Tax Administration REVIEW

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EDITORIAL POLICY

The Technical Cooperation Agreement signed by CIAT and the State Secretariat of Finance, 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 disseminat the different tax approaches in force in Latin America and Europe.

An Editorial Board formed by CIAT officials (the Executive Secretary, the Director of Tax Studies and Research, the Director of Training & Human Talent Development and Head of the Spanish Mission) is responsible for determining the topics and selecting the articles for each edition of the Review.

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

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Content

Editorial

Dear Readers,

We are pleased to present to all the tax administrations officials of the members and associates member countries of our organization and, in general, to the entire international tax community, the Tax Administration Review that is published as part of the Technical Cooperation Agreement that CIAT maintains with the State Secretary of Finance, the Institute of Fiscal Studies (IEF) and the State Agency for Tax Administration (AEAT) of Spain.

This edition presents eight (10) articles: Public tax policies in Angola: Challenges and constraints; The impact of COVID-19 over the tax residence rules for companies and individuals: A Latin American approach; The monophasic sales tax and informality of MSMEs activities; Artificial Intelligence in tax administrations; Tax control of criptocurrencies by the IRS and the opportunities that this may offer to Latin America for regulating their use; COVID and SDG, present and future of taxation in LAC; Relevant aspects of the commercial leasing agreement. Analysis of its treatment according to IFRS and applicable tax legislation; The tax incorporation regime and its tax context in Mexico; Simple tax regime in Colombia: Relevant issues and analysis for the promotion of small business formalization in Colombia; Transaction tracing strategies for addresing tax evasion in the shadow economy: International success stories and lessons for Kenya.

We appreciate the great reception given to the call to submit contributions for this edition of the Tax Administration Review.

We reaffirm our commitment to disseminate information of interest that contributes to learning and stimulates the transfer of useful knowledge for the international tax community.

Márcio Ferreira Verdi
Director of the Review

PUBLIC TAX POLICIES IN ANGOLA:

Challenges and constraints

António Feliciano **Braça**

SYNOPSIS

The object of this article is to map the implementation of fiscal public policies in Angola, and the consolidation of the fundamental tasks of the state. We tried to understand the concepts of public policies and fiscal policies relating them to the Angolan tax system.

This article concludes that the Angolan tax system is changing, and that corporate informality is one of the constraints to its implementation and to the achievement of the public policy objectives. The challenge for the tax system is that tax revenues should contribute exponentially to the balance of payments

Keywords: Public Policies, Tax Policies, Economic Growth.

CONTENT

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INTRODUCTION

In this study on public fiscal policies in Angola: challenges and constraints, the objective is to address the organizational issues of public tax policies in Angola, their challenges and constraints in the context of their implementation.

During the war period, the economic growth was based on the high price of a barrel of oil, which represents more than 90% of GDP. In mid-2014, due to external shocks, with an immediate impact on Angola's balance of payments, there was an intention to consolidate public policies, guided by tax policies.

Pursuant to article 21 of the Constitution of the Republic of Angola (2010) "Fundamental tasks of the State", in its sub-paragraph d), constitute fundamental tasks of the Angolan State to "promote well-being, social solidarity and the improvement of the quality of life of the Angolan people, namely the most disadvantaged population groups".

The fulfillment of these tasks, which are understood as public policies, presupposes the adoption of a tax policy, which adjusts to the Angolan fiscal structure, with a view to boosting revenues.

In order to shorten this article, we will make a literature review of the theme in question by national and international authors, as well as other studies already carried out on fiscal public policies in Angola: challenges and constraints.

In this sense, the research theme is based on the consolidation of the tax reform taking place in Angola, with the emphasis on the replacement of the Consumption tax by a VAT-type tax.

In the methodological field, given the general objective outlined, it was decided to carry out a qualitative investigation, having as fundamental procedure the graphical analysis developed, based on a descriptive approach.

According to the Constitution of the Republic of Angola (2010), in its article 88th "The tax system aims to meet the financial needs of the State and other public entities, ensure the implementation of the State's economic and social policy and carry out a fair and distribution of income and national wealth". The effectiveness of the tax system is guided in the best contribution of taxes, the duty of contribution is called by article 88: "Everyone has the duty to contribute to public and society expenditures, according to their economic capacity and the benefits they enjoy, through taxes and fees, based on a fair tax system and in accordance with the Law"

Accordingly, this article has the following guiding questions:

a) How are tax public policies being developed in Angola?

b) What are the challenges and constraints in implementing public educational policies in Angola?

From this questioning, the following general objective of the study was outlined:

> Mapping the implementation of fiscal public policies in Angola, considering the decrease in the growth rate of Gross Domestic Product and the consolidation of the State's basic tasks.

The general objective of this dissertation is based around six specific objectives described below:

- Characterize the current Angolan tax system.
- Identify the constraints on the implementation of fiscal public policies in Angola.
- Analyze the challenges of tax public policies in Angola.
- Map the main public policy measures.
- Assessing the impact of public tax policies adopted.

- Analyze the implementation of the Value Added Tax; and
- Investigate the impacts of tax revenues on the population's lives.

We believe that the research strategy that best serves the purpose of this study is the qualitative methodology, having as fundamental procedure the graphical analysis developed from a descriptive approach.

This work's organization is structured in three chapters. In the first chapter, we present the theoretical framework where we approach the concept of public policies and fiscal policies, we characterized the Angolan tax system, as well as an approach to the implementation of public tax policies in Angola and their challenges.

The second chapter presents the outlined research plan, the general and specific objectives, given the methodology and information collection that is intended.

The third is dedicated to the presentation and analysis and interpretation of the data collected by the research instrument, used and presented in graphs, depending on the survey.

Finally, we conclude the presentation of the article, reflecting on the analysis of the results, which indicate that the challenges and constraints are the biggest obstacles to the implementation of public tax policies in Angola.

1. THEORETICAL FRAMEWORK

CONCEPTS

1.1 Public policies

Currently, with the various voices that are increasingly raised in favor of democracy, it is common to affirm that the role of the State is to promote the well-being of society, based on education, health, sport, the environment, and others. To achieve this well-being, the State must develop public policies, which must be understood as:

The setting of government actions and decisions, aimed at solving (or not) the society's problems, (Carvalho, 2008, p.5).

Carvalho understands Public Policies as the totality of actions, goals, and plans that governments (national, sub-national or municipal) outline to achieve the well-being of society and the public interest. It is true that the actions that public leaders (governors or decision-makers) select (their priorities) are those they understand to be the demands or expectations of society. In other words, the well-being of society is always defined by the government and not by society. This is because society cannot express itself in an integrated way.

It is important to emphasize, initially, that the public policy does not refer only to issues that involve its formulation, that is, from the consequences of the application of resources, the legal aspects, legitimacy, or only as an attribute of the State. But its historicity, the emergence of ideas and the actors involved must also be debated. After all, it is from the relationship between actors, such as the State, the social classes, and the civil society, as explained by Boneti (2007), that agents capable of defining public policy emerge. Furthermore, as Dias and Matos (2012) well observe, the cooperation between the actors involved, in a participatory and dialogued way, is essential in the process of implementing a given public policy (Estevão e Silva, 2018,172).

Public policies are, therefore, instruments to make citizens' rights effective, intermediating the pact between the State and society. However, there is no certainty that social rights will be implemented, as everything will depend on the greater or lesser representation that each represented segment has (Estevão and Ferreira, 2018, pg.172).

The «Public Policies» are guidelines, guiding principles of action of the public power, rules and procedures for the relations between public power and society, mediations between the actors of the State's society. In this case, there are explicit policies, systematized or formulated in documents (laws, programs, lines of financing) that guide actions that normally involve the application of public resources (Teixeira, 2002, pg.2).

Boneti, cited by Estevão and Ferreira (2018), emphasizes the definition of public policies as the determination of the interests of global elites, such as the International Monetary Fund and the World Trade Organization. These organizations interfere in the development of public policies in peripheral countries, taking advantage of the economic power, through loans, making them adopt homogeneous models of economic and social development meeting the interests of the elite.

However, it is noteworthy that the concept of Public Policy has evolved over time, especially in Political Science. Initially, Public Policies were considered almost exclusively as outputs of the political system, that is, actions carried out by a state entity based on demands captured, negotiated, and transformed from society; and political science was concerned with studying only the inputs, which were those demands of society responsible for the formation of these outputs (Tude, 2010, pg.11).

1.2 Fiscal Policies

Fiscal Policy are actions and measures, focusing on revenue collection and expenditure, with the objective of achieving income distribution, resource allocation, macroeconomic stabilization, reduction of inflation, unemployment rate, and a better supply of goods and services. Good fiscal management is seen as a basic condition for reformulating the macroeconomic aspects, favoring a sustainable economic growth.

For the tax policy, it is important to consider the following elements: government, business, family, and balance. It is up to the government to devise, implement, execute and supervise tax policies, whereas companies, employment generation factor, production of goods and services, income generation and fiscal contribution, and as a result, families that earn income, are taxed and present themselves as the main consumers of goods and services. In this context, the assessment of the implementation of the fiscal policy is consolidated with balance when the revenues are sufficient to cover expenses. The 2008 crisis greatly showed the importance of fiscal policies in capitalist economies such as Angola, where some financial losses are always financed, *e.g.:* some public companies, despite the divergence of economic schools of thought as to the policies to be implemented in the context of crisis. Thus, taxation arises as a set of legal provisions designed to ensure the possibility for the public treasury, to assume responsibility for the payment of these expenditures through taxes.

Thus, considering the theoretical reference, tax policy is understood as the set of measures that influence revenue and expenditure, in order to achieve and maintain sustainable growth rates, focusing on taxation in general, and in particular on taxes, in order to maintain the governmental structure.

1.3 Characterization of the Angolan economy[1]

In 1908, the rubber represented 65% of Angola's exports; In 1946 and 1972, the most profitable production was

1 Presentation by Amadeus Nunes Leitão in 2015, at the Alto Minho Business Confederation "Angola economic market, evolution perspective".

coffee, which became the main export product, with emphasis also on sisal, cotton, and fishery products.

Between 1960 and 1972, the production progression of extractive industries was particularly sensitive in three areas: diamond, iron, and oil.

The diversification of the manufacturing industry took its first steps in this period. Four light sectors, namely food, textiles, beverages and tobacco represented 64% of the total of the industry.

In 1974, Angola entered a turbulent period of war. During that period, the country's productive structure deteriorated to a point of near a standstill for many of the traditional sectors. Even in the face of a war situation in the period 1975-2002, the average GDP growth rate was 2.4%, Capital investment had an average annual growth of 2.4%. This was totally a governmental effort because, at that time, the private sector was practically non-existent.

1.4 Identify the constraints on the implementation of fiscal public policies in Angola

Due to more than 30 years of civil war in Angola, a budget deficit forced the Angolan government to resort to other sources of financing, such as credit revenues. This debt was large, largely exceeding 60% of the Gross Domestic Product. Currently there is talk of more than 90% of GDP, endangering the repayment capacity and the welfare of future generations.

Here we highlight some constraints that jeopardize the implementation of tax policies, which have an impact on public policies in Angola, such as:

1. **Issues for obtaining loans;**

   Having obtained loans, and difficulty in repaying them, many credit institutions put obstacles in the way of the Angolan state's limited ability to repay on time.

2. **Low consumption;**

   Being a country with little production capacity, and with a shrinking economy, reduced domestic production, imports are impossible, and without imports, there is no consumption and without consumption, there is no taxable income.

3. **Credit reduction;**

   With an unbalanced payments balance, financial institutions have less and less of a credit portfolio. Credit has been a preponderant factor for entrepreneurship, for micro, small and medium-sized companies, originating from financing. When there is no credit, the financial capacity to undertake is greatly reduced, with a negative impact on tax policies.

4. **Bureaucracy in the incorporation of companies**

   Currently, the companies are in the economic circuit are the ones that most contribute with tax to the state. However, the intervention of many institutions is almost mandatory to open a company, it is said that the bureaucracy in the constitution of companies reduces the total number of existing companies.

1.5 Challenges of tax policies in Angola

The challenge of fiscal policy in Angola begins with the approval of Presidential Decree No. 50/11 of 15 March, which approves the Executive Guidelines for Tax Reform, consolidated with the Organic Statute of the General Tax Administration, on 15 December 2014, whose objective was a better coordination in the execution of tax policies. The transfer of the personnel, assets, attributions, and legal powers of the National Tax Directorate (DNI), the National Customs Service (SNA), and the Project for Tax Reform (PERT) to the AGT, as well as the attribution of autonomy and administrative, financial, and asset management, are the goals.

Also, the Provisional Plan is also a challenge, a guiding instrument for the economic and social management of Angola, among the required actions. It advocates the creation of "Policy Measures and Actions to Improve the Current Economic Situation. It also guides the creation of a cycle of macroeconomic stabilization, in order to lay the foundations for development, the promotion of trust, economic growth, and social inclusion, with a view to resuming the path of prosperity and inclusion that was interrupted with the 2014 crisis and is in perfect alignment with the 2018-2022 National Development Plan and adjusting the tax policies in harmony with SADC countries.

The challenge of tax policies in Angola is to make them more fair, rigorous, and less prone to fraud and tax evasion, and with tax benefits for the business community. Regarding the General Tax Administration, with competence to execute tax policies, the primary objective is to become an integrated organization of reference, capable of responding to current requirements, capable of reducing the need for external financing, highlighting the taxation as the main source of financing.

Tax policy aims to reduce costs in the taxation sector by simplifying the management structure, strengthening investment in information technology systems and rationalizing the organization of regional and local services, training employees. Finally, as a result of the decrease in oil revenues, this policy becomes a privileged ally of the Executive in the achievement of the goals set out in the government program that can contribute to improve the social well-being of all Angolans.

2. METHODOLOGICAL PROCEDURES

2.1 Methodological Options

Recalling that the central research question raised in this study is mapping the implementation of public fiscal policies in Angola, considering the decrease in the Gross Domestic Product growth rate and the consolidation of the fundamental tasks of the State, this chapter aims to present the strategies and methodological procedures to effectively respond to this guiding goal of the research. Basically, it seeks to map the tax public policies, as well as the challenges and constraints of their implementation.

Figure 1, below, shows the organization of specific objectives according to the general objective, which should not be understood as independent, but rather as consequences for the understanding of the subject under study:

Figure 1. General and specific objective

GENERAL OBJECTIVE
Mapping the implementation of fiscal public policies in Angola, considering the decrease in the growth rate of Gross Domestic Product and the consolidation of the State's basic tasks .

SPECIFIC OBJECTIVES
- Characterize the current Angolan tax system.
- Identify the constraints on the implementation of fiscal public policies in Angola.
- Analyze the challenges of tax public policies in Angola.
- Mapping the main public policy measures.
- Assessing the impact of public tax policies adopted.
- Analyze the implementation of the Value Added Tax; and
- Investigate the impacts of tax revenues on the population's lives.

The qualitative method is suitable for studies of history, representations and beliefs, relationships, perceptions, and opinions, that is, the products of interpretations that humans make during their lives, the way they build their material artifacts, and themselves (Minayo & Deslandes, pg.5).

According Andrade (2001, pg.95) "the research is the set of systematic procedures, based on logical reasoning, which aims to find solutions to proposed problems by using scientific methods "Doxsey. Research is understood as "the construction of original knowledge, according to certain scientific requirements. It need not be exclusively empirical, although this is normally assumed to be the most common and important. The methodology will then be defined as the study of instruments for assembling a theory and the study of theoretical foundations.

After identifying the objectives of the study and determining the methodological strategy to be used, the information collection instruments used to analyze the understanding of public fiscal policies in Angola are now presented: challenges and constraints.

The information collection instrument will be based on a questionnaire with 6 questions addressed to senior employees of the General Tax Administration, as an entity with competence to implement and execute tax policies, as well as the civil society, on which the policies fall, randomly selected on March 9th and 10th, 2020, in a sample of 31 respondents, in the provinces of Benguela, Kwanza Sul, Huambo and Bié, territorially representing the Fourth Tax Region.

The data obtained will be analyzed from a descriptive approach whose objective is to map the implementation of fiscal public policies in Angola, considering the decrease in the Gross Domestic Product growth rate and the consolidation of the fundamental tasks of the State, through the description of facts, seeking to identify, analyze and describe the evidence that must be observed, aiming at scientific knowledge. Descriptive analysis is carried out with the aim of describing the characteristics of the phenomenon (Doxsey, 2011) and "it has as its primary objective the description of the characteristics of a given population or phenomenon or the establishment of relationships between variables" (Gil, 1999, pg.42).

Carvalho discriminates 4 (four) of Public Policies, understanding that the Public Policy formulation process, also called the Public Policy Cycle, has several phases:

- Agenda formation (Selection of priorities).
- Policy elaboration (Presentation of solutions or alternatives).
- Decision-making process (Choice of actions); and
- Implementation (or enforcement).

In view of the above, we consider that the research strategy that best serves the purpose of this study is the qualitative methodology, having as its fundamental procedure the analysis of graphics developed from a descriptive approach, and the questions will be focused on point 4 (four), implementation or execution of actions, upon inquiry.

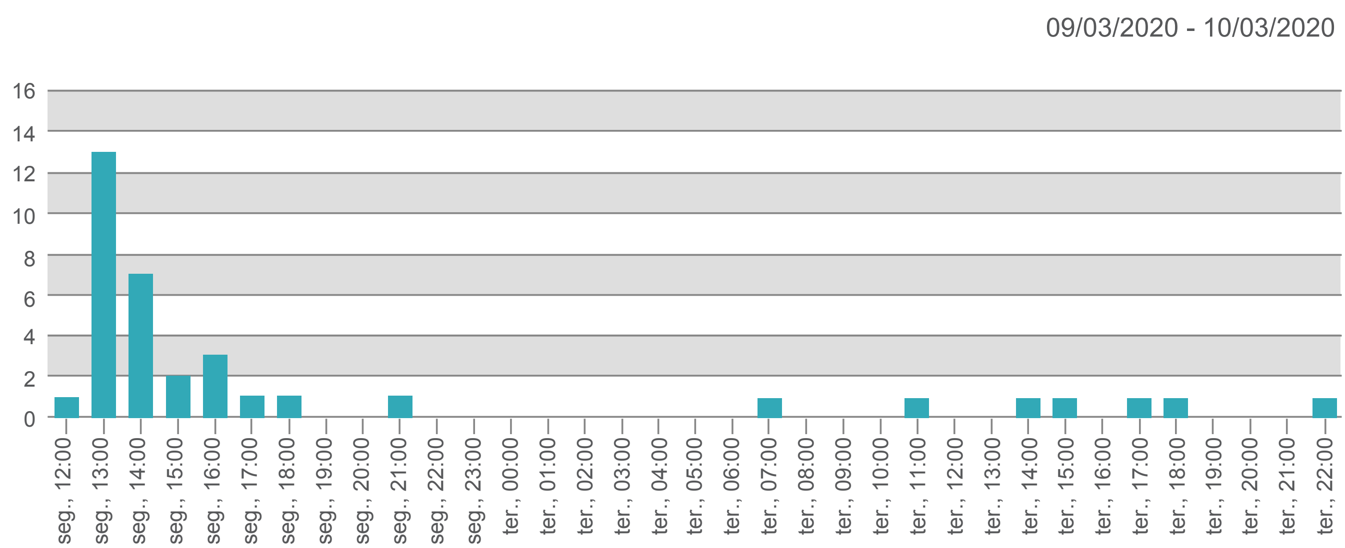
3. PRESENTATION AND ANALYSIS OF THE RESULTS

3.1 Results analysis

In this chapter, we will begin to analyze the results of this article, which has the general objective of mapping the implementation of public fiscal policies in Angola, considering the decrease in the Gross Domestic Product growth rate and the consolidation of the fundamental tasks of the State.

It is possible to verify that the survey was done between March 9th and 10th of 2020, and was done by SurveyMonkey software, sent by e-mail to the respondents. It is noticeable that the period with the most response was 1:00 pm, when some of them have a lunch break and there is more availability.

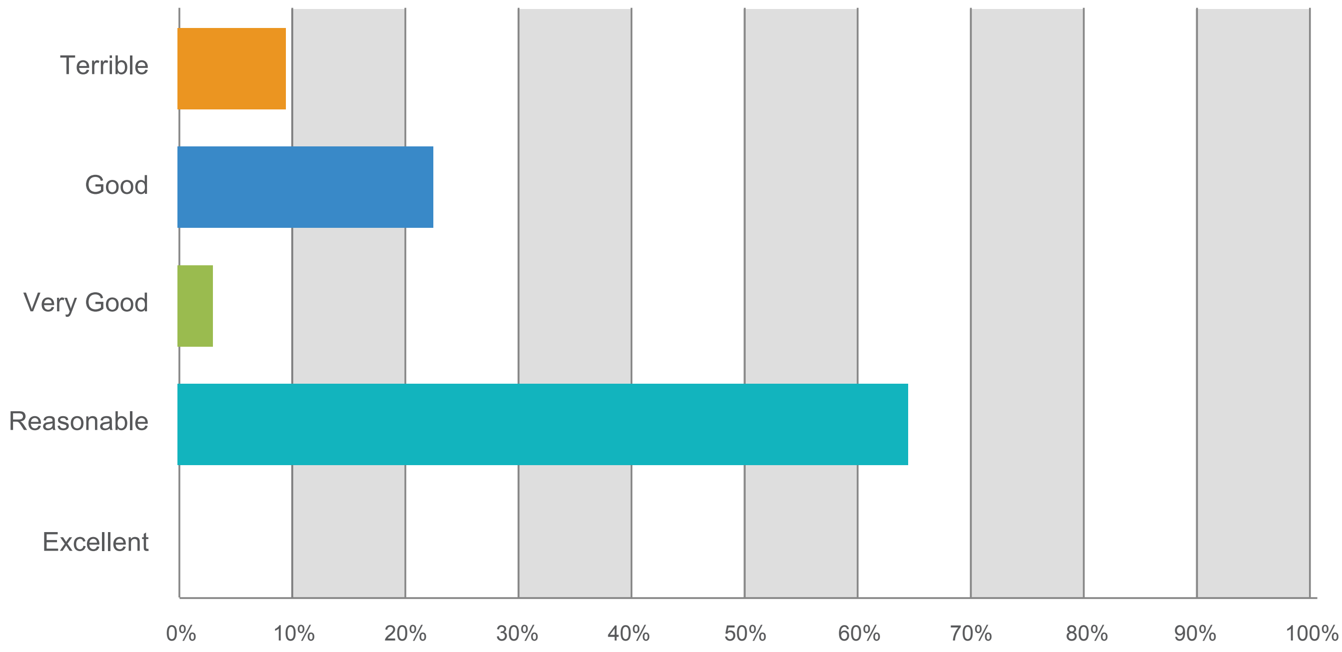
Graph 1. Response volume



Graph 2, and according to the survey, shows that over 60% of respondents consider the Angolan tax system to be reasonable. The tax system is made up of a set of legal norms, which aim, through taxes, for the treasury to carry out public expenditure.

The tax systems must be adjusted according to current changes, the contextual mismatch of Angolan tax laws led to the implementation of the tax reform in Angola, and, although not desired, there is optimism that everything is being done to consolidate the tax bases, with a potential increase of revenue for the consequent implementation of public expenditures.

Graph 2. **Evaluation of the Angolan tax system**

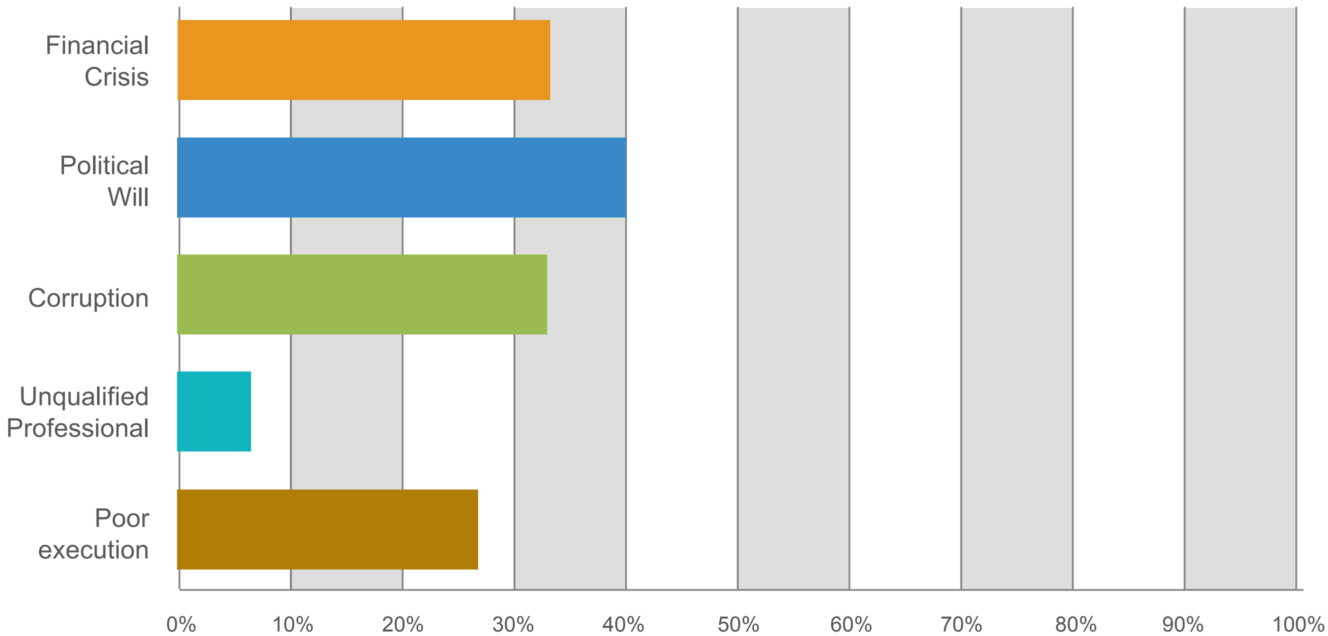


The following graph highlights the financial crisis resulting from the volatility of the price of a barrel of oil, widespread corruption, lack of political will, and poor budget execution as constraints on the implementation of fiscal public policies.

One of the governance targets of the current executive is the fight against corruption, which plagues the country, and is still considered widespread, which respondents associate with constraints.

With regard to qualified personnel, the entities that govern the implementation and execution of fiscal policies have focused on gradual training, and this element has been excluded as a constraint to the implementation of fiscal public policies.

Graph 3. Constraints on tax public policies

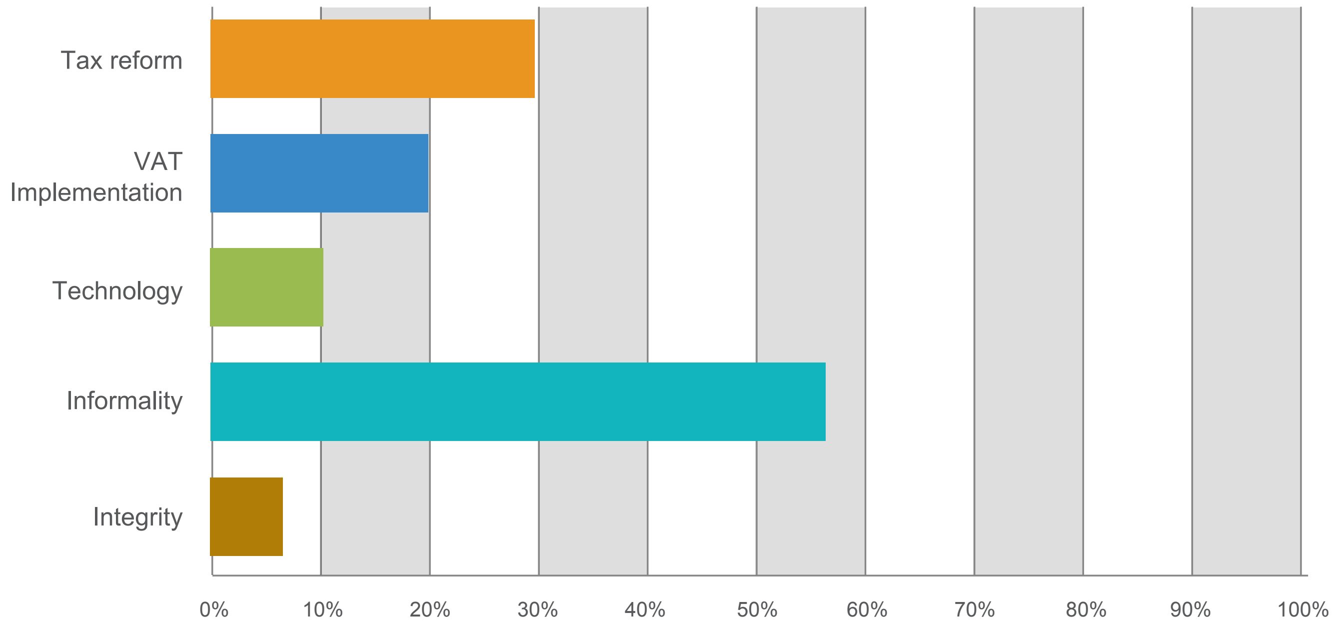


The Executive's General Guidelines for Tax Reform in Angola is undoubtedly the greatest challenge to tax policy in Angola. Among other objectives, they aim to make the Angolan tax system fairer, closer to the taxpayer, modern, able to prevent or reduce fraud and tax evasion, with technicians trained for the major objectives that are sought.

Our economy is mostly informal, and the informal commercial sector stands out as the main element and challenges that must be considered in tax policy.

The insufficiency of skilled technicians for the inspection processes, high unemployment rate, as well as institutional bureaucracy in the formation of companies drive the exercise of commercial activities on the fringes of the law, and this element is a great challenge in the tax sector.

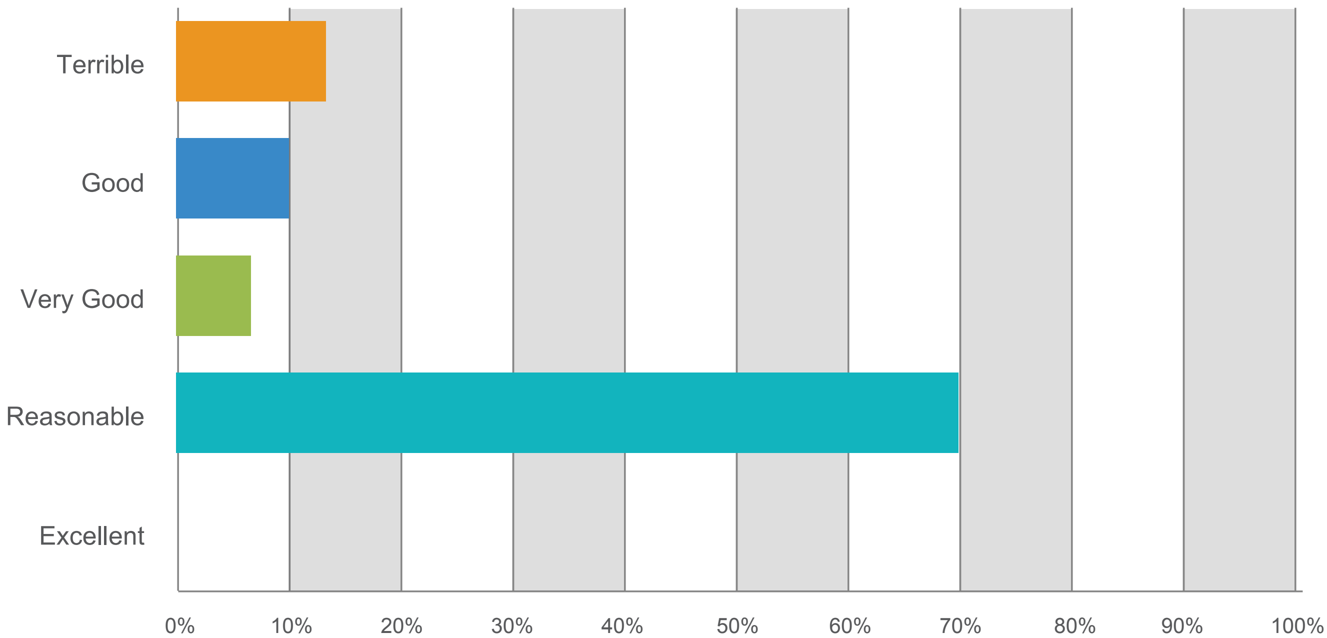
Graph 4. Challenges of tax public policies



Pursuant to Article 101 of the Constitution of the Republic of Angola “The tax system aims to meet the financial needs of the State and other public entities, ensure the implementation of the State’s economic and social policy and carry out a fair distribution of income and national wealth”

The study concludes that the impact of fiscal public policies is reasonable, as the level of financial literacy has increased, and delays the purposes of the fiscal system, including social inequality, health system, education, roads, electricity, communication, poor basic sanitation. Without forgetting the great effort that is being made to revert and maintain high Human Development indices.

Graph 5. Impact of public tax policies

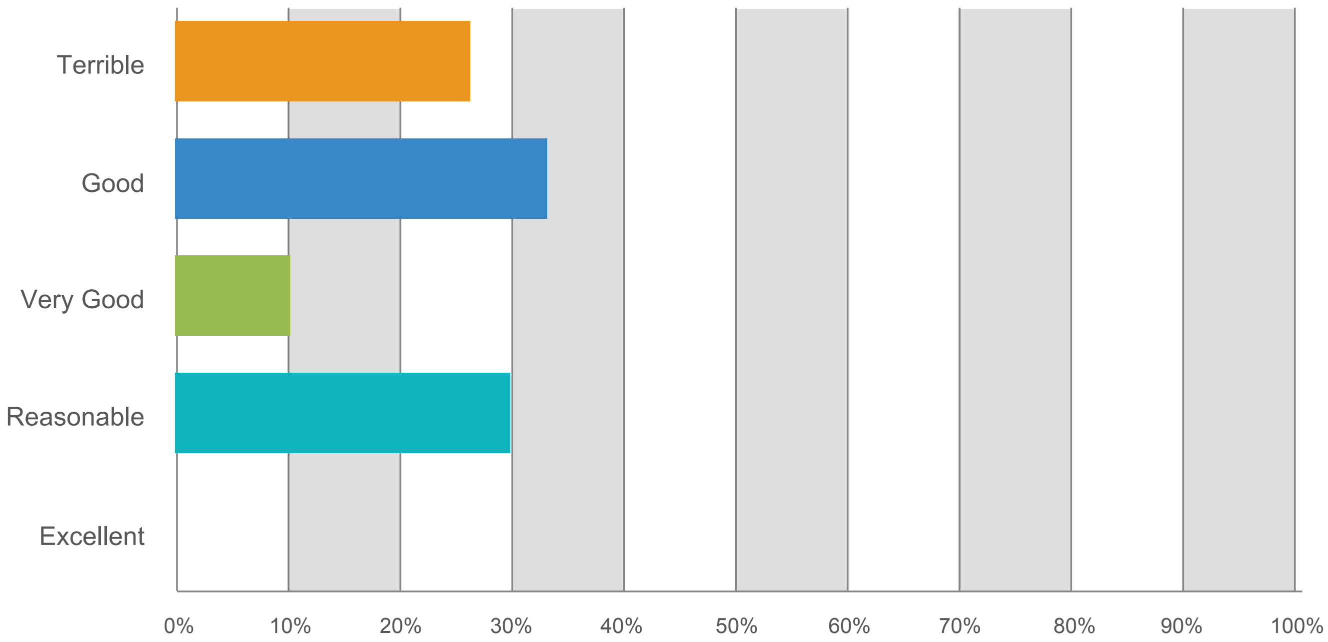


Within the scope of the objectives defined in the Executive Guidelines for Tax Reform, approved by Presidential Decree No. 50/11, of 15 March, with a view to implementing legislative changes, in order to adapt tax legislation to the economic and social reality of the country, as well as the tax practice and the lived experiences wanted and ensured the need to carry out adjustments at the legislative level, namely in the area of Consumption Tax.

The constitutional principles, with equality, legality, contributory capacity, the decontextualization of the Consumption Tax, the IMF recommendations, the Interim Plan and the alignment of SADC policies, led to the adoption and implementation of the Value Added Tax, as it is of the few countries in SADC that did not have VAT in their tax structure.

The graph shows that the implementation of VAT in Angola is good, combined with the pessimism and reasonableness of the respondents.

Graph 6. Assessment of VAT implementation



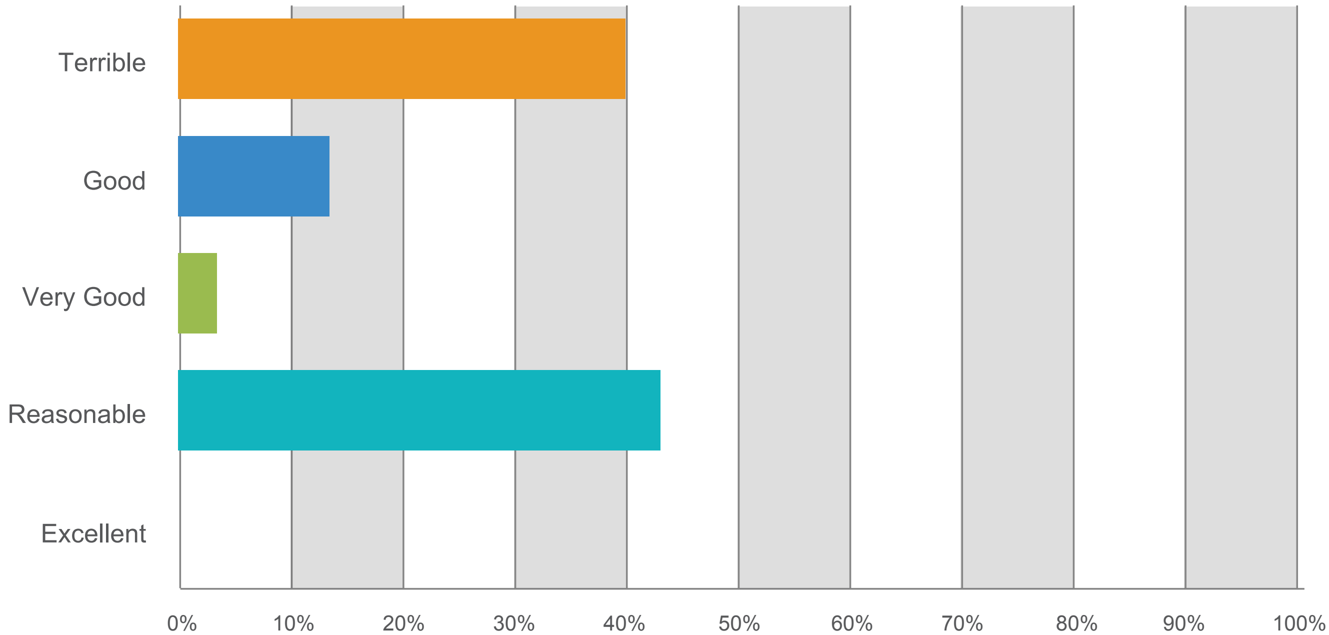
Among the various sources of revenue in the state, the fiscal, considered modern and effective for the consolidation of public expenditure, the growth and development of society depends on the good execution of public expenditure, they lack revenue, each is discontinued. equity and credit income, due to the cost, both of research, and interest, is increasingly focused on tax revenues.

When legal entities and individuals pay taxes, they are contributing to the country's growth and development and, consequently, to national progress.

Part of the respondents consider the impact of fiscal policies on citizens' lives to be terrible, due to the economic slowdown, which has made economic growth and development unfeasible, together with inflation, unemployment, and social inequality.

Most respondents consider the impact of tax revenues on the population's lives to be reasonable, the justification being that efforts have been made, but the insufficiencies and bad practices of old budget execution have reflected the ineffectiveness of current public policies.

Graph 7. **Impact of tax revenues on people's lives**



4. CONCLUSIONS

In this study, we propose to analyze fiscal public policies in Angola: challenges and constraints, and considering the general and specific objective, we reach the following reflections:

The Angolan tax system is changing, and more and more people are trying to adopt the best tax practices adopted internationally. Currently, the tax system is typical of developing countries, with several taxes, complex tax legislation, many technicians, with reduced impact on the national budget balance.

The informal sector, among others, constitutes constraints for the implementation of tax public policies in Angola. It is pertinent that actions concerning the process of formalizing economic activities are increasingly visible and at the mercy of tax policies. Therefore, public policies are consolidated with effectiveness, based on tax policies.

We conclude that 17 years after the end of the civil war that for more than 30 years plagued economic growth, there was still a substantial lethargy related to the execution of public policies. This is resulting from nepotism, corruption, and impunity, the reversal is of this paradigm is essential.

On the other hand, the reasons that led to the implementation of the Value Added Tax have been affected by misinformation and expectation, rather than in terms of the consolidation of tax bases. It is an important tax to boost revenue and expenditures. Exogenous factors, such as technology, tax literacy, informality, have been the focus of improvement in order to achieve the goals intended by the AGT regarding VAT. It is guaranteed that after the transition from the gradual implementation of VAT, the intended goals will be achieved.

In reality, poorly executed public policies have been a reason for rejecting the implementation of tax policies, the weakness of the education, health, infrastructure, basic sanitation sectors, and unemployment, inflation issues should be improved for the synergy of public policies (efficiency) and tax policies (effectiveness).

Finally, it is understood that public tax policies in Angola are not the desired one. More efforts are needed so that the effectiveness of fiscal policies must be the sustainability of public policies. That political discourse must be allied to factual execution, in order to minimize constraints and overcome challenges, in order to effectively carry out the fundamental tasks of the State.

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THE IMPACT OF COVID-19 OVER THE TAX RESIDENCE RULES FOR COMPANIES AND INDIVIDUALS:

a Latin American approach

Omar Sebastián **Cabrera Cabrera**

SYNOPSIS

The adoption of strict lockdowns and quarantines have been usual and common in the early outbreak of the COVID-19 pandemic and were maintained in some places of the world during 2021. In that sense, the closing of borders had a significant impact for the purposes of asserting tax residence for both individuals and companies considering the rules in Comparative Tax Law. In spite of the fact that the OECD released a couple of reports concerning this matter, the truth is that the lack of uniform regulation and the clear impossibility of applying the OECD's tax model tiebreaker and distributive rules in all cases triggered a relevant debate over this topic, which includes Latin American countries.

Keywords: Tax Residence, Place of Effective Management, World Income Taxation, Dual Residence, Tiebreaker Rules, Double Taxation Conventions.

CONTENT

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INTRODUCTION

From the declaration of the virus COVID-19 as a global pandemic in March 2020 by the World Health Organization, the vast majority of countries across the globe have imposed rigid quarantine measures and lockdowns on their citizens in order to prevent the spread of the disease as much as possible.

In this view, to implement this effective protection of the population, an overwhelming number of States ordered the physical closure of their land, air, water and maritime borders. This, of course, resulted in the impossibility of being able to operate ports, airports and other infrastructure related to the transport of passengers to and from abroad.

Under this scenario, many individuals who were temporarily in different territories of the world for different reasons (e.g., holidays, short family visits or temporary jobs) could not leave due to the cancellation of flights and the total prohibitions on cross-border transit described above; put in other words, for reasons of force majeure completely unforeseeable and not attributable to these individuals.

As expected, this unfortunate situation led to the loss of millions of jobs, both formal and informal, in countries on all over the continents of the world, which forced governments to take measures of subsidy and payroll financing, mainly in the sectors most affected by the pandemic, in order to preserve these jobs and thus avoid a greater impact on the economies.

Obviously, the confinement of thousands of their workers forced companies to implement new remote home office work schemes instead of the traditional system of on-site employment in offices, factories, workshops, warehouses, among others, mainly for those employees who could perform their duties in this virtual way without generating major setbacks to the operation.

From income tax´s perspective, this extraordinary situation has generated an interesting and never-before-seen debate in international taxation regarding the application of tax residence rules for both individuals and legal entities, since the criteria of physical presence for individuals and place of effective management for legal entities are at play, and since these two criteria were clearly affected by this new reality, as well as the situation of the so-called cross-border workers.

Based on this background, it should be noted that this article aims to perform an analysis of the impact caused by the Covid-19 pandemic on the tax residence rules of taxpayers, which will consider the documents on the subject issued by the Organization for Economic Cooperation and Development (OECD), as well as the way in which some of the most important countries in Latin America have faced this situation from their internal tax regulations.

For the purposes of text and for the sake of simplicity, we will be using as analogous the terms of “residence” and “tax domicile”, unless otherwise indicated, considering these concepts may, in some cases, not be identical, whereas, in principle, the concept of domicile is more related to a private law approach[1].

Finally, we make it clear that this article will not address the issue of tax residence of diplomatic or consular agents accredited by Public International Law and treaties on international relations, since it is a matter that, in principle, is not completely impacted by the pandemic because these people have a certain tax immunity in the States where they are on duty, so to speak.

1. CRITERIA FOR DETERMINING TAX RESIDENCE

1.1 General considerations

There is no doubt about the importance of the concept of tax residence in terms of direct taxation, particularly in income tax, since historically this criterion has been used as a jurisdictional basis of taxation, along with that of the source (Cabrera, 2017).

1 See comment No. 3 to article 4 of the OECD Model.

Thus, since the issuance of the report of the committee of economic experts of the League of Nations in 1923, the criterion of tax residence has been added to the vast majority of tax systems in the world as a way of exercising taxation based on a subjective factor considering the recipient of the income (Cabrera, 2018).

The importance of this matter is no minor since the status of a taxpayer as a tax resident in a given State generally means that he or she is subject to income tax there on the basis of his *worldwide income*, namely, considering their income from local and foreign sources and also on their global assets, thus materializing a real mechanism of unlimited taxation, which is based on the principle of *ability-to-pay*.

Additionally, it is essential to establish in a precise manner in the domestic tax legislation the rules or guidelines to determine the tax residence not only of individuals but also of legal entities, taking into account the characteristics of these taxpayers, since it would be completely incoherent to apply the same rules to both indistinctly; it is clear that individuals exist, corporately speaking, having mobility, wealth and family ties, while legal entities are merely legal inventions for the development of meritorious, mercantile or economic activities.

In this line, thanks to the great importance of the OECD´s Tax Model (OECD Model), which can be considered as the tax guidelines of the greatest acceptance and use worldwide, a kind of common tax language has been created, in which several institutions of International Tax Law included in this tax model have disseminated and become customary in domestic tax systems with a certain familiarity and similarity between them.

The above conclusion is clearly reflected in these tax residence criteria, since, from a comparative tax law analysis perspective, it is possible to notice the use of the criteria of physical presence and center of vital interests to assert the tax residence of individuals; while the incorporation criterion and place of effective management (POEM) are the yardsticks used to establish which legal entities are national for tax purposes, where it is fair to say that the use of the latter concepts is also due to the influence of Private International Law (Kulcsar, 2011).

1.1.1 Individuals

Without seeking to generalize about this, it is fair to point out that, in terms of the physical presence of individuals, by general pattern, a presence greater than or equal to 183 calendar days is required to be considered as a tax resident. Thus, it can be said that this period of approximately 6 months of physical location corresponds to a magic number in international taxation that has been universally accepted to impose tax residency on individuals; of course, without leaving aside the fact that there are variants and alternatives regarding this rule in each particular tax legislation (for example, the way of calculating the days, if the days of entry and exit are taken into account, etc.).

This statement is supported by a study of the domestic tax laws of different States located on different continents, since countries such as Germany[2], Australia[3], Canada[4], Spain[5], Italy[6], France[7], India[8], Portugal[9], New Zealand[10], just to name a few, adopt this physical threshold, and

2 Articles 8 and 9 of the Abgabenordnung.

3 Income Tax Assessment Act 1936.

4 Section 250 (1) (a) Income Tax Act.

5 Article 9 of the Personal Income Tax Act.

6 Article 2 Codice Fiscale.

7 Article 4 (b) of the Code Général des Impôts.

8 Section 6 (a) of the Income Tax Act of 1961.

9 Article 7 of Decree-Law No. 442-A/88.

10 Section YD1 Income Tax Act 2007.

the same applies to a significant number of countries in the LATAM region, as will be seen later in the text.

However, it is also possible to demonstrate in comparative tax law that the criterion of the “center of vital interests” is adopted as an autonomous mechanism for determining the tax domicile of individuals, which basically refers to the nation where the person maintains his or her closest family, financial and economic ties.

1.1.2 Legal entities

With regard to companies, the first criterion that emerges is the place of incorporation, punctually, the jurisdiction where the status or legal personality of this entity is recognized (Rivier, 1987). Even though we cannot talk *stricto sensu* of the nationality of companies, since citizenship is exclusive to individuals, the truth is that the legal system that recognized the moral entity determines its nationality (Couzin, 2002).

On the other side is the POEM criterion, considering that also from the legal and commercial perspective it is possible to recognize entities when their administration and management are within a certain territory, although they were not incorporated under the law of that State. That said, for tax purposes, it is possible for a foreign entity being considered as resident or national for tax purposes for having in a country its material day-to-day management needed to carry out the business. However, it is worth saying that this has been a controversial issue in the tax doctrine, as the analysis should be made on a case-by-case basis, considering all the facts and circumstances applicable to each specific situation and considering the tax law in each jurisdiction.

This criterion, which can be said to be originated in the United Kingdom by a court ruling of 1876 upheld in 1906 in the famous case *Beers Consolidated Mines v. Howes*, was added as a tie-breaker rule in the London model of 1946, which was prepared by the League of Nations, but also in the first OECD model of 1963, and it has remained there since as a concept related to the tax residence of legal entities, which has led many jurisdictions to adopt it in order to implement article 4 of the OECD model, among other reasons.

However, it is essential to emphasize that due to the OECD´s model update in 2017, carried out taking as a guideline the recommendations of action 6 of the *Base Erosion and Profit Shifting* (BEPS) action plan, the use of the POEM as a tie-breaker mechanism in cases of companies with dual residence was abandoned in order to avoid abusive tax structures. Hence, the POEM was replaced by a consultation instrument between the competent authorities, who must determine the place of tax residence of the entity being subject to this procedure (considering the POEM, country of incorporation and any other criterion), which would be necessary to grant access to the benefits of such tax convention unless these authorities agrees otherwise.

Having said that, the impact that COVID-19 has had on these tax residence criteria will be analyzed, which have been generated and exacerbated by the almost complete and hermetic closure of the countries.

1.2 Difficulties generated by COVID-19 in terms of tax residence

1.2.1 Individuals

For individuals, it is easy to understand that the problem here is reduced to the application of the criterion of physical presence within the territorial limits of a country, since it is precisely with respect to this element that the effects of restrictions on the international movement of individuals are seen.

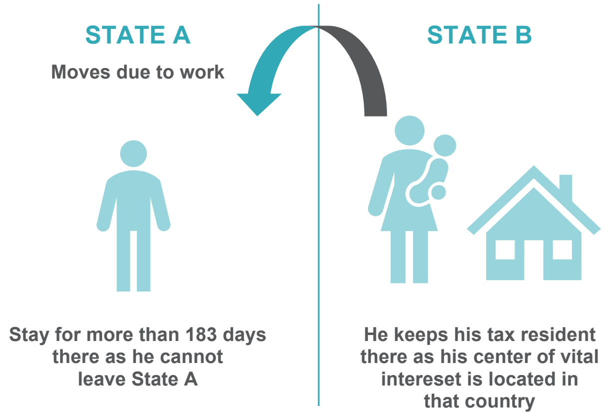
As a result, it should be pointed out that the problem lies with all persons who, prior to the outbreak of the pandemic, were on foreign territory for whatever reason, but who planned to return to their home countries, which they were unable to do because of the closure of international borders.

Thus, if in the territory mentioned in the first place there is a tax rule in which any person who remains there for more than 183 days during the year is considered as a tax resident subject to taxation on its worldwide income, there is a very high possibility that this person, against his will and intention, becomes or has become a tax resident there.

This fact is exacerbated by the fact that there is a significant possibility that the country of origin also considers him as a tax resident by the fact that he or she has his center of vital interests or main business center there, causing this person to have dual residence and, consequently, to be taxed on all his income and capital in those two countries simultaneously.

However, this situation could be reduced if these States in question grant a right to credit foreign taxes, but it should be noted that this may not be sufficient to avoid this double taxation that should not have been generated in the first place, or it could hypothetically occur that this tax credit would not available due to domestic tax restrictions.

To illustrate the case brought up, note the illustration below made by us, in which there is an individual who before the pandemic moves from State B, which is his country of residence, to State A, where he goes for work. We see here how this individual, spending more than 183 days in State A because of an impossibility to leave, becomes a tax resident there, although he maintains his residence in State B since his assets, properties, and family are in that country.



It is worth saying that this problem can be solved by means of the tiebreaker rule stipulated in article 4 of the (OECD Model), only if between both States there is a Double Taxation Convention (DTC) that resolves the issue.

Considering this, article 4 of the OECD Model establishes the tiebreaker rule that puts an end to conflicts of double residence, which, in the words of the OECD´s Model comments[11], serves as a tool to determine in which State the subject in question has greater attachment, considering certain factors.

Following this tiebreaker rule, the prevailing State can be determined, that is, the one that can consider the taxpayer as a resident in order to have the right to impose taxation on his or her worldwide income; while on the other side will be the looser country which can only taxed this person considering the local income generated therein, provided that it is in line with the distributive rules of the tax treaty.

Due to this, there are the hierarchical criteria foreseen in the tiebreaker mechanism, which seek to determine that the ties of the person with the prevailing State are much more intense and clearer than those he has with the other country. These criteria are, in order of importance, the following:

a) *Permanent residence:* the person will only be a resident of the country where he / she has permanent residence. The commentary defines it as the place where the person lives in a stable manner, without inferring that he could live there only temporarily. Regarding permanent residence, the OECD model guide indicates that it can be owned or rented, but that it has to be available to the person on a constant basis and not on a short-time basis for reasons of pleasure, business trips, or similar situations[12]. In the event that the person has permanent residence available in both countries, the tiebreaker is decided in favor of the place where the center of vital interest is located.

b) *Center of vital interests:* it refers to the place where the person has his closest personal and economic relationships. Hence, it must be considered the place where the family, friends, occupation, political

11 Commentary No. 10 to article 4 of the OECD Model.

12 Commentary No. 13 to article 4 of the OECD Model.

and cultural interests, business, the management of his assets, etc.[13], are located which should be analyzed in each specific case.

There can be two different outcomes: (i) the first is that this person has permanent residence in both contracting states, but it is not possible to establish the place of his center of vital interests, or (ii) the second corresponds to the events in which the person does not have permanent residence in any of the countries, in which to illustrate this case the comments bring the example of a person who lives in hotels between both jurisdictions. In either of these two cases, the rule is resolved in favor of the place he/she stays more (place of abode).

c) *Place of abode:* here it is important to indicate that, in principle, this concept would correspond to the State where the person spends most of the time, regardless of the reason for which he or she does so[14]. Although a certain threshold of time of presence is not established, it must be of such a magnitude that it is characterized as being frequent, lasting and regular[15]. In the event that the individual does not live in both States either, the hierarchy chooses the country of which he or she is a national.

d) *Nationality:* for this purpose, the definition of "national" established in article 3 (g) of the OECD Model must be used. Finally, if the person is a national of both or none of the countries, the matter must be resolved through an amicable procedure (known as MAP[16]) considering the rules of article 25 of the OECD Model.

It can be noted that these rules do generate tax relief for the situation under study, by giving priority to one tax residence over the other. However, considering the problem generated by the COVID-19, the issue here is that there will not always be a DTC that can resolve this problem, especially considering that comment N°5 of article 4 of OECD Tax Model expressly points out that, in the absence of the tie-breaker rule, it would not be possible to solve this double residence based solely on the internal rules, which is why a large number of individuals could become or will become unlimited taxpayers in two or more States because of the pandemic.

1.2.2 Cross-border workers

For contextualization purposes, let us remember that the distributive rule that governs the taxation of labor income and similar payments – other than pensions - is set forth in article 15 of the OECD Model. This article enshrines the principle by which labour income must be taxed only in the State in which the labour activity is materially carried out (known as "*principle of place of work*"), regardless of whether the effects or results of such work are consummated or have implications in the other Contracting State.

However, this tax distribution rule also refers to cross-border workers, i.e., employees that are residents in one of the Contracting States who move to the other State to provide their services. That being said, the source country where the worker arrives to develop his work may also tax the labor income derived from these activities if any of the following conditions are met:

a. The worker remains there for more than 183 days within a 12-month period beginning or ending in the respective taxable year.

b. The employment liability is assumed by an employer who is a tax resident of the source country.

c. The wage cost is assumed by a PE that the employer owns in the source country.

13 Commentary No. 15 to article 4 of the OECD Model.

14 Comments No. 17 and 18 of Article 4, OECD Model.

15 Comments No. 19 and 19.1 of article 4, OECD Model.

16 Mutual Agreement Procedure.

Therefore, the challenges posed by the pandemic are related almost exclusively to paragraph (a) above, since it is the criterion that has to do with a physical presence.

Therefore, it is feasible that considering these rules of article 15, a border worker would be subject to taxation in both the country of source and residence, even if this was not the intended purpose from the beginning, although here the advantage of the treaty is the obligation of the country of residence to grant tax relief considering article 23 of the OECD Model.

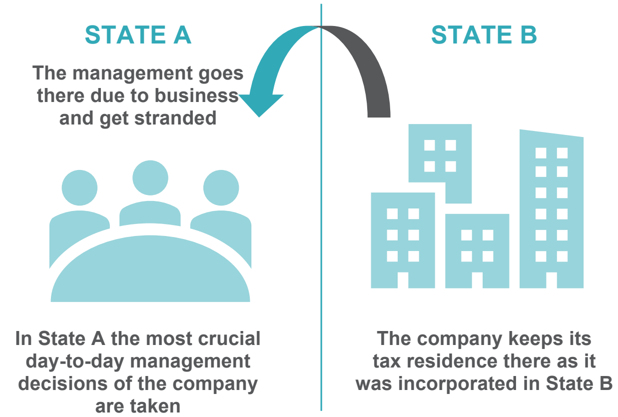
Although the matter was previously analyzed independently, this tax issue of cross-border workers clearly interrelates with the criterion of tax residence, since, if the worker stays more than 183 days in the country of source, he can become a tax resident there.

Finally, it is worth clarifying that, considering the OECD Model, these rules do not apply to workers regularly linked to entities that develop the international transport business, since in these cases, these labor incomes can only be subject to taxation in the country of residence of said operator.

1.2.3 Companies and other entities

Starting once again from the reality that various domestic tax rules provide both the criteria of POEM and incorporation, it is possible that high officials and top management of a company, who in turn met with functions of managing the day-to-day, could have moved individually or to a particular jurisdiction for a reason such as, for example, business, or a business summit, making that the place of control and management migrate temporarily to that new State.

It is possible that, based on the management and direction of these officers of the company, it can be considered that the company to which they deploy their functions is considered as a local entity in the host country for tax purposes because the POEM is now settled there. This shows that, if in the country of origin the incorporation criterion is adopted for determining the tax domicile, double taxation may be generated as the legal entity becomes an unlimited taxpayer of income tax in those two countries, which can be looked at the graphic below made by us.



Again, the only possibility of solving this problem of dual residence results in the situation where between the two States there is a DTC including a tiebreaker rule. In this regard, before 2017 the tiebreaker rule was resolved in favor of the POEM country, while after 2017 the agreement of the tax authorities is necessary, considering the aforementioned.

Thus, for that purpose, one would have to look at the particular tie-breaker rule of each DTC, but in the event there is not a DTC in place, this entity would simply have dual tax residence. However, it should be emphasized that this dual residency situation, while theoretically possible, in practice it may not be so feasible for the entire management of a company to be trapped in another State, although again it is a possibility.

2. OVERVIEW OF THE DOCUMENTS PREPARED BY OECD

2.1 April 2020 report

At the behest of the OECD´s member countries, on April 3, 2020, the first report prepared by this international body was released, which analyzed the most important impacts of the restrictive measures on the movement and mobility of people on some issues of DTC and international taxation. The above considering that these OECD documents, as a rule, are considered simply as elements of soft law and hence its observance is not mandatory, although this depends on each country.

Thus, these individualized topics were: (i) risk that employees delocalized for reasons of COVID-19 activate a permanent establishment (PE) of their employer in the country where they were located; (ii) migration of the tax residence of companies due to changes in the POEM; (iii) considerations in the tax residence of migrant workers, and (iv) aspects of tax residence for individuals.

These points above-mentioned will be analyzed individually, without taking into consideration the aspect of the PE, since it is beyond the scope of study of this article.

2.1.1 POEM-related changes

On this issue, it was emphasized that it was possible that the lack of international transportation could cause the POEM to migrate from one State to another because the management and senior executives of a company were located in a foreign territory, which could eventually lead to a dual residence of this company for the reasons explained.

However, the OECD indicated that these possible situations of simultaneous residence in two or more countries are a strange and uncommon phenomenon in the real world, and should not be generated by the COVID-19 as indicated by the comments to the OECD Model.

The first argument to support this idea is that some jurisdictions, although only Ireland is mentioned, have implemented specific legislation that exclude the presence of directors of foreign entities in that territory on the grounds of restrictions on international travel for the purposes of determining whether or not there was a POEM.

The second argument, which may be controversial in our view, was based on the idea that a temporary change of location of a company's management should not per se move the tax residence there, considering the formal criterion of POEM, mainly by the application of the OECD Model tiebreaker rules, minimizing, in our opinion, the importance or effects of this issue in events in which a DTC has not been signed between the respective jurisdictions.

Under this idea, the OECD indicates that this problem can also be solved peacefully through the tiebreaker rules of article 4 of the OECD Model, where the solution will depend on whether or not the DTC contains the new BEPS standards implemented by the OECD in 2017 and that were previously outlined in the text, which is analyzed separately below.

2.1.1.1 Treaties with post-2017 residency clause

Thus, in the event of a dual residence dispute to be resolved in the light of the 2017 OECD Model rule, the guide establishes that the tax authorities must reach an agreement to determine the tax residence, considering incorporation, the POEM and any other criteria, and that, in the absence of this agreement, this entity was not entitled to the benefits of the DTC.

However, for the above case, the dossier focuses entirely on the new comments to Article 4 of the OECD tax model, since it is emphasized that this agreement must be reached considering the place where: (i) meetings of the company's board of directors or equivalent body are *usually* held; (ii) the chief executive officer and other senior executives *normally* carry out their activities; (iii) where the day-to-day senior management of the company takes place; (iv) where the company's headquarters are located, among others.

As the guide does, we have intentionally italicized the words "habitually "and" normally", as we believe it is one of the pillars on which the OECD position rests.

In this sense, this special emphasis on these two words implies that the reason why it is considered that the POEM would not migrate is because the day-to-day administration of the company was not constantly in the territory where its management moved and from where it could not leave, but that the latter was in the State where traditionally and historically these management activities had been developed.

To illustrate the above, consider the following example, where both State A and State B adopt both incorporation criteria and POEM to establish the tax residence of companies. This being said, there is an entity called CompanyCo that was incorporated under the law of State A and also its top management and senior officers are generally there, which means that the POEM is in that territory. Now, imagining that these officers moved to State B for business reasons and that they could not leave that country after the closure of its borders, it would happen, in principle, that CompanyCo will have dual residency in A and B for reasons of being incorporated in A and having its POEM suddenly in B.

Based on OECD considerations, if between State A and B there is a DTC drafted under the OECD guidelines after 2017, there would not be a dual residence problem, since, again, in a habitual and normal way the place of management was always in A, where the fact that decisions were made in State B was purely fortuitous reasons. As noted, in this case, it is essential to define that the normality in the direction of the entity has been maintained consistently and for a relevant time in the initial country.

However, we believe that the note does not solve the problem that may arise when among the jurisdictions in question there is no DTC in force, which could have a significant probability considering those countries that have a limited network of tax agreements. Thus, for example, if in the case in question no such international agreement has been signed, the truth is that CompanyCo may end up being taxed on its world income in both States, unless State B has put into force legislation that excludes the possibility of generating a POEM there.

We refer to the fact that this double residence is likely to occur, since the matter will depend to a large extent on the tax regulation of the POEM and its judicial and administrative interpretation, considering the migration jurisdiction (in this case State B), because it is possible that the factor of habituality is not of interest when determining this element. In any case, it may happen that the legislation of the country to which the POEM moved considers these two concepts as objective yardsticks for assessing tax residence, in which case the OECD theory could be applied in a general way.

However, we believe that in either case this analysis should be carried out on a case-by-case basis considering all the relevant facts and circumstances, the tax laws involved and the specific DTC rules that might apply.

2.1.1.2 Treaties with pre-2017 residency clause

Returning to the difference between the OECD Model after and before 2017, regarding the pre-2017 clause the OECD indicated that in this case the tiebreaker rule was resolved in favor of the State of location of the POEM, as is obvious from the existing rules before the update carried out in that year.

Again, it is indicated that also in these situations there would be no impact on the POEM of a company due to the pandemic, where once again a specific comment from the OECD Model is resorted to justifying the position. However, it is essential to emphasize that this is a comment to article 29 of the OECD Model, a provision that regulates the new anti-abuse clause of this agreement also included in 2017 due to the influence of action 6 of the BEPS plan.

From the outset, this is an issue that can become controversial; we refer to the adoption of the dynamic and not static vision of the comments to the OECD Model, since this comment is new and, therefore, did not exist when these agreements were signed. Without entering into the discussion as to whether or not the comments can be applied retroactively to previous DTCs, which basically depends on each domestic legal system, the fact is that there is a debate on this issue, which makes it a position that is not so clear.

Apart from this contentious point, the commentary in question indicates almost verbatim that some States consider the concept of “POEM “ to be *ordinarily* the place where the highest-ranking person or group of people (e.g., a board of directors) makes the key management and business decisions necessary for the conduct of the company’s business.

Again, the dossier italics the term "ordinarily", from which it can be extrapolated logically that, similar to the cases of post-2017 DTCs, the OECD justifies its interpretation considering an element of frequency and the territory where the POEM conventionally was.

Likewise, we consider that this very sharp conclusion of the OECD has some drawbacks, since again this depends on different factors, one of them being the way in which the element of ordinary is weighed in the POEM analysis in the country of migration.

Under this scenario, it can happen, in the hypothetical case raised above, that the tie-breaker rule is resolved in favor of State B, where although there will be no double taxation for a residence-residence conflict, the taxation of world income will go from State A to B, clearly damaging this first country. However, this would not happen in those DTC that deviated from the OECD Model and, to that extent, added the criterion of incorporation instead of that of the POEM for the purposes of the tiebreaker; here the Company would undoubtedly maintain its status as a tax resident in country A.

2.1.1.3 Topic's general conclusions

As a general conclusion of this issue in relation to companies, although the OECD considers that in terms of POEM it would be no implications regardless of the date of the DTC, either before or after 2017, considering the comments to the OECD Model, we believe that this has some drawbacks.

First, it would be necessary to determine the value of the comments in each jurisdiction, since all the arguments are based on these. Secondly, there is not always going to be a DTC and hence a tie-breaker rule that could resolve the residence dispute. Thirdly, this matter depends too much on the legal, judicial and administrative approximation that the concept of POEM has in the migration jurisdiction, mainly in the absence of a DTC.

In addition to these factors, we believe that this solution, which the OECD seeks to give a universal scope, must be contrasted with each case and, therefore, could not be applied automatically or absolutely.

2.1.2 Individuals

About this topic, the report begins by indicating that, despite the difficulties of the issue and the multiple factual situations that could arise, adverse tax effects of double residence should not be generated for individuals who were trapped in a certain territory, considering the inconvenience in mobility generated by COVID-19.

One of the points to support this view, which might be questionable in our view, is that it highlights the fact that a group of countries had enacted legislation or regulations to expressly exclude from counting days spent in that territory by a person against his will. However, it is worth noting that only the cases of the United Kingdom, Ireland, and Australia were mentioned, where we share the criticism of Báez and López that this approach is quite anti-technical if we bear in mind that the purpose of the document is to be a guide to the impacts of this pandemic on the provisions of the DTC and not matters of interference in domestic tax rules.

Now, on this issue, the report goes on to say that it is possible to identify individuals in two different situations. The former, who were temporarily outside their country of residence for vacation or short work, but because of the pandemic could not return to their place of residence and could become tax residents in the country to which they had moved; and the latter, who are people who had migrated to a territory becoming tax residents there, although on the occasion of the Coronavirus they had returned to their countries of origin being able to become tax residents again there, or who had always maintained simultaneously a tax domicile in that place and the State to which they emigrated.

Below are the reasons why the OECD considered that there would be no impact in either case. However, before we get in there it is important to put in mind that the note develops a known issue, which is that the local tax legislation is the starting point for determining the tax residence of individuals under the framework of the DTC and that, for this reason, it is possible for an individual to have dual tax residence in both contracting States, which can be resolved, as we said previously, by using the tie-breaking rules and considering their order of hierarchy.

However, one has to mention that the OECD set aside a fundamental issue; we refer to what happens to the tax situation of these people when there is no DTC between the country of initial or permanent residence and the country of temporary migration from which they could not leave, as the case may be. That being said, it is clear that, in principle, under this circumstance, these people would not have a window to escape and could end up being domiciled tax in both jurisdictions (Cabrera, 2020), in which case their only way to overcome somehow these surcharges would be the tax credit for taxes paid abroad (although considering that this may not be enough) or the exemption (if this method exists in the domestic law of that country).

Finally, we consider it important to mention that, at the end of the study of this section of the report, the OECD calls for the tax authorities to consider a more normal time of physical presence in the short term when determining tax residence in these situations.

2.1.2.1 First group

Based on the hierarchy of the tiebreaker rule, it is concluded that the individual, in most cases, would not become a tax resident in the country to which he or she moved, since it is most likely that his permanent home will remain intact in the country of origin, considering that this criterion is the first to be considered within the tiebreaker ladder.

Now, it goes on to say that in the hypothetical case in which the person would have rented a home for a significant period of time in the country where he/she had to stay in a forced manner and, simultaneously, has put in rent their dwelling place in the country of origin, to exist, somehow, permanent home in both countries, one has to look to the following criteria of tie-breaking rule that corresponds to the center of vital interests (location of family ties on economic and financial, etc.), which should be located in the real country of residence, leading to not generate double residence or migration in the initial and historic residence.

2.1.2.2 Second group

In this other group of individuals, the issue of establishing their tax residence is not as clear as it seems, since the OECD´s note recognizes that it is possible that the person still maintains relevant and stronger links with their country of origin (called by the report as the "*home country*"), which may tip the balance in favor of this State against the current state of residence (called by the report as the "*current home country*").

However, it is concluded that the residence should not migrate from the jurisdiction of current residence to the jurisdiction of origin, by reason of the application of the tie-breaker rule that takes into consideration the habitual residence, that is to say, the place where traditionally this person had been living since before the pandemic. Therefore, it is indicated that, in the light of the rules of the DTC, in this situation the person would maintain his tax residence in the first mentioned State, and, in this way, there would be no problems of dual tax residence.

2.1.3 Cross-border workers

In this matter, we begin by considering the payroll subsidy measures that were implemented in several countries in order to prevent the pandemic from affecting employment. Having said that, for our part, this situation is illustrated in the case of a worker from the State of residence who moved to the country of the source to provide his professional services on a temporary basis, but who was unable to leave, although he receives a total or partial labour subsidy from an entity or employer from the State of residence.

Thus, the OECD concludes that these subsidies can be classified under the concepts referred to in commentary No. 2.6 of article 15 of the OECD Tax Model, which, it must be said, corresponds to indemnity payments for not notifying dismissal within the time established in the labor law for this purpose. As can be observed, this conclusion is quite contradictory, since, in our opinion, the subsidies treated in the paragraph described above and compensation payment for breaching a labor provision cannot be taken as equivalent, since precisely the first of them is paid with the purpose of maintaining in employment, while the other when the labor bond has already ended or is intended to be completed.

However, it is worth clarifying that, under this view of the OECD and the comments to the OECD Model, wage subsidies can only be taxed in the place where labor services were traditionally provided, that is, it is the initial country of residence, thus avoiding double taxation.

Leaving this antagonism behind, the note establishes that, by applying the above commentary, these payments of employment benefits can only be taxed in the country of initial residence, so that the jurisdiction to which this person moved cannot claim any amount, resulting, as mentioned, in the absence of international double taxation. However, the note remains rather confusing, as it points out that in the case of multiple taxation, the State of residence must grant tax relief in accordance with article 23 of the OECD Tax Model. Finally, we again draw attention to the fact that these questionable solutions can only be put into practice if a DTC is applicable.

On the other hand, it is possible that the State of residence of the employee loses its tax law following the application of article 15 of the OECD Tax Model, bearing in mind that this person could stay more than 183 days in the country of the source and, thus, lose their resident status in the initial country of residence. Under this scenario, it must be said that the document recognizes that these situations can result in tax compliance problems for both the employee and the employer.

From the employer's point of view, the problem consists in the fact that since the employee is still on the payroll, it is quite feasible that he/she must continue to perform the tax withholding required in that jurisdiction, which is aggravated by the fact that this withholding is no longer based on substantive tax law since this country could not request any tax because this employee is no longer a resident or generates a local source income (the work is performed in another territory), resulting in the note advocating ways to avoid this withholding or that the employee is entitled to an effective refund of the amounts withheld.

For its part, considering the situation of the employee, by becoming tax resident in a new jurisdiction, different from his or her country's traditional tax residence, he could be forced to register for tax purposes and file tax returns there, where we believe that the great difficulty revolves around having to ensure this tax compliance in respect of a tax system that, in principle, is completely unknown to him or her. This can lead to hiring experts on the matter to avoid falling into tax violations, clearly generating new costs for the worker.

Now, in one or another case of the negative situation that could be generated for both the worker and the employer, the OECD invites the different jurisdictions to implement regulations or guidelines that allow reducing as much as possible these additional tax burdens that should never have been activated in the first place.

To conclude, although it is not a strictly fiscal issue, the dossier indicates that this difficult situation in the limitation of international transit may affect the special provisions on the regulation of cross-border workers agreed in other bilateral international treaties (we consider that they would mainly be treaties on migration matters), especially those that limit the number of days a foreign worker can work in the other State.

2.2 January 2021 report

Again, on the basis of the 4 points developed in 2020, in January 2021, an update of the 2020 report drafted by the OECD was disclosed to the international tax community. That document makes it clear that this analysis is simply a guide expressing the opinion of the OECD General Secretariat, which does not reflect the individual position of each member country and includes the comment that it also outlines the particular solutions used by different States. As before, the issues will be addressed individually for each topic analyzed in the 2020 report.

2.2.1 Legal entities

It is clear that the update made in 2021 did not establish a shift or change from the conclusions already reached in 2020. In that regard, the only new thing that can be highlighted from this report at this point is that more examples were provided of jurisdictions that had taken steps to ignore the fact that senior executives of foreign entities had not been able to emigrate from those places.

Hence, in addition to indicating again the case of Ireland, the examples of other new countries were included, among which are Australia, Canada, New Zealand, the United Kingdom and Greece. Although a guide adopted in the United States by the Internal Revenue Services (IRS) is mentioned, it draws attention to the fact that it refers to individuals and the application of the *substantial presence test*, thus it is not understood why it is indicated in that chapter and again also in the section on individuals, as will be seen below, all the more so when that country has not adopted the POEM criterion for the purposes of determining the tax residence of legal entities.

Finally, it is necessary to bring up the fact that the 2021 report no longer states in italics the terms “habitually”, “normally” and “ordinarily”, although not being speculative this may simply correspond to a difference in lithography style and not be intentional or have any impact.

2.2.2 Individuals

As with the POEM analysis for legal entities, the 2021 report does not, in fact, bring anything that could be considered new or different compared to the comments already made in the 2020 report. Again, the same arguments are brought forward, but within the examples of countries that have adopted special measures in this regard, Canada, Finland, France, Greece, India, Ireland, New Zealand and, as mentioned, the United States are added.

Likewise, it is concluded that, under the DTC tie-breaker rules and the measures that States are suggested to adopt unilaterally to ignore the involuntary physical presence of individuals, the limitations to the international locomotion of persons by COVID-19 would not affect the migration of the fiscal residence that existed before the occurrence of the pandemic, unless once these restrictions were lifted, the situation of these persons was maintained and, thus, they would not have returned to their places of origin when they became able to do so.

2.2.3 Cross-border workers

Unlike the comments for the implications on POEM and on individuals, in this topic, the 2021 update did introduce new and relevant elements regarding the issue of the impact of the coronavirus on cross-border workers.

That said, now the impacts of the pandemic on these subjects are analyzed from three perspectives:

a. Workers who receive subsidies or similar amounts for their wages (situation previously analyzed in the 2020 report).

b. Workers stranded by restrictions on mobility that generated a physical presence of more than 183 days in the country of the source and, therefore, could not apply the exemption of paragraph 2 of article 15 of the OECD Model.

c. Teleworkers who work in a jurisdiction on behalf of an employer who is a tax resident in a different State.

2.2.3.1 Workers receiving subsidies or similar payments

On this matter, the current report brings up the points of the previous report, only making an additional clarification by indicating that these benefits also have a similarity with the payments that employees periodically receive for reasons of absence from their work, such as, for example, payments for holidays or leave for medical or sick reasons. Again, it can be seen how the OECD, in our opinion with some imprecision, takes the matter to a not so clear extreme, since it is not very consistent to treat these payroll subsidies as payments for taking public holidays as a form of rest for the worker.

2.2.3.2. Workers stranded because they cannot travel to their places of origin

As a first step, it should be noted that new examples of domestic tax rules are added of legislation to alleviate this issue of COVID-19 in regard to not count the time spent physically there over the threshold of 183 days, among which are: Australia, Austria, Canada, Finland, Ireland, Greece, New Zealand and the United Kingdom.

Secondly, it is also indicated here that these employees who moved to the source jurisdiction and were unable to leave that place should not be taxed in that State for their labor income, considering the rule of 183 days of physical presence referred to in article 15 of the OECD Model, since the comments expressly indicate that, although the days in which the worker was unable to work due to illness are taken into account for the calculation of the time indicated above, the days that due to illness prevented the worker from leaving this place should not be considered in the summation.

Thus, the note categorically concludes that both requirements are met. First, that the coronavirus can clearly be regarded as a disease and, second, that because of this disease the worker could not return to his country of origin with all the intention of doing so. That said, although in the vast majority of cases it may be that the worker has not contracted the virus and, therefore, cannot speak in the strict sense of a disease, if it is true that these border closure measures were taken for reasons of quarantines, which, if they qualify as a matter of public health, where the individual could not leave, not by a simple recommendation of that State, but by a real health impossibility.

In addition, we believe that everything could not be taken so literally, since obviously both the comments and the OECD Model were not prepared for this completely extraordinary situation, resulting in alternatives to the existing norms and provisions that should be sought without having to put unnecessary obstacles to possible solutions.

2.2.3.3 Teleworkers

On this subject, as a novelty, the 2021 note simply limits itself to bringing two specific examples of teleworkers, which are those who before the pandemic were:

a. Individuals who are residents of State A and regularly engaged in work in State B, but after the pandemic, serve virtually from State A to State B.

b. Persons who were workers in State A and are stranded in State B, working there remotely on behalf of the employer located in State A.

In the first case, in order to resolve the matter, it must be considered that two circumstances may occur if analyzed from the perspective of whether or not the employer is a tax resident of State B. First, that, since the employer is a tax resident in State B, that jurisdiction may only tax that portion of the labor income that originated in the services provided within the territorial limits of that State, which implies a reduction in its tax rights. Second, that the employer is not a tax resident of State B, nor does he have a PE there that assumes the labor expense, in which case the only way for State B to tax that labor income is for the employee to be in that place for more than 183 days, which will not happen, resulting in State B completely losing its tax rights.

For the rest, the note emphasizes the same considerations of April 2020 in the sense that recommend to the different jurisdictions to implement measures to avoid tax compliance burdens.

3. ANALYSIS OF THE TOPIC IN LATIN AMERICA

This section examines jointly the existing tax residence rules for individuals and legal entities in some selected countries of Latin America and whether these have established any regulations or guidelines regarding the impact of confinement on this matter, considering the domestic tax regulations in force and without considering the special residence rules established in the DTCs signed by these jurisdictions, which must be analyzed in each specific case.

3.1 Argentina

3.1.1. Individuals

Considering the current standards of tax residence of individuals in Argentina, it is worth mentioning that the analysis and the considerations vary considerably depending on whether the person has or not the citizenship of that nation, without leaving aside that in this country there is a regime of worldwide income in income tax for those who are residents.

Although a tiebreaker rule is foreseen for individuals with dual residence that is generated by maintaining fiscal domicile in a foreign country, but establishing definitively in Argentina, this matter will not be addressed, since we consider it unrelated to our object of study, as in the case under mention it is people who voluntarily return to the country to stay there (contrary to the impossibility of returning or leaving this State generated by COVID-19).

3.1.1.1 Argentine nationals

According to articles 119 and 120 of the Business Income Tax Law (CIT), tax residents in the Argentine Republic are those with Argentine nationality, unless they have lost their resident status.

Thus, this condition is lost when these people have acquired permanent residence in a foreign State, according to the immigration rules applied there; or, not having acquired this condition, have remained abroad for more than 12 months continuously, considering that the temporary presences in Argentina do not interrupt this calculation. In both cases, the residence is lost from the first day of the following month in which the cause of loss is established.

For its part, article 283 of the Regulations of the Corporate Income Tax Law (RLIG) defines temporary presences as those that do not exceed 90 days within a threshold of 12 months. On the other hand, Article 120 of CIT law states that a person who is abroad, but does not intend to establish his domicile there, may prove this circumstance to the tax authority.

As can be seen, the complete Argentine regulation allows nationals to prove that at the time of the closure of borders they were outside the country, although they did not want to live there, in order not to lose their tax residence in that jurisdiction.

3.1.1.2 Foreign citizens

Paragraph b) of 119 CIT states that non-nationals who acquire permanent residence in Argentina, or who, not having had it, stay there for a period exceeding 12 months, are also considered Argentine tax residents, considering that in the latter case the temporary absences of these persons from Argentina do not affect the calculation of the time spent in Argentina.

In addition to the above, article 281 of the RLIG defines temporary absences as those that do not exceed 90 days, whether consecutive or not, within a period of 12 months counted from the day after leaving the country until the day of return to the country.

However, there is a loophole for individuals who have had a stay in Argentina for reasons that do not result in the intention of having residence there, who may prove this circumstance before the tax authority.

In line with this, the accreditation of the causes that the foreigner can argue to demonstrate the non-intention of habitual stay in Argentina must be presented in writing, for a single time, before the Argentine fiscal authority (Federal Administration of Public Revenues) with a notice not less than 30 days before the 12-month threshold is met. However, it is important to indicate that, if the foreigner remains in the country for more than the last indicated period, he will be considered as a tax resident in Argentina.

As evidenced, those foreigners who were stranded within the Argentine territorial limits in the meantime of the health emergency can change their status of residence using the aforementioned procedure, which we believe is a relief in these situations.

3.1.2 Legal entities

Article 119 (d) of the CIT establishes that the entities mentioned in article 69 (a) are also considered as tax residents in Argentina. Thus, the local entities listed in this provision are, among others, corporations, limited liability companies, limited partnerships by shares.

Hence, in this country, the material criterion of the POEM has not been adopted for tax purposes, so that the fact that senior managers of foreign companies have been unable to leave Argentina would not have significance in this tax matter.

3.2 Colombia

3.2.1 Individuals

Article 9 of the Colombian Tax Statute (ETC) enshrines the principle of world income taxation for resident individuals and article 10 of the ETC regulates the criteria for determining the tax residence of individuals, which vary depending on whether the person is a Colombian citizen or not.

3.2.1.1 National and foreign citizens

A Colombian tax resident is considered to be any person who has remained in the country, continuously or discontinuously, for more than 183 calendar days, counting the days of entry and exit, considering any 12-month period, in the understanding that, when this stay in Colombia lasts for more than one year, the person will be considered to be a resident as from the second year.

3.2.1.2 Colombian nationals

Any person who is a Colombian national, in addition to the criterion of physical presence described above, also apply the following conditions:

a. The spouse or non-legally separated permanent partner or minor dependent children have tax residence in the country; or,

b. 50% or more of their income is from a Colombian source; or,

c. 50% or more of its assets are administered in the country; or,

d. 50% or more of its assets are understood to be held in the country; or.

e. Who, having been requested by the tax administration, does not prove his or her status as a resident abroad for tax purposes; or,

f. Those who have tax residence in a jurisdiction qualified by the Government as a tax haven.

3.2.1.3 Pronouncements of the fiscal authority of Colombia on the subject

- ***Tax ruling No. 612 of 2020***

In this first document, the DIAN indicated that the only terms that were suspended for the counting of days were those related to tax and customs administrative processes before that agency and that, therefore, the days that had remained in the country those persons forced to stay in Colombian territory should be added in the calculation of the 183 days.

- ***Tax ruling No. 687 of 2020***

In a later tax ruling, the tax authority of Colombia reconsidered, in a fortunate way in our thinking, the position indicated above, since it was established that it was possible to ignore in the count these days of unwanted presence in the country, provided that the taxpayer demonstrated acts of force majeure.

For this purpose, the DIAN brings up an example in which a foreigner who arrives in Colombia cannot leave the country for reasons of closure of borders, but who can show that he or she had a two-way ticket and that his intention was indeed to leave Colombian territory. Therefore, in Colombia, this interpretation of the fiscal authority allows those persons to ignore these days spent there in a forced way.

3.2.2 Legal entities

In accordance with article 12-1 of the ETC, a company is considered a national for tax purposes in Colombia when: (i) it has its registered office in the country; (ii) it is incorporated under Colombian law; and (iii) it has its principal domicile in Colombia. In any of these cases, this moral entity is subject to taxation in the country for its income from a world source.

In this way, it is possible that a foreign entity is considered a national company, understood as a tax resident when its day-to-day administration has been found in Colombia on the occasion of COVID-19. This situation is exacerbated by an opinion made by the DIAN, who, in Tax ruling No 058445 of 2013, indicated that it was not required that the POEM has been a constant in Colombia, but simple enough that the POEM was verified in the country, even for a single day within the taxable year. As a criticism, we consider that this view is contrary to Article 12-1 of the ETC, since this rule adds the adjective “usually”, with which we believe it would be possible to apply the conclusions of the OECD reports described above.

3.3 Chile

The Chilean tax law enshrines the principle of universal taxation on income from Chilean and foreign sources, both for natural and legal entities deemed as residents.

3.3.1 Individuals

In the case of individuals, from the Chilean perspective it should be mentioned that there is a special rule of residence and, therefore, of taxation of local income that only falls on foreigners. Therefore, the analysis is carried out considering the common rules applicable to Chilean individuals and the special rule mentioned.

3.3.1.1 Chilean nationals

As a first point, it should be mentioned that article 4 of the Chilean Income Tax Law (LIRC in Spanish) establishes that any person domiciled or residing in Chile taxes there for their income from a world source. As it stands, there are two separate criteria for establishing unlimited direct taxation, namely a binomial based on the concepts of domicile and residence.

From the perspective of residence, article 8 of the Chilean Tax Code states that a resident is any individual who stays more than 6 months in a calendar year within this nation, or more than 6 months in total there within two consecutive calendar years. Thus, this criterion is of an objective nature, since only the validation of physical permanence in Chile is required, regardless of the internal element that motivated the individual to be in that country.

On the other side is a criterion of subjective nature, insofar as, in the absence of delimitation of the concept in the tax law, article 59 of the Chilean Civil Code defines the domicile as the residence, accompanied, real or presumptively, by the intention to remain in it. It is precisely this demand for *animus* the one that gives this subjective ingredient.

Under this scenario, it is necessary to emphasize that the simple absence or lack of a residence in Chile is not generated by the loss of the residence there, combined with the fact that this provision also applies to those individuals who do not have a physical presence in Chile, but have their main seat of their businesses, either individually or through partnerships, in the country. For the purposes of determining the above, the Chilean tax authority (SII) has resorted to the criterion of main income generation and where the main interests of the person are located.

Given these comments, it is easy to understand that the domicile factor does not come into play in terms of forced tax residence due to COVID-19, basically because in this situation the person does not have the willingness to be in Chile.

However, the physical concept of residence does have a relevant impact, where it must be said that no regulation has been implemented in this regard, nor are there any guidance from the SII to indicate that these days of forced presence do not count, so that these days must be added to determine tax residence, although only for Chilean citizens, as will be seen below.

3.3.1.2 Rule applicable only to foreign citizens

Article 3 of the LIRC states that the foreigner who causes domicile or residence in the country will only be considered tax resident from the third year of residence in that State, counted from his entry to Chile, although this period is allowed to be extended in qualified cases.

Consequently, we consider that foreign citizens who were unable to leave Chilean territory due to the closure of borders has this regulatory shield in order not to be considered Chilean tax residents and, therefore, not to be taxed there on the basis of their worldwide income.

3.3.2 Legal entities

According to the LIRC, companies are only tax residents in Chile when they were incorporated under Chilean law, expressly rejecting the POEM criterion. Therefore, there is no room for further analysis of the impact of the Coronavirus on the tax residence of entities in Chile.

3.4 Ecuador

3.4.1 Individuals

Based on Article 4.1. of the Internal Tax Regime Law (LRTI), the criterion of physical presence is adopted by virtue of which an individual, regardless of his nationality, will be a tax resident in Ecuador when: (i) his physical presence there is 183 days or more in the same tax period, (ii) his physical presence in that country is 183 days or more, in a 12-month period within two tax periods, unless he proves that he or she has his tax residence for the corresponding period in another country; in both cases regardless of whether the presence is consecutive or not and including for the calculation sporadic absences, or (iii) has not remained in any other country or jurisdiction for more than 183 calendar days, consecutive or not, within the tax period and his closest family ties are maintained in Ecuador.

Article 7 of the Regulation for the Implementation of the Law on Tax Procedure (RLRTI) adds a few clarifications relevant on this topic, to indicate, first, that the concept of “permanence” of an individual refers to his physical presence and account for full days, including the day of admission but not the day of departure, and includes the presence not only in the Ecuadorian territory, but also in ships with the national flag or port with base of operation in that country and second, that the absence of the country shall be considered to be sporadic, provided that it does not exceed 30 consecutive days.

On the other hand, the article of the LRTI cited at the beginning also establishes that an individual will have tax residence in Ecuador when the main nucleus of his activities or economic interests is there, either directly or indirectly. This regulation continues to indicate that this nucleus is understood to be in the country when the person has obtained in the last 12 months, either directly or indirectly, the highest value of income in Ecuador compared to other countries, valued at the average exchange rate of the period, or provided that the highest value of the assets is also located in this nation.

Finally, article 7 (5) of the RLRTI points out that an individual has his or her closest family ties within Ecuador when his or her spouse and dependent children have remained in the country, as a whole, more days in the past year than in any other country. If it is not possible to determine the above, the permanence of their dependent parents is considered, under the same parameters.

3.4.2 Legal entities

Article 4.2 of the LRTI states that a company is only a tax resident in Ecuador when it has been incorporated or created in Ecuadorian territory, according to the national legislation on the subject.

Based on article 1 of the Companies Law of Ecuador, a company contract concluded there is governed by Ecuadorian law, with which it is possible to say that if the company contract is signed in this country, this will constitute a local entity.

Thus, given that Ecuador only adopts the incorporation criterion to determine the residence of companies, it is fair to say that the quarantine measures adopted by

COVID-19 will not impact this issue for the Ecuadorian case.

3.5 Mexico

As a first comment, it should be mentioned that article 1 of the Income Tax Law of Mexico states that tax residents of that nation are taxed there for all their income, regardless of the source or the country where it originates.

3.5.1 Individuals

Article 9 of the Federal Tax Code states that Mexican residents are considered to be those who have established their dwelling in Mexico. Now, those who have a house concurrently in Mexico and abroad, will only be residents in Mexico if their center of vital interests is located there.

Thus, it is understood that this center is in that country provided that: (i) more than 50% of the total income obtained by the person in the calendar year has a Mexican source, or (ii) when in Mexico, they have the main center of their professional activities.

However, Mexican tax residents are those nationals who have tax residence in a jurisdiction where their income is subject to a preferential tax regime under Mexican tax law, although this does not apply when a comprehensive agreement for the exchange of tax information with Mexico has been concluded with that State.

Mexican tax law brings a presumption under which individuals of Mexican nationality are presumed to be residents of Mexico.

3.5.2 Legal entities

Unlike most countries in the region, in Mexico companies are considered tax residents there when the main administration of the business or the POEM is located in that country. Therefore, this aspect can play an important role in a possible dual residence of a company due to COVID-19.

3.6 Panama

As it is known, article 694 of the Panama Tax Code (CFP) establishes a tax system of a territorial nature in the isthmus, that is, that only income from Panamanian sources is subject to taxation, regardless of who receives it or where.

3.6.1 Individuals

In article 762-N of the CFP, Panamanian tax legislation regulates that individuals who remain for more than 183 calendar or alternate days in the fiscal year in that country will be considered tax residents there.

Likewise, individuals who have their residence or place of residence in Panama are considered residents for tax purposes, unless in the calendar year they remain in another country for a threshold of more than 183 calendar or alternate days and demonstrate that they have tax residence in that other State. For these cases, this foreign residence must be proven before the tax authority (Directorate General of Revenue) through an official document.

In addition to the above, Executive Decree No. 958 of 7 August 2013, in articles 10 and 11, states that the following criteria must be considered to determine tax residence in Panama:

a. The person must have permanent housing within the country; or

b. They must have their center of economic interest in Panama and be able to prove that fact, or

c. They must have their family interest center there.

From the above it is simple to extrapolate that these criteria do not deserve further consideration for people trapped in Panama on the occasion of quarantines, considering that they could not, in these situations, speak of permanent housing, center of economic interest or family, starting from the fact that these people could not leave for a fortuitous event having all the intention to do so.

In this context, it is possible to affirm that despite the fact that Panama adopts the criterion of physical presence of 183 days, and that its borders were closed for an important time, we do not see, in principle, that there is an affectation for those people who were unable to leave this Central American country, since there is no world income system in this territory. However, the problem here is that if they provide their labour services from Panama, they could generate income from local sources, as indicated in article 694 (b) of the CFP.

3.6.2 Legal entities

With regard to companies in Panama, there is the POEM criterion, where it must be demonstrated that meetings of the members of the board of directors or any other equivalent decision-making body are held within Panamanian territory. Likewise, if partially or totally, the members that make up that body of the company have transferred their responsibilities to third parties. In addition, in order to determine the tax residence, it must be considered whether the persons who exercise this responsibility (direction and administration) are within Panama to exercise it, or if the main offices are established in Panama.

3.7 Peru

Article 7 of the Peruvian Income Tax Law (LIRP) enshrines the principle of global income taxation for taxpayers considered to be domiciled for tax purposes in that South American nation. However, it should be clarified that this element in question differs from the concept of “fiscal domicile” provided for in Article 11 of the Tax Code of Peru, used mainly for procedural matters.

3.7.1 Individuals

Under Article 7 of the LIRP, the residence criteria vary whether it is a Peruvian national or a foreign national. That said, for nationals the criterion is that of domicile under the rules of ordinary law, which means that it is necessary to resort to civil legislation to determine who are residents for tax purposes in Peru.

On the other hand, this provision in comment indicates that foreigners are tax residents in Peru when they have resided or remained in the country more than 183 calendar days during any period of 12 months, considering the days of entry and exit and fractions of days as indicated by the income tax regulations of Peru. However, this standard provides that individuals, except persons employed in the foreign representative functions or official positions and designated by the National Public Sector, lose their status of domiciled in Peru when acquiring a residence in another country and have left the country, which must be verified.

On this point, the tax authority of Peru, known as SUNAT, indicated, in Report No. 133-2020-SUNAT/7T0000, that the days spent by foreigners in Peru during the closure of borders should be counted in the calculation of the 183 days, since this term does not have the nature of being procedural. In this way, there is no relief for these foreigners, and it is even the opposite, since there is an official interpretation that expressly requires those days to be counted.

3.7.2 Legal entities

The Peruvian tax law, in its paragraph d) of article 7 already mentioned, adopts exclusively the criterion of incorporation, and not of POEM, to determine the tax residence of companies, since only those legal entities incorporated in the country are considered Peruvian, for which article 6 of the General Law of Companies of Peru must be considered[17]. Therefore, like the Ecuadorian case there will be no impacts on this issue from the Peruvian perspective, considering the quarantine measures.

17 This article states the following: “The company acquires legal personality from its registration and keeps it until its extinction is registered””

4. CONCLUSIONS

It is logical to understand that the measures of confinement, quarantines, and closure of international borders adopted during the health emergency have generated an important debate about the effects that they trigger on international taxation.

Without a doubt, one of the points in which a significant impact in tax matters is evident is in the rules of tax residence, both for individuals and legal entities, which results in possible changes of residence, mainly for reasons of unwanted physical presence in certain territories, or because the migration of the management of a company to another place that may cause that the POEM also moves to that new State.

For this reason, the OECD issued a couple of guides that analyze the issue in 2020 and 2021, which concluded, in a general way, that should not be a large effect considering the reality that is lived from the Covid-19 on the topic of tax residence, considering the tie-breaking rule in article 4 of the OECD MODEL, the provision of the taxation of labor income in the article 15 of this template last fiscal and the way to eliminate the double taxation article 23 of the OECD MODEL (either a credit or an exemption).

However, we believe that there are certain points of these guidelines that are not entirely clear and may generate controversy, but most of all, we believe that the problem here is that there will not always be a DTC in force to relief the situation, which is why it is possible fundamental changes arise in the residence of individuals and companies, where there are possible cases of dual residence in two or more jurisdictions, considering the domestic rules of tax residence instead of the OECD Tax Model.

On the other hand, a comparative study of the tax laws of Latin America shows that, with the exception of Colombia, Panama and Mexico, the trend in this part of the world is towards preferring the use of the formal criterion of incorporation as a way of determining the tax residence of a company, rather than including the concept of POEM. Therefore, considering the countries analyzed, in this matter there will only be implications from the Colombian and Mexican perspective, considering the territorial tax regime of Panama.

In the area of residence of individuals, in general, countries in the LATAM region have not adopted legislation or special guidelines for coping with the problems created by the COVID-19 on the rules of tax residence, except for Colombia and the rules that already in place in Argentina or Chile (in this case only for foreigners), with the worst case of Peru, where there is an instruction that expressly mandate to add the days spent there by foreigners during the pandemic. However, from the Panamanian perspective, the matter does not really have great tax significance, considering the territorial taxation regime that exists there, unless the person generates an income from a local source in Panama for developing a work activity there.

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THE MONOPHASIC SALES TAX AND INFORMALITY
of MSMEs activities

Angel Marco **Chávez Gonzales**

SYNOPSIS

This article analyzes the monophasic sales tax at the retail level in the tax formalization of Peruvian MSMEs. We show the advantages and disadvantages of a monophasic sales tax over a multiphasic sales tax to evaluate them in the context of MSMEs informality.

The research shows that the monophasic sales tax at the retail level has a positive impact on the formalization of the MSMEs to expand the tax base and reduce tax evasion because the final consumer can credit the bank payment.

Keywords: Monophasic sales tax retail level, MSME Informality.

CONTENT

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INTRODUCTION

The tax rules that regulate certain activities or acts must modulate the reality in which those activities or acts of the citizen operate, and not pretend that everything is seen from the point of view of what the State needs.

The current sales tax system is a value-added tax that taxes all economic stages from manufacture or import to sale to the final consumer. From the economic point of view, this increases the price of the good or service among MSMEs business agents, which affects their liquidity, even though fiscally they are entitled to deduct the tax levied on purchases, and transfer the sales tax to the buyer, who generally pays the purchase in months and parts; To this is added the tax cost of the mechanisms for collecting the Sales Tax as in the Peruvian case (deductions, withholdings, and perceptions). This complicates the administration and accounting of this tax to micro and small enterprises (MSMEs).

This means that the formal MSME company carries out informal activities and the informal ones remains informal, affecting tax collection, concentrating it on the small group of formal companies that end up paying more taxes and, on the other hand, the state wastes millions of resources on costly strategies to detect evasion.

The importance of this research is based on confronting informality by proposing for MSMEs companies the replacement of the current multiphasic sales tax by a monophasic sales tax at the retail level. This favors the formalization of the activities of the MSMES, along with their financial formalization from the use of mobile digital technology of payment vouchers and bank payments, financial institutions and savings banks as withholding agents, and allowing the final consumer to credit the tax assumed as a contribution to their health or retirement contribution or deduction of their work income tax.

This research paper identifies and compiles documents from experts from different countries in order to make a proper balance of the advantages and disadvantages of Monophasic Sales Tax at the retail level with respect to Multiphasic Sales Tax in the context of MSMEs, and its quantitative effect of this type of tax on the price and liquidity of MSMEs, and tax collection.

The organization of this paper includes in a first section the informality of MSMEs, in a second and third section, the analysis of the advantages and disadvantages of the monophasic and the multiphasic sales tax at the retail level, making a balance against the MSME reality; a fourth section shows how this type of tax would impact on the price and liquidity of MSMEs, and the tax collection; and a fifth section presents the conclusions and finally the bibliographical references.

1. INFORMALITY OF MSMES

According to De Soto, (1986) the informal sector is constituted by companies, workers, and activities that operate outside the legal and regulatory frameworks that govern economic life, it means being at the margin of the tax and legal rules; but, it also implies not having the protection and services that the state can offer. Informality is characterized by a growing dynamic of economic activities that are carried out outside the established legal framework; informality becomes a "refuge zone" when the costs of formalizing economic activity exceed its possible benefits (De Soto, 1986).

As De Soto says (1986), individuals are not informal, but their deeds and activities. Informality is neither a precise nor a static sector of society, but an area of gloom that has a long border with the legal world and where individuals take refuge when the costs of complying with the laws exceed their benefits (pg. 12)

"Many formal companies are partly informal or carry out activities that are informal and vice versa" (De Soto, 1986, pg. 186).

Likewise, for Portes and Haller (2004) the informal economy should not be understood as a set of marginal economic activities associated with the survival of people; on the contrary, these are activities that produce unregulated economic income.

These definitions are in line with the concept of the informal economy adopted by the International Labour Organization (ILO) which refers to all economic activities developed by workers or companies that are not, legally or in practice, covered or sufficiently covered by the formal framework of institutions.

For example, in Peru the informality of companies in 2016, according to figures from the Institute of Economics and Entrepreneurship Development (IEDEP) of the Chamber of Commerce of Lima, was 6,901,786 informal enterprises. The largest number of informal enterprises are located in the service sector, around 2.2 million, representing 31.2% of the informal business universe, followed by the trade sector (21.3%) and manufacturing (7,2%) (Peñaranda, 2017).

According to data from the National Survey of Homes – ENAHO, there are about 6 million people who declare to have a business in Peru, of which only 15% declare to have the Single Registration of Taxpayer - TIN. According to data from the National Survey of MSMEs, which interviewed only those with RUC, of 100% of companies surveyed, 70% had a municipal license and only 50% had a payroll registration. These figures show that the formality is a gradual process, and a business can be formal in some dimension, but informal in another. (Chacaltana, 2017).

For example, most taxpayers of the Simplified regime (RUS) pay a monophasic tax and are “formalized” in terms of taxation, pay a monthly fee of fewer than 20 soles, and at the same time, all their workers are informal. (Arias & Arias, 2017).

According to INEI figures, as of 2018, informal workers reached 72%, i.e., 12,152,600, of an economically active population of 16,776,500, composed of 9,354,900 men -56% and 7,421,600 women -44%. (INEI Citado por Defensoria del Pueblo, 2019).

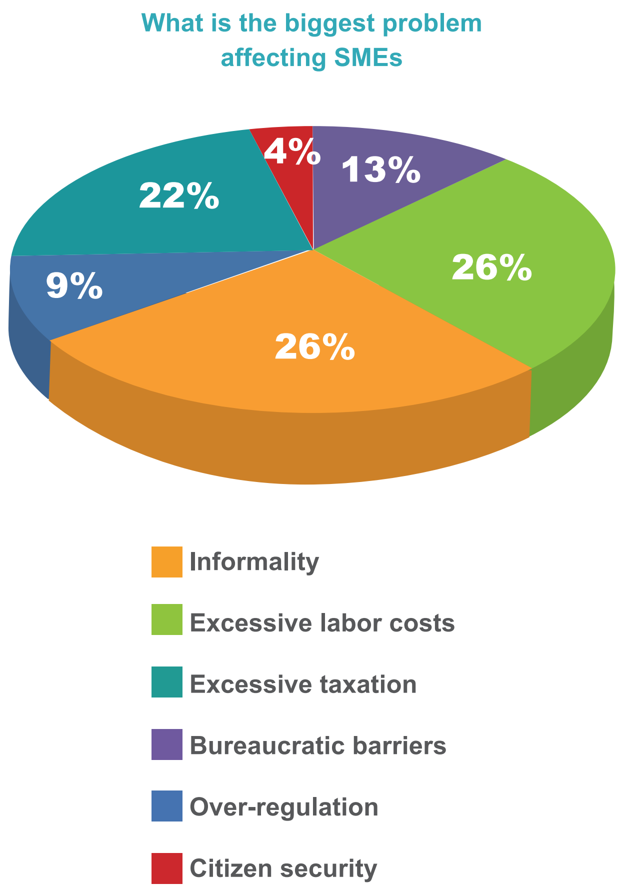
Regarding the contribution of the informal sector to the national GDP, according to INEI figures in relation to the GDP of 2015 (S/. 602 527 million) it was 19.2% (S/. 115 685 million), versus 80.8% (S/. 486.842 million) in the formal sector (Redacción Perú 21, 2016).

Although informality has been able to disguise structural problems of the economy and generate employment, avoiding social outbursts and contributing to the national GDP, it also brings disorder, illicit income (money laundering, drug trafficking, trafficking, illegal gold trading, and the like), erodes the formal sector, institutions, laws and authority, and limits government revenues for public investment purposes (productive, technological or social). We assume that the main reason why people carry out a productive activity in an informal or formal way is the series of costs they must assume (taxes, administrative and legal costs, among others); the state of law is not free, the rules cost, for example: Paying taxes costs, obtaining municipal licenses costs, making contracts costs. (Enriquez, 2016).

Consequently, it is clear that the legality has an economic function that is to reduce the transaction cost (Enriquez, 2016), so when the state produces laws or legislative decrees or administrative regulations, and specifically tax regulations, these must create a lesser cost overrun on transactions.

According to a survey conducted by the Lima Chamber of Commerce (CCL) to more than one hundred formal entrepreneurs, informality and excessive taxation as factors that discourage the creation and growth of small and medium enterprises, 26% of the entrepreneurs surveyed recognized labor overcosts and informality, and 22% identified the tax burden as discouraging factors, as shown in Figure 1. (Cámara de Comercio de Lima, 2015).

Figure 1. Survey on the problems of MSMEs. Chamber of Commerce of Lima, 2015.



Regarding informality and excessive tax burden, we have focused on this research to propose for MYPES companies a monophasic sales tax at the retail level that taxes only the economic stage of sale or provision of service to the final consumer, in such a way that its administration is simpler, replacing the current non-cumulative multiphasic sales tax.

2. MONOPHASIC SALES TAX AT RETAIL LEVEL

Indirect taxes on consumption, in their technical structure, can be monophasic or multiphasic (Cosciani, 1969).

Monophasic taxes are those that are caused only in one "of the phases or stages of the process of production or commercialization of the good" (Plazas, 2005, pg. 330).

However, the ideal method, from the point of view of the purity of the system, is to tax the product when it passes from the retailer to the final consumer (Cosciani, 1969) that is, in the stage of sale of the good or service to the final consumer.

According to John Due, this retail-level tax is designed to be levied on retail transactions: sales to the final buyer, whether these are made by a retailer, a wholesaler, or a manufacturer. What is essential in this tax modality is not the quality of the seller but in the nature of the sale, if it has as purpose its final consumption or its subsequent sale. (Bravo Sheen & Walker, 1998)

2.1 Advantages of monophasic sales tax at the retail level

Zolezzi highlights the following advantages (Zolezzi, 1983):

1. It allows reducing the number of taxpayers, thus facilitating their management, this advantage is greater if it is the tax is imposed on the sale made by the manufacturer.

2. It does not stimulate industrial concentration or penalize specialization; the neutrality of the tax is marked if the taxed phase is the sale made by the retailer

3. Allows differentiating the aliquots by products.

4. The calculation of the tax incidence is not difficult, especially if the system taxes the sale at the retailer level.

5. It does not give problems in import or export or hinder a common market, especially if the tax is applied on the sale of the retailer.

Cosciani refers the following advantages (Cosciani, 1969):

1. It constitutes for the consumer a charge equivalent or proportional to the selling price.

2. It allows to know exactly the incidence of the tax; therefore, it does not create complex problems at the time of import or export.

3. It does not determine distortions, nor does it stimulate business concentration.

4. It facilitates the fairness of the magnitude of the tax since retailers are forced to resort to balance prices or special discounts for various reasons automatically consulted in the process of determining the tax at the last stage.

5. It ensures, as Due and Friedlaender say, an equal treatment to domestic and imported products.

Due adds the following as advantages of monophasic sales tax at retail level (Bravo Sheen & Walker, 1998):

1. It allows the treasury to collect as much as the price increases to the final consumer.

2. By incorporating all profit margins until reaching the final stage, the tax base is larger, which determines that the applicable aliquot is lower, this, in turn, minimizes the tendency of traders to evade the tax.

Professor Plazas presents as advantages of the monophasic tax in the last stage (Plazas, 2005):

1. To the extent that the taxable base is the selling price to the final consumer, the financial results of the tax are optimal without the need to resort to higher rates, as is the case with first-stage or intermediate-stage taxes.

2. The fact that the tax is caused only in the last stage of the process of production, distribution, and sale of the good largely eliminates the distortions that arise if the monophasic taxation is in the first or intermediate stage in terms of marketing margins and price formation factors (advertising costs, quality control, packaging, etc.).

3. It eliminates the influence of the tax factor on the form of legal organization and integration of companies.

2.2 Disadvantages of monophasic sales tax at retail level

What are the disadvantages of the monophasic tax? Do these disadvantages make our proposal unviable?

Zolezzi points out these disadvantages of monophasic tax (Zolezzi, 1983):

1. By concentrating the tax on a single stage, the rate is very high, which can stimulate evasion and have inflationary effects.

2. When evasion occurs, it is total.

3. If it is decided to tax at the retailer stage, the audit is very complex because of the number of taxpayers who usually have poor accounting.

4. The taxation at the retailer stage is not politically convenient, because psychologically the retailer feels affected by the tax however it transfers it to the final consumer.

5. The tax applied at the stage of the manufacturer or wholesaler creates problems in the definition of the taxable person, and on the other hand as regards the taxable matter, there may be cases in which a matter that should not be included in the tax is affected.

Cosciani refers to the following disadvantages (Cosciani, 1969):

1. Since the tax is concentrated in a single stage, the tax rate must be higher, and its rise constitutes a powerful stimulus for evasion.

2. Once there is evasion, as it may not be recovered even partially, because all of the tax is concentrated in a single stage, without which the tax is totally and definitely avoided...and so much the more, because the retailers, by number or by lack of regular accounts, are the most difficult to control, for which there are ample possibilities of evasion.

Professor Due explains that the major disadvantage of this model is given by (Bravo Sheen & Walker, 1998):

1. Evasion can be total, and this type of criminal conduct is even more likely in countries where the administration does not have enough capacity to control a huge mass of taxpayers.

2. It turns out that, in countries with predominantly ambulatory and informal trade, this model is impracticable.

The disadvantage of this monophasic sales tax is that in “developing countries there are administrative difficulties that arise from the fact that the tax is levied on retailers...because of their large number and often inadequate organization, retailers in underdeveloped countries are virtually uncontrollable by the tax authorities” (see Table 1)” (Plazas, 2005, pg. 334).

2.3 Monophasic sales tax at retail level in the context of MSMEs

The monophasic Sales Tax that we propose for MSMEs companies is a tax that is applied:

1. At the level of sale of goods or provision of the service to the final consumer; and

2. In the case of sales of goods or provision of services to non-MYPES companies, i.e., to large companies.

Therefore, the tax does not apply on the sale of goods or provision of services from an MSME company to another MSME company; or from a non-MSME, large company, to the MSME.

2.4 Balance of advantages of the monophasic tax on sales in the context of MSMEs

We agree with the advantages described by the cited authors, in addition, in our research we have identified more important advantages from an approach to our reality that promote the formalization of MSMEs, as follows:

- The multiphase sales tax is eliminated in sales transactions between MSMEs, and in sales transactions from non-MSMEs, large companies to MSMEs, as well as the mechanisms for collecting this tax (detractions, withholdings and perceptions), paying in practice a single payment for corporate income tax (in Peru: MSME tax regime, or General Regime or Special Income Regime).

- The sales prices of MSMES importing, manufacturing, wholesale and retail companies are lowered because they do not contain a tax, also favoring MSMES exporters by lowering the prices of their inputs.

- By reducing the price of goods and services of companies, MSMES encourages supply and demand, therefore the efficiency or economic well-being of these companies increases.

- It creates savings for companies, as the Multiphasic Sales Tax and the collaboration mechanisms of the IGV detractions, withholdings and perceptions affect their liquidity (Chávez, 2011).

- The savings obtained generates economic growth because MSME companies will have cash to reinvest in capital goods and technology, increasing production and employment.

- By allowing this modality to tax the sales of goods or provision of services to the final consumer, and non-MES companies, large companies, these are involved in the control of the tax, on the one hand, the final consumer has an interest in deducting the bank tax payment of their purchases from their work income tax or serves as a contribution to their health or retirement contribution, and the large company will be interested in obtaining their tax credit.

- The elimination of the multiphasic sales tax and its collection mechanisms discourage the tax evasion and the informality of activities of MSMES companies, including the concealment of income, therefore, companies will formalize their activities and improve the collection of sales tax and corporate profits tax.

- Since there is a single sales tax incidence, its administration is simplified by only recording and declaring the sales tax.

- Efficient administration and fiscal control of sales tax by electronic means. In the Peruvian case, taxpayers of the general or special income regime with an annual income equal to or greater than 75 UITs are required to keep records of their electronic sales and purchases; and from January 01, 2021, they are required to issue invoices and electronic accounting notes. In subsequent years, this obligation will be extended to lower-income taxpayers.

- It facilitates the control and supervision of the tax administration because it concentrates on this final stage of retail aided by technology.

- It allows applying different tax rates or exonerations at the stage of sale to the final consumer according to product and service.

- It allows reviewing and rationalizing the current system of exemptions and tax incentives to sales tax for MYPES, since this taxation modality ensures that MYPES companies are not subject to the tax, thus avoiding the price distortion that the exemption generates by not allowing the right to a tax credit, nor the right to a refund of the tax paid on their acquisitions, ending invisibly added to the sale price of the final consumer. (Chávez M. , 2011)

2.5 Balance of advantages of monophasic sales tax on sales in the context of MSMEs

Of the disadvantages mentioned, the majority revolve based on the fall in tax collection due to the evasion of the retailer, then follows the disadvantage referred to being politically non-desirable to tax only at the retail stage to the final consumer; and finally the disadvantage that the tax applied at the manufacturer or wholesaler stage, according to Zolezzi (1983), would tax "the direct sale from the manufacturer to the final consumer or the wholesaler to the final consumer".

Regarding the disadvantage referred to tax collection in the sense that in the modality of a monophasic sales tax at retail level, these are affected because "evasion, if it occurs, entails the total loss of the tax" we propose the following:

1. Encouraging the final consumer to intervene in the control of the collection of the tax by granting him the right to deduct totally or partially the sales tax assumed on his purchases paid through banking and electronic means from his working Income Tax or serve as a contribution to his health or retirement contribution.

2. MSMEs tax their sales of goods or provision of services to non-MSME companies, large companies, these are involved in the control of the tax to obtain their tax credit.

3. Banks, Financial Institutions, and Savings Banks will be encouraged to intermediate in bank payments and, from there, participate as withholding agents of sales tax, reducing non-compliance.

All of which leads to increase sales tax collection at the retail level and even having a positive impact on corporate income tax collection, as the monophasic sales tax at the retail level eliminates the incentives of MSMES in the previous economic stages for hiding revenue and evading or avoiding the tax.

In the Peruvian case, with the formalization of informal activities, the impact on the collection is calculated according to data from the tax administration (SUNAT) in approximately S/. 23, 306 million which is equivalent to 3.4% of the national GDP of 2017 according to calculations of non-compliance with the General Sales Tax, and of approximately S/. 29 903 000 million soles which represents 4.1% of the national GDP of 2017 according to calculations of non-compliance with the Corporate Income Tax.

Regarding the disadvantage that it is not politically convenient to tax only at the retail stage to the final consumer, we consider that at present it is economically, socially and politically clear that the formalization of informal activities is a priority to face future economic or sanitary crises such as COVID 19. With respect to the disadvantage that the tax applied at the manufacturer or wholesaler stage, according to Zolezzi (1983), "tax the direct sales from the manufacturer to the final consumer or from the wholesaler to the final consumer", we do not consider it a disadvantage because the idea is to tax the sales to the final consumer even if they originate from them.

3. MULTIPHASIC NON-CUMULATIVE SALES TAX

3.1 Advantages of a non-cumulative multiphasic sales tax

Zolezzi highlights the following advantages (Zolezzi, 1983):

1. The biggest advantage is economic neutrality. This is notorious if the tax is applied to all goods and services and a single rate is used.

2. Knowledge of the tax incidence, whatever the stage of production or distribution in which the good is located.

3. Facilitates integration or common market processes. The European Economic Community has adopted the system for its member countries.

4. The rate or aliquot is distributed throughout the process. This reduces the debt of manufacturing and wholesale companies, compared to a monophasic system, but at the same time ensures that approximately 70% of the collection is obtained in the stages prior to the sale of the retailer, which is the phase where there is the greatest evasion.

5. The opposition of interests among taxpayers helps fighting evasion. Indeed, if the buyer of the goods cannot evade the payment of the tax himself, when selling the product, he has no incentive to buy from his supplier without an invoice proving the payment of the tax, because if he does so he will have no tax credit and will have to pay a higher tax on his own sales.

6. The demand for organized accounting helps to better control the income tax.

Cosciani refers the following advantages (Cosciani, 1969):

1. Uniformity of treatment even in the case of disparities subsisting in the production process from sector to sector, from company to company, and use of different factors of production.

2. As the taxable value is lower, the average real rate is the same for the partial stages, which is an advantage over the monophasic tax that exempts a series of stages to concentrate the tax in a single stage.

3. Opposition of interests between taxpayers avoids evasion, every entrepreneur has an interest in accounting for their purchases with an invoice to increase their deductible amounts.

4. The accounting and other elements that the taxpayer may have constitute an element for the determination of direct taxes. It does not determine distortions, nor does it stimulate business concentration.

5. It allows an exact calculation of the incidence of the tax in any of the productive stages of the good and facilitates the computation of the compensations in the imports and in the exports.

6. It allows neutrality in international trade.

Due add as advantages of the multiphasic tax (Bravo Sheen & Walker, 1998):

1. In developing countries, the multiphasic consumption tax eliminates the difficult task of delimiting the stages taxed by the tax, since companies are present in more than one of the stages of the production cycle.

2. It allows greater revenue to the Treasury by affecting all economic agents involved in the cycle of production, distribution, and marketing.

3.2 Disadvantages of multiphasic non-cumulative sales tax

Zolezzi points out the disadvantages of the multiphasic tax (Zolezzi, 1983):

1. Greater complexity than other systems, requiring highly organized accounting, which is not common in countries like ours.

2. It does not facilitate the use of different rates or aliquots, nor of exonerations since their implementation notoriously complicates the system.

3. For goods and services that have a profit distributed over several years, the way to deduct proportional taxes is complex.

4. If an oligo-phasic system is used, problems arise in the definition of the taxable person and in the taxable amount as explained in the case of the monophasic system.

Cosciani refers to the following disadvantages (Cosciani, 1969):

1. The tax is based on the accounting of companies and partial invoices, and this means keeping regular accounts.

2. Since the amount of purchases or sales taxes must be deducted from the value or sales tax, the problem arises of identifying those to be deducted.

3. The exemptions complicate the system and therefore the administration of the tax, creating disturbances in the operation of this tax.

4. Difficulty of introducing in this tax a differentiation between the aliquots by product or sector, drawbacks that with an appropriate management of the tax can be reduced not eliminated.

Plazas says that the disadvantages of this multiphasic sales tax on the added value are evidenced by comparing it with the monophasic retail stage tax, and he takes the synthesis exposed by Due and Friedlaender as follows (Plazas, 2005):

1. The management and administration of the tax by the taxpayers is more complicated to carry detail of the purchase and sales tax.

2. To the extent that this tax falls on all economic stages, it involves a significant number of taxpayers.

3. It is less adaptable to exonerations.

4. The transfer of the entire tax is done in stages is presented as many times as the successive causes of the tax in the process of production, distribution and sale.

An increase or reduction in the multiphasic tax causes more economic disturbance by integrated wholesalers and retailers such as hoarding of goods or postponement of purchases.

3.3 Balance of the advantages of non-cumulative multiphasic sales tax in the context of MSMEs.

Faced with the advantages of the multiphasic sales tax to the added value pointed out by the aforementioned authors, we believe that with respect to the MSMEs companies they do cause disadvantages that favor applying the monophasic retail stage tax that Due and Friedlaender synthesize (Plazas, 2005):

1. The MSME taxpayer has a simplified administration and declaration of the tax since it only formally requires keeping a record of its sales therefore the mechanisms of deductions and withholdings of the Multiphasic Sales Tax that complicate the taxpayer's administration would no longer be applicable.

   Perceptions are also eliminated by being sales to end consumers.

2. It is easier for the State to monitor the taxpayer's sales since it only controls income and no longer invest time in monitoring purchases or their supporting documentation or verify if they meet the formal and substantial requirements of the tax credit, and verify compliance with payments, withholdings and drawdowns.

3. The retail stage tax covers a greater number of taxpayers to tax inconvenient that can be overcome by expanding the current use of electronic means incorporating them to the record of sales, invoicing, and use of electronic payment means for control and crossing information online by the tax administration.

4. It is more adaptable to the exonerations since they apply to this last phase of sale to the final consumer, allowing to review and rationalize the current system of exonerations and tax incentives to the GST that are onerous and inefficient, nor benefit the final consumer.

5. The transfer of the tax to the final consumer is done once in a single stage.

6. More possibility of evaluating the results of tax reform of increasing or lowering tax since it only applies to a single stage of the retailer.

To these advantages of the monophasic tax at the retail level over the multiphasic value added tax for MSMEs companies are added the following:

- Sales prices are lowered between MSMEs manufacturers, wholesale and retail marketing companies because they do not contain a tax, also this system of taxation is favoring importers and exporters by lowering prices; that is, it encourages supply and demand, therefore, the efficiency or economic well-being of the companies increases.

- Since the price of the good is not increased by the tax, MSMEs companies will not seek informality to obtain liquidity and will participate in all stages of production, since the multiphasic tax makes "the informal entrepreneur is excluded from the areas of intermediate production" (De Soto, 1986, pg. 202).

- It improves the liquidity of MSMEs companies to reinvest in capital goods and technology by increasing production and employment, since the multiphasic Sales Tax and its collection mechanisms, drawdowns, withholdings, and payments affect their liquidity (Chávez, 2011).

- The retail stage tax discourages tax evasion and the informality of activities of companies, including the elusive behaviors to avoid the multiphasic Sales Tax or its collection mechanisms, therefore, companies formalize their activities, having a positive impact on tax collection.

- The collection will stop concentrating on a small group of people who retain their formality and end up paying more tax which makes many companies do not prefer to grow in order to defect to informality (De Soto H., 1986, pg.222).

- The state will stop wasting millions of resources on costly strategies to detect evasion, and on the other hand, evaders will stop spending resources to prevent it. (De Soto H., 1986, pg. 222).

4. BALANCE OF THE EFFECTS OF MULTIPHASIC SALES TAX AND MONOPHASIC SALES TAX ON PRICES, LIQUIDITY OF MSMES, AND TAX COLLECTION

Let us compare the current multiphasic sales tax system with a monophasic sales tax to see how they affect prices between companies and their effect on the liquidity of the MSME company, and the tax collection.

Table 1. Current multiphasic non-cumulative Sales Tax system (sales value includes a profit margin of 30%)

	MANUFACTURER	WHOLESALER	RETAILER	FINAL CONSUMER
Sales value	100.00	130.00	169.00	
Sales tax	18.00	23.40	30.42	
Sale price	118.00	153.40	199.42	199.42
		23.40	30.42	
		(18.00)	(23.40)	
VAT to pay	18.00	5.40	7.02	
Total tax collection	**30.42**			

Source: Own elaboration.

Table 2. Proposal of a non-cumulative monophasic Sales Tax that affects the stage of transfer of the good or provision of the service to the final consumer (the sale value includes a profit margin of 30%)

	MANUFACTURER	WHOLESALER	RETAILER	FINAL CONSUMER
Sales value	100.00	130.00	169.00	
			30.42	
Sale price	100.00	130.00	199.42	199.42
Total tax collection			**30.42**	

Source: Own elaboration.

The monophasic sales tax at the retail level has a positive effect on the prices of the MSMES, the multiphasic value-added tax increases the sales prices of the manufacturing and wholesale MSMES companies as shown in Table 1; compared to the monophasic tax in which the sales price of the MSMES decreases, see Table 2.

It also has a positive effect on the liquidity of the MSMEs, our reality is that the sales made by the MSMEs currently taxed with the Multiphase Sales Tax are paid by the clients in months and in parts, however, they have to declare and pay it in the first weeks of the following month of maturity with their own economic resources; and on the other hand, the purchases that they make taxed with the tax originate a greater outflow of money.

Some can question this aspect by saying, fine we recognize this effect of illiquidity that generates this tax and for this you can give an additional period by law for the payment of the tax, for example in Peru there is the “Fair sales tax”, a tax benefit that allows micro and small companies with annual sales of up to 1,700 ITU to extend the payment of the IGV of a tax period for up to three months, under certain characteristics and conditions, however we believe that in practice it does not definitively solve this issue since if you do not comply with all the characteristics and conditions that are not few, you lose the deadline and return to the previous situation.

In a monophasic sales tax scenario at the retail level, as shown in Table 2, since sales operations between MSMEs are not taxed, nor sales operations of non-MSMEs, large companies, to MSMEs, this illiquidity effect is significantly resolved.

In relation to tax collection, it is not quantitatively decreased in both forms of taxation as shown in Table 1 and 2, the tax authority collects the same S/. 30.42 in phases in one system and in a single stage in the other.

Finally, in relation to the fear of the tax administration that the Monophasic Sales Tax, by concentrating on a single stage makes the rate very high and invites tax evasion, we do not believe it since, as shown in the tables, the incidence of the tax on the sale price to the final consumer with monophasic or multiphasic Tax is the same. Regarding the fact that it invites total tax evasion, we do not agree either, since the final consumer will intervene in its control by stimulating it through the deduction of this tax from his labor income tax or it will serve as a contribution to his health or retirement contribution, preferring to buy from formal MSMEs who will have an incentive to formalize; and if it is a non-MSME client, a large company, he will take care of his tax credit; and when banks, financial or savings banks participate as withholding agents, the tax is collected since the payments are banked.

5. CONCLUSIONS

The monophasic Sales Tax at the retail level significantly reduces the informal activity of the MSMEs because by not taxing the sale of goods or provision of services in the previous stages between MSMEs, nor those made by non-MSMEs, large companies, to the MSMEs; there is no interest of these in hiding income, nor in evading or avoiding the tax, nor its collection mechanisms (withholdings, drawdowns, and payments) with a positive impact on the collection of sales tax and profit tax of MSME companies.

It has a positive effect in reducing the sales prices of products and services in the MSMEs and therefore in their cash flow, allowing them to obtain money to meet their obligations.

By having a single incidence of the tax, the accounting and administration of the tax are simplified, by only registering and declaring the sales tax. in the same way, it simplifies the control of MSME tax obligations by the use of sales records, payment vouchers, and electronic means of payment, which allows making crosses of information online.

And the collection of the tax is protected on the one hand with the end consumer and the non-MSME company, the large company, both involved in the control of the tax because on the one hand, the end consumer has the incentive to deduct the bank payment of the tax from their purchases on their income tax or serve as a contribution to their health or retirement contribution, and the large companies will have interest in their tax credit; and the banks, Financial companies and Savings banks have interest in intermediating this money, and they will withhold the tax when bank payments are used.

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ARTIFICIAL INTELLIGENCE
in tax administrations

Alfredo **Collosa**

SYNOPSIS

Today more than ever, the Tax Administrations (TAs) seek to use new technologies to become more efficient in their work. In this sense, this article deals with the use of artificial intelligence (AI) in various functions of TAs.

First, the basic concepts of AI, the risks and benefits of its concrete use in TAs are presented. Then, current cases of concrete application of AI in the different functions of TAs are presented: information and assistance, control, collection and collection and Customs. It addresses the issue of AI and taxpayers ' rights and guarantees and provides some ideas or aspects to consider for incorporating AI into TAs. Finally, conclusions are presented.

Keywords: Tax Administrations, Artificial Intelligence, Benefits and Risks, TAs' Functions, Taxpayers' Rights.

CONTENT

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INTRODUCTION

The Tax Administrations (TAs) seek to permanently use the new disruptive technologies to be more efficient and effective in their mission, which is the correct application of the tax system through the strategic objective of raising the voluntary compliance, by the two lines of action that is to give facilities to those who want to perform a radical struggle against tax fraud.

Within this new technology in this article, I will address the topic of the use of artificial intelligence (AI) in the various functions of TAs.

For this, in the first part, I refer to basic concepts of AI, its risks and the benefits of its specific use in TAs.

Then there are current cases of concrete application of AI in the different functions of TAs: information and assistance, control, collection, and recovery, as well as in Customs.

In another part of the article, I refer to the importance of respecting the rights and guarantees of taxpayers in the implementation of AI.

I then offer some ideas or aspects to consider for incorporating AI into TAs.

Finally, I present conclusions or final ideas on the topics.

1. DEFINITION OF ARTIFICIAL INTELLIGENCE

While the term "artificial intelligence"[1] is often associated with science fiction, in reality it is much broader and multifaceted than is believed in the collective imagination.

It was first used at the 1956 Dartmouth Conference by John McCarthy who defined it as" the science and ingenuity of making intelligent machines, especially intelligent computer programs " (Guillén Torres, 2016).

In turn, Brad Smith (2019), president of Microsoft, in his book Tools and Weapons, defines AI as a computational system that can learn from experience, distinguishing patterns within data; patterns from which it is fed back to recommend actions.

Although there is no consensus on the definition of AI, in general, refers to the ability of a digital system to exert cognitive functions such as learning, interact, create and replicate, functions that previously only attributed to humans.

AI can be defined as the science and engineering that makes it possible to develop machines and computer programs capable of solving problems that normally require human intelligence.

Regarding its operation[2], AI relies on machine learning to identify patterns from data, this is the engine that gives power to information and works from data and algorithms that follow the following process:

1. Identify an important problem.

2. Analyze situations and prepare a study of all the variables related to the problem that you want to analyze.

1 Constanza Gómez Mont, Claudia May Del Pozo, Ana Victoria Martin del Campo. Data economy and artificial intelligence in Latin America opportunities and risks for Responsible Use. This report was developed by C Minds and commissioned by the Center for Studies in technology and society (CETyS) of the University of San Andres in Argentina.

2 Whitepaper Inteligencia Artificial en las Entidades Tributarias. Microsoft- PWC.

3. Predict the future outcome of this problem, always based on known data and using a statistical system.

4. Once the system has all the data, provide the most feasible solution for the problem. Thus, AI learns how to fix the problem for the next similar situation it encounters

Data analysis and AI are based on algorithms that recognize patterns through sequential analysis of data, even inactive data or data collected long ago.

Machine learning, one of the main areas of AI, learns from the data that was previously collected and continues to be collected in the present.

It is difficult to establish a clear boundary between big data and data analytics, or even between data analytics and AI, which is increasingly used to solve big data and data analytics problems.

At the moment, the existing AI is known as soft AI, able to perform a specific task with better performance than a human being, as opposed to hard AI, which would be able to reason as a human being in every aspect.

Being limited in scope, AI actually refers to a set of different techniques that allow to obtain a desired result.

“Hard” AI has not yet been developed and experts disagree on the possibility of developing it.

2. RISKS IN THE USE OF ARTIFICIAL INTELLIGENCE

AI being a disruptive and general-purpose technology, is a tool with a power of change of great magnitude, which entails the need for a responsible use approach, as well as the taking of necessary precautions to prevent unexpected and harmful consequences.

Responsible use of AI goes beyond not engaging in illegal practices through its use. It is about using AI in a way that does not violate minorities, that avoids human rights violations and that does not lead to the widening of the existing inequality gap, either intentionally or accidentally.

Among the consequences of the use of AI, there are intrinsic risks, directly related to data, and extrinsic risks, linked to the adoption of AI in society[3].

There are at least four intrinsic risk types to consider in the planning, programming and implementation stages for responsible use of AI.: fairness and inclusiveness, system reliability and security, user data privacy and security, and transparency and accountability

On the other hand, among the extrinsic risks, one of the concerns has to do with the Future of Work.

The OECD estimates that, globally, 14% of jobs will be affected, while 32% will be significantly impacted. In Latin America, the IDB (2018) estimates that between 36% and 43% of jobs could suffer the impact of AI.

Despite common belief, these risks are not an inevitable side effect; they can be mitigated with sufficient planning, control and governance.

For this reason, leading actors on the subject such as the Organization for Economic Cooperation and Development (OECD), the Inter-American Development Bank (IDB) and other institutions speak of the responsible use of AI.

This refers to an AI development framework that aims to guarantee the ethical and transparent use of user data by adopting mechanisms that allow them to meet their expectations of accountability, always considering the values of the organization and the laws and norms of society

3 Ídem Nota 1.

In this topic, the OECD[4] recommends five complementary values-based principles for responsible management of trusted AI:

- AI should benefit people and the planet by driving inclusive growth, sustainable development and well-being.
- AI systems should be designed to respect the rule of law, human rights, democratic values, and diversity, and should include appropriate safeguards, for example, allowing human intervention, when necessary, to ensure a just and equitable society.
- There must be transparency and responsible disclosure around AI systems to ensure that people understand AI-based results and can challenge them.
- AI systems must operate robustly and safely throughout their life cycles and potential risks must be continuously assessed and managed.
- Organizations and individuals who develop, implement or operate AI systems must be held accountable for their proper functioning in accordance with the above principles.

For its part, the OECD, in accordance with these values-based principles, also offers five recommendations to governments:

- Facilitate public and private investment in research and development to stimulate innovation in trusted AI.
- Foster accessible AI ecosystems with digital infrastructure and technologies and mechanisms for sharing data and knowledge.
- Ensure a policy environment that will pave the way for the implementation of trusted AI systems.
- Empower people with AI skills and support workers for a just transition.
- Cooperate across borders and sectors to progress with responsible management of reliable AI.

In Latin America and the Caribbean, the IDB, together with several leading global partners, launched fAIr LAC[5], a pioneering project that unites governments, universities and the private sector to promote the ethical use of artificial intelligence. The initiative was born with the aim of taking advantage of the immense potential of this new technology to create more efficient, fair and personalized social services for the citizens of the region, who in turn manage their data in an ethical and responsible way.

Cristina García Herrero Blanco[6] states that there are risks about what could be a misuse of it, which requires an appropriate assessment from an ethical perspective and the adoption of a series of principles that should preside over administrative action. The author states the principles of prudence (avoiding the complexity of the algorithms or the scope of the projects in which it is used, adopting the advances according to the results are safe), non-discrimination (risks that human errors can be transferred to the algorithms), proportionality, transparency and data governance to ensure its security.

4 See: https://www.oecd.org/going-digital/ai/principles/

5 See: https://www.iadb.org/es/noticias/bid-lanza-iniciativa-fair-lac-para-promover-el-uso-etico-de-la-inteligencia-artificial

6 The use of Artificial Intelligence by tax Administrations, a matter of principle-CIATBlog 3/3/2020.

3. MAIN ADVANTAGES OF AI IN TAX ADMINISTRATIONS

The purpose of the use of AI is to transform data into an asset of knowledge and impact tax and customs management, as well as to achieve the intelligent use of such data to transform TAs and the way in which they will interact with taxpayers.

The combination of AI, IoT, Data Analysis and Data Analytics, will give exponential benefits through the collection and analysis of a large volume of taxpayer data in real time for better decision making that will positively impact several administrative areas of the TAs.

AI is great at automating repetitive tasks, increasing accuracy and efficiency, and uncovering hidden ideas and trends.

You can interpret the best way to achieve a response and learn the routines that get the best result. You can automatically upload documents, understand entries, and classify them into the correct accounting codes, among other tasks.

Among its main advantages[7] stand out:

- **Increase in tax collection:** AI allows processing high volumes of economic information by categorizing much faster, with greater objectivity and accuracy than human beings, with the aim of identifying situations of non-compliance, improving control and preventing tax fraud. Revenue forecasting is an area with great potential for AI application development.

- **Taxpayer classification:** AI can develop an accurate profile of each taxpayer based on the analysis of their past and present behavior, allowing a clearer vision of how they will conduct themselves in the future. In the context of e-invoicing, an individual's consumption patterns can be identified through "machine learning "technology.

- **Reduction of tax evasion** AI allows to detect possible irregularities through the use of algorithms in addition to performing a real-time transaction analysis to reduce fraud based on sophisticated Deep learning systems.

- **Diagnosis and support in decision making:** AI is an ideal example of how a machine can reduce errors and accelerate processes based on the use of systems capable of generating optimized strategies to solve problems of great complexity and help make decisions.

- **Efficiency in calculations** AI has high power and efficiency in making any type of statistical calculation.

- **Optimization of time and resources** that is to say processing a large volume of information in less time.

- **Support in audits:** AI can be applied in audits, which allows the reduction of times since there is information in real time.

4. ARTIFICIAL INTELLIGENCE IN INFORMATION AND ASSISTANCE

The fourth Industrial Revolution that we are going through, in terms of constant advances in technology, is obviously constantly changing the function of information and assistance to the taxpayer, taking advantage of all the advantages that such technology provides.

The virtual office is nothing more than a general access point that the TA makes available to taxpayers so that they can easily carry out their tax procedures on-line.

7 Whitepaper Artificial Intelligence in Tax Entities. Microsoft-PWC.

One trend noted in modern TAs is the increasing use of apps, many of them with the help of AI.

In the aspects of prefilled or pre-filled tax returns with AI development, especially machine learning, it will be possible to forecast and predict taxpayers' behaviors and help them meet obligations with more and better draft pre-filled returns.

So, for example, the Tax Control Plan 2021 of the AEAT of Spain provides for the implementation of analysis of "Big Data" in the field of personal income tax, for the implementation of a project that seeks to reduce, using the experience gained, the errors of the taxpayer to file the tax returns. This is in line with international strategies and "nudge" techniques (directed to encourage and promote a correct tax behavior) based on the approach "behavioural insights" (approach towards a better understanding of the behavior of the taxpayer).

Through these analysis techniques, descriptive characteristics are obtained that define the typical taxpayer who, in previous years, when presenting his income tax return did not use the tax data that were provided and was wrong in doing so, defining a typical profile.

It will focus on work income boxes, and it is intended to implement assistance systems to alert the affected taxpayers in order to reduce possible errors in the filing.

In the not-too-distant future I understand that the taxpayers' own accounting can be kept at the TA's headquarters, as they do today with VAT books.

This is the integration of the electronic services of TAs with the administrative, accounting, and tax information systems used by taxpayers[8].

This is part of the concept of accounting collaborative, about the Spanish Startup Anfix[9], develops a cloud that uses AI and big data, and is able to connect in real time to a company with your bank, its customers and Finance to optimize your accounting processes.

The cloud tool of this company focuses on providing a solution to the new global situation of companies, which need to transform their way of managing business. Today more than ever it is necessary to have remote access to the finances of a company, from any device, in real-time and connecting all agents: company, banks, customers, and Treasury.

Specifically, it allows the creation of automatized budgets and invoices and ensures that the information is integrated directly into the accounting. Invoices and tickets can also be digitized to avoid entering them manually, with intelligent extraction technology.

Another AI solution that is also in the proof -of- concept phase is the Virtual Tax Advisor, a system developed by Deloitte Netherlands for the European Union, that evaluates the probability of success of court cases-related to tax proceedings-in European courts. It is based on the arguments put forward by the petitioner and their lawyers, selects similar cases already tried from an extensive database and analyzes them based on the judgments (favorable or not) of the courts, thus determining their probability of success. This type of application is an extremely useful element for a taxpayer to decide whether it is in their interest (or not) to formalize their claims.

In this area we want to emphasize also that which was spoken by Antonio Secco, and Andres Muñoz[10], who claim that the use of new technologies and digital services, such as process automatization and AI, which facilitate conversational relations with intelligent robots, can overcome

8 To enlarge see: The digital transformation of Tax Administrations. Is a new management model emerging? Alfredo Collosa. *CIAT Blog* 20/01/2021.

9 See: https://innovadores.larazon.es/es/asi-es-la-contabilidad-colaborativa-en-tiempo-real-gracias-a-la-inteligencia-artificial-de-anfