the case of rol (real estate) type debtors every claim accumulated in the files, has a similar procedural time frame, except those where there are incidents of a legal proceeding nature, which is not very frequent in this type of debtors.

Thus every year collective files are generated, which are notified by means of certified letter in a centralized and synchronized manner. Likewise, in the case of those debtors who do not pay or formalize an agreement, the procedure is carried forward in a collective manner, until the public sale of the properties in case of nonpayment.

Taking the above into consideration, it is a coherent practice that the distribution of rol-type debtors in each OCU continue to be by claims.

The recovery strategy to be developed for each OCU

A strategy is the course of action determined for achieving short and long-term objectives. Its degree of sophistication responds to numerous factors; nevertheless, there are always central elements that condition success. In the case of the treasuries that begin with the project for strengthening judicial recovery, a special strategy has been determined for each region, although with the same central elements.

Rather than a sophisticated strategy covering a significant number of actions aimed at optimizing recovery, a general strategy was developed according to the following considerations:

It was deemed a necessity and priority to establish general portfolio management criteria, which implied a close relationship with the recovery actions undertaken (strategy).

Likewise, it was necessary to standardize the recovery criteria used in every regional and/or provincial office.

As shown in the following graph, the recovery strategy to be implemented should allow for standardizing the recovery process in the treasuries that began to use this modality, although without disregarding the collective performance and collection goals established for the period and including management control elements to the actions carried out. Within medium term, it was possible to consolidate a management model that allowed the incorporation of more refined and sophisticated elements in the collection strategy, always proceeding in a standardized manner, increasing collection and achieving the continuation of the collection process. Within short and medium term, a central element was the closing of the judicial processes that are uncollectible in order to clear up the portfolio that is manageable from that which is not. Finally, within long term, the idea is to increase the collection indexes, by achieving a balance between the capacity for closing judicial processes and new delinquencies, thereby providing a service of excellence that may once again make the normalized resources available to the country.

Graph 2
OCU recovery strategy

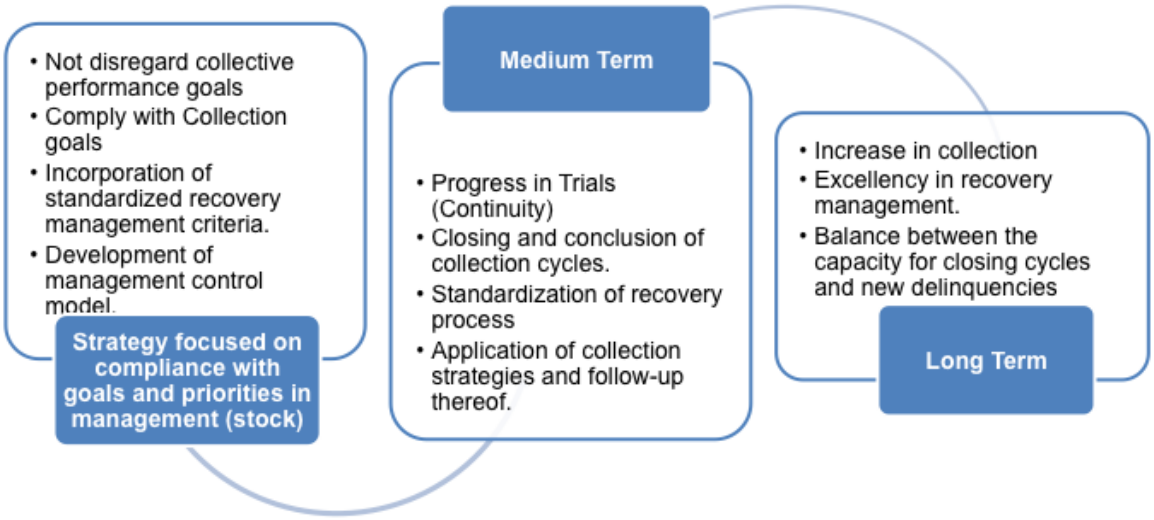


Diagram of OCU Recovery Strategy, Recovery and Bankruptcies Division

In order to determine the particular strategy to be implemented in each treasury, an analysis was made of the portfolio and a series of collection actions was proposed, which maintains a standardized guideline between treasuries, although in keeping with the reality of each regional office.

The Management control modality and indicators to be used in monitoring the process

In order to control de results of the recovery process, a series of indicators has been determined for monitoring the result of each OCU and the respective treasury and the calculation modality and required periodicity has been determined for each of them. The purpose is to establish in each working unit and in the regional and/or provincial centers, a methodology related to the management of the indicators; that is, that the series of indicators may contribute to take the necessary corrective actions if there are differences in the results expected.

The flow of information required for each unit and its interaction with the central level.

An information flow has been determined, from and toward the Recovery and Bankruptcy department, with which a strategic alliance will be developed to facilitate management of the treasuries and which at the same time may ensure the standardization of management, although considering the aspects that are common to each regional reality.

2.1.3. Recovery business model

Since the implementation of the Project for Strengthening Recovery in 2009, the processes began to be improved and standardized. The Recovery Process involves actions for the recovery of taxes and delinquent obligations, through administrative and judicial procedures and actions, from the time the debt is generated until it is paid or the sale of the seized properties.

The foregoing is based on article 35 of Law 1.263 and Organic Law of the GTR, D.F.L. N° 1 of 1994, which regulates the GTR´s responsibility of carrying out the judicial and extrajudicial, or administrative recovery of delinquent taxes, with their interests and sanctions, the fines applied by the administrative authorities and other executive credits of any nature provided by Law.

Having established the responsibility which the Law attributes to the GTR and which it must obligatorily comply, when a taxpayer does not pay its tax obligations, the GTR begins a continuous process in time, which endeavors to obtain the taxpayer's payment of that owed. To this end, the GTR has powers which the Organic Law of the State's Financial Administration has granted it, that is: To administratively and judicially collect the tax obligations and credits of the public sector that have not been paid within the respective expiration terms.

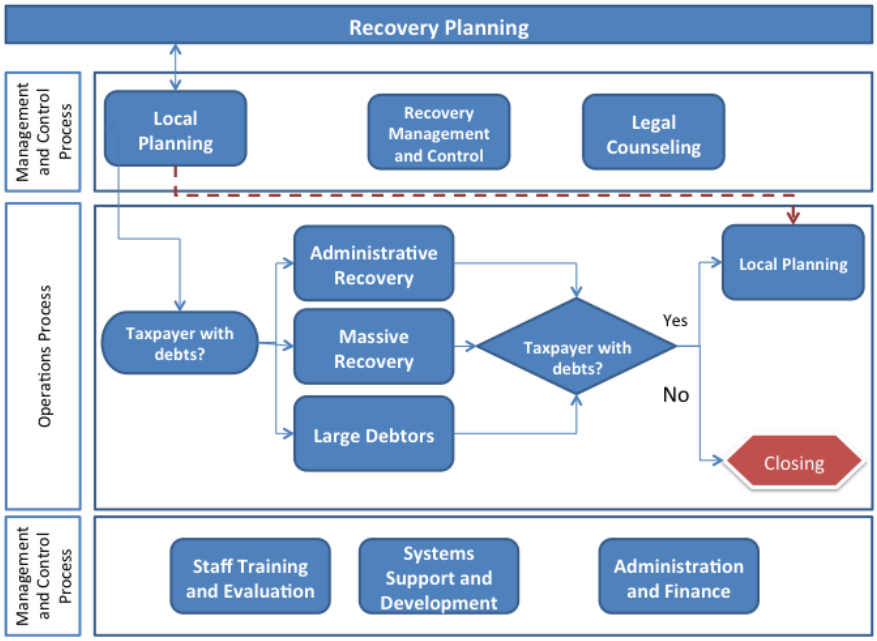
The objective of the Recovery Planning Process is to establish the guidelines for the management of the delinquent portfolio, as well as the initiatives and projects for increasing collection, achieving the reduction of said portfolio and the progressive procedural advance, in accordance with the institutional objectives. This planning document will have a horizon with respect to its one-year goals and in relation to the control processes and procedural standards of a permanent nature, except for new instructions in future regulations and/or planning.

The procedures carried out at the level of Management and Control Processes such as, for example, analysis of compliance with the standards of the process, at a distance controls, generation and analysis of indicators, among many others, endeavor to comply with the definitions established in the strategic process through annual plans, at the national as well as local levels, where the work of the treasuries is organized with respect to the recovery of the delinquent portfolio.

Accordingly, mechanisms are established for management control and the subsequent eva-luation of the results of the operational processes (Administrative Recovery, Massive Recovery, Specialized Recovery and Bankruptcies and Uncollectible Debts).

On the other hand, the working teams are established at this level of Management and Control and the resources are provided for carrying out the projects. Likewise, the implementation of the plans and initiatives are documented in order to follow up the results and make available said information to the units requesting it, for the evaluation of the work carried out.

Graph 3
Recovery planning



At the **Operational level** one evidences the execution, as such, of the procedures for collecting from the debtors according to their characteristics and always under the legal framework established in the Tax Code; that is, from the notifications of the debt up to the seizure and sale of the debtor's properties. Said process is based on information provided by the management and control level, either through the assigned portfolio, or through judicial counseling in the processing of recovery cases.

Finally, the **Support level**, groups the areas that provide services for the appropriate conclusion of the processes at all levels discussed; namely: training of officials, computerized and financial support.

The collection portfolio is separated into three levels and each one is managed according to specific business rules depending on the complexity of collection and the amounts involved. The segments of the portfolio are: Small debtors, Medium debtors and Large debtors.

Small debtors: corresponds to the portfolio of taxpayers with delinquent tax obligations with a net consolidated debt amount (without legal surcharges) lower than 10 million Pesos (US$ 17,500) and have no claims (executory collection proceedings) in force.

There are two procedures in this segment: a Multichannel Platform at the central level, which generates all notices to debtors with debts of

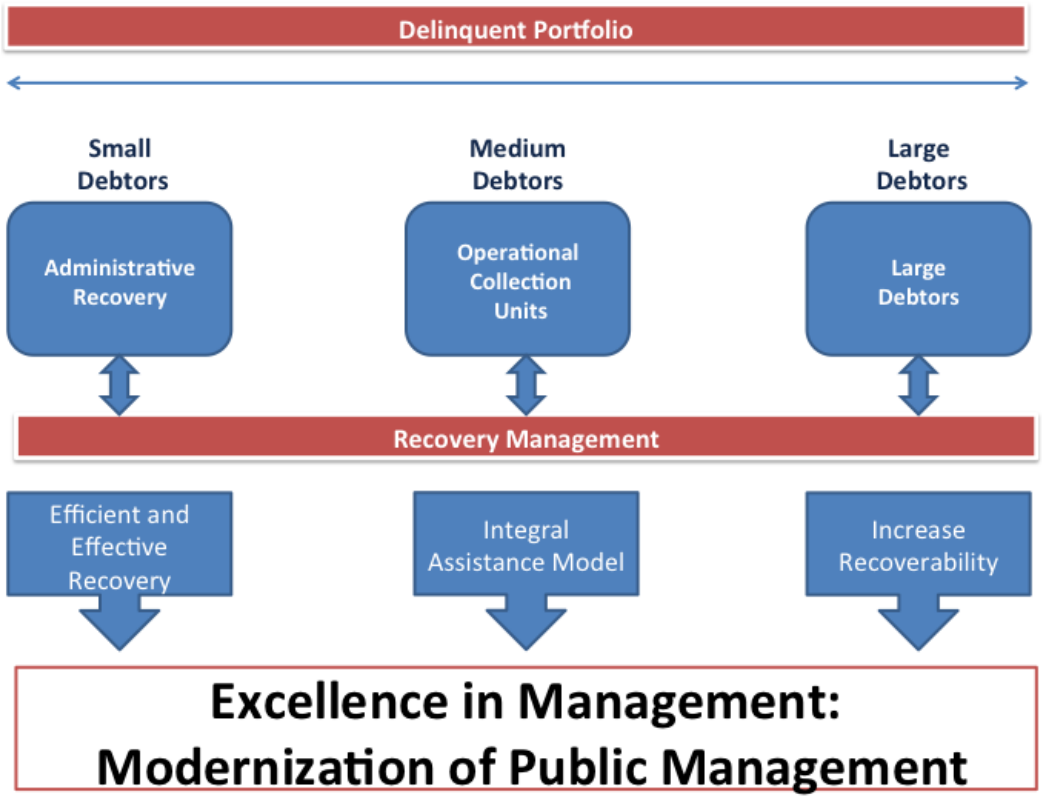
less than 10 million and a second component, a Specialized Assistance Executive in each of the country's Treasuries, which communicates directly and face-to-face with the debtor and negotiates with the latter the conditions for the payment or regularizations of the debt.

Because of the massive nature of the means of communication used in administrative recovery (letters, telephone calls, emails, tele messages, etc.), this type of recovery is used to focus efforts on a specific and massive group of debtors, whose debt amounts are not high and therefore, judicial recovery would not be profitable for the State, taking into consideration the significant expenses involved in this latter process.

Medium debtors: this portfolio is under the responsibility of the OCU throughout the country, in each of the Regional and Provincial Treasuries. It corresponds to debts that are under judicial recovery, whose debtors have unpaid obligations of which the net consolidated balance (without considering legal surcharges) is less than 90 million Pesos (US$ 158 thousand).

Currently in this segment there are 115 Collection Units. Each of these units has a structure consisting of an attorney, an analyst, a collector and a counsellor, with the attorney being the leader of the team.

Graph 4
Delinquent portfolio



Large debtors: This segment consists of debtors whose net balance (without considering legal surcharges) claimed is equal to or greater than 90 million. Currently there are 5 Specialized Collection Units (SCU) in the Metropolitan region, in the Large Debtors Section, and 5 in the main Regional Treasuries (Iquique, Valparaíso, Rancagua, Concepción and Puerto Montt).

2.2. Administrative recovery model

Within the framework of the 2009 Strategic Plan, in order to carry out the administrative recovery, technology is acquired to assist in establishing contact with the debtors, by means of virtual or telephone channels. Initially, the Project consisted of 12 tele operator positions, which were installed in the GTR offices. In late 2011 they were increased to 23, and by late 2014 there were almost 50 positions.

In mid-2013, version 2.0 of the New Administrative Recovery Business Model was implemented. It is mainly based on a Multichannel Platform whereby massive procedures are carried out through Remote Channels, covering the Administrative Collection and Special Portfolios which mainly correspond to the Treasury support campaigns.

This model has afforded the taxpayers reliable and important information, orientation, quality assistance and proximity among other things. On the other hand, it has contributed to the objective of restraining delinquency and greater compliance with commitments or regularizations.

Currently, Administrative Recovery has focused its procedure on delinquency comprising from day 30 to 210, to then continue with delinquency in a judicial collection process.

In order to achieve continuous improvement and provide a service of excellence, it has been proposed for 2015, to extend the current collection cycle used by Administrative Recovery, that is, to process delinquency from day 1 to day 330.

Policy for treating debtors under administrative collection

According to the proposed new collection cycle, debtors are treated according to the type of tax, the amount owed and the time of delinquency, among other characteristics and thus, this framework is used to determine the Management channel and type of collection to be carried out (informative or Pre claim). The expansion of the collection cycle endeavors:

- To be able to carry out at least 4 procedures to every taxpayer within the collection cycle.
- Update and improve the demographic data.
- Improve the quality of the Institutional Bases
- Greater restrain in delinquency.
- Reduction of cost, by delaying for a segment of the portfolio, the step for judicial collection.

It should be noted that the new administrative collection cycle considers dividing the portfolio according to the type of tax and likewise, according to the net delinquent balance.

Territorial tax

In managing Territorial taxes, it is proposed that the procedure be segmented according to the delinquency period, for a preventive procedure and according to the balance period, for an informative type collection procedure.

Starting on day 1 and until day 330 of delinquency, the procedures complement the segmentation based on the delinquency period and the net balance period by setting ranks to the more specialized channels, such as the Call Center for debts of a greater amount and longer delinquency, up to the virtual channels such as the Tele message, SMS or Email for lower amount debts, in order to achieve greater restraint prior to the judicial collection process.

Federal tax

In the case of the Federal type tax, it is proposed that a differentiation be made according to the net balance. In this way the Federal type portfolio is restricted to the amounts, thus being able to establish an early contact with the taxpayer.

Administrative recovery policy in support of judicial collection

Support is given to the judicial portfolio of the Treasuries by means of the multichannel platform, in order to increase the rate of recovery of the delinquent debt. On a monthly basis, through the Contact Center, efforts are undertaken with a delinquent portfolio, in order to provide information about the judicial situation, the benefits for the taxpayer and the payment channels, as well as to invite him to undertake Payment Commitment or schedule specialized assistance with analysts from the different Treasuries of the country.

Calendar of multichannel platform loading

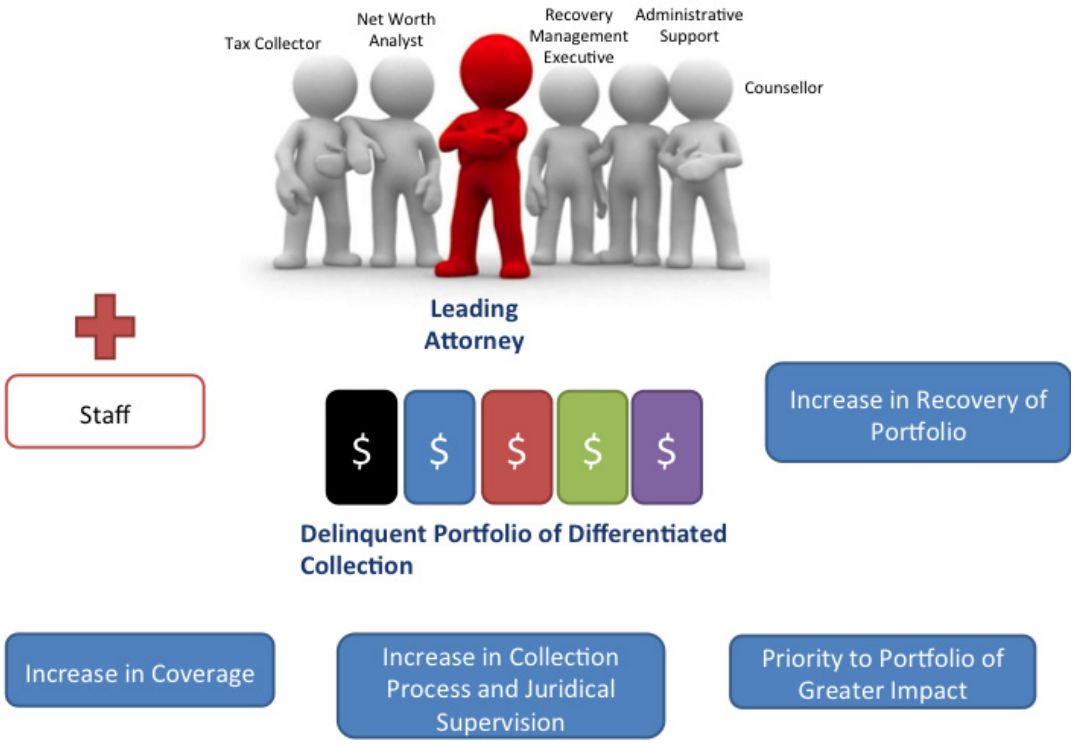
The purpose of the annual calendar is to determine the duration of each processing period each month of the year. A minimum of 4 weeks is considered and each initial period should take into account the terms that may allow for an extraction as clean as possible. The first weekend of each beginning of the month is used for all aspects dealing with the accounting closing and updating of agreements. Between 7 and 10 subsequent working days, the processes carried out are selection, validation, extraction, verification and loading of the data bases in the contact center of the taxpayers to be processed period by period.

2.3. Massive judicial recovery

Business model

The massive recovery strengthening project, in all its phases, allowed the consolidation of the current business model, thereby optimizing and standardizing the processes at the national level, and resulting in substantial improvements in collection, as well as in the management indicators, through the focusing of efforts and existing resources.

Graph 5
Business model



In the judicial sphere, there are positive trends in the results of collection and procedural progress, which is reflected in compliance with the indicators.

The difficulties observed in the collection process are permanently being faced by the central level, through the feedback provided by the treasuries at the national level, which is evidenced in a series of measures that have been adopted in the following spheres:

- Increased issuance through postal notification, which has resulted in substantial resource savings, in the first stage of judicial collection, while at the same time mitigating the risks of statute of limitations of this portfolio.
- Follow-up and control of payment agreements that are at risk of expiration, which is favorable for the recovery of the delinquent portfolio.
- Consolidation and definition of the procedure for the collection of tax obligations, through the creation of internal instructions, which facilitates understanding and the terms associated to each of the macro stages of the judicial collection process.
- Strengthening and creation of the Bankruptcy and Analysis of Uncollectible Debts Section, with the incorporation of staff qualified in these matters, redefining its structure, responsibilities and functions, with a view to concluding the process and covering the portfolio with the greatest deterioration.
- Updating and improvement of the procedures of the Division under the ISO 9001:2008 standard, as a result of the observations resulting from the Quality audits held in August 2013.
- Maintenance and improvements in the Recovery System, which provided more reliable data for its parameterization, in addition to the support to the OCUs in administering the delinquent portfolio.
- Continuous theoretical and practical support of the different areas of the Recovery Division.
- Management indicators and goals of greater impact and in keeping with the business model.

2.4. The Specialized judicial r∫ecovery

The large debtor segment corresponds to the STL of fiscal portfolio with a net debt exceeding 90 million (US$158 thousand). The judicial collection of this portfolio is carried out by the large debtors units at the national level. There are 5 units in the metropolitan region, located in the Large Debtors Section and 5 other units in the regional Treasuries of Iquique, Valparaíso, Rancagua, Concepción and Puerto Montt.

These units focus their efforts on three main axes:

- Collection.
- Efficient and consequential progress of the collection processes;
- Normalization of the portfolio.

The work of these axes is based on a recovery effort by STL and the adequate segmentation of the delinquent portfolio, all of this aimed at collection as main objective and standardization of the net worth investigation, juridical-operational, execution and negotiation processes.

Through the recovery process, the GTR becomes the tool whereby the State guarantees tax equality and the effectiveness of its regulatory and control task for recovering significant amounts originating from delinquent debts. The recovery carried out by the Large Debtor Units (LD Section and regional Units) is a selective and specialized recovery, involving complex negotiation processes, whose objective is to obtain full payment of that owed and/or normalize the amounts claimed.

3. CONCLUSIONS

The greatest asset of the General Treasury of the Republic of Chile is its Single Tax Account because it constitutes a valuable historical macro-economic record of the tax transactions of individual and corporate taxpayers. Thus, the STA is a transactional data base which is daily updated with all the transactions involving charges and payments of tax obligations and, accordingly, is appropriate for applying business intelligence tools for the behavioral analysis of the taxpayers vis-a-vis the different taxes they must pay. It is active and online 365 days a year, and transactions are registered 24 hours a day through the web portal that is available to any taxpayer without any territorial distinction.

An adequate use of the records of this data base is what renders possible the optimization of the enforced collection work, since it allows for applying discriminating computerized tools for understanding behaviors and promoting the adequate design of policies for recovering the delinquent debt. In essence, the STA becomes a repository of extremely valuable information for time series, cross-section and market segmentation studies of the tax debt. It is on the basis of these elements that administrative recovery develops an information system for managing the field work, carrying out executive collection processes and interacting with the judicial system.

The Recovery and Bankruptcies Division and the Operations Division must act in an integrated manner to carry forward a real time updating process of all of the STAs transactional records, which would be impossible without the support of computerized applications that have been developed through time. In practice, the STA is a real time transactional space and the GTR analysts are account executives whose main task is the online administration of the tax account of over 9 million taxpayers.

For Recovery purposes, the STA is a very powerful analytical tool which affords a very broad series of attributes dealing with the delinquent debt, to which an action plan must be applied. There are attributes linked to the maturing of the debt, source thereof, according to type of tax, territorial location of the debtor, entity applying the tax or fine, and additionally allows the consolidation of debts of individual or corporate debtor. Based on these records collection strategies are designed and pressure tools are used in order that the debtors may agree to negotiate ways for paying the delinquent tax debt.

Thus, the STA becomes not only an instrument that facilitates accounting management of spontaneous and enforced collection, but in addition is a key tool for institutional administrative management. Its potential use for the design of public policies is part of the institutional obligations of the GTR for ensuring the best standard of tax compliance by the taxpayers. With respect to transparency of the public function, the STA affords full traceability of the tax transactions carried out by each taxpayer, thus affording a detailed basis of the original debt, its readjustments for inflation and the legal interest and fine surcharges that have been applied. It is on the basis of this information that the GTR analysts establish their collection strategies and the payment modalities that may be offered to the taxpayers. Finally, the STA transactions are the fundamental explanatory record of movements reflected in the SFA and which allow the Public Treasury the possibility of carrying out the bank settlement of each individual tax account found in the GTR records.

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Inter-American Center of Tax Administrations
Executive Secretariat
P.O. Box 0834-02129
E-Mail: ciat@ciat.org
Web Site: http://www.ciat.org
Tels.: (507): 265-2766, 223-1044, 307-2428
Fax: (507): 264-4926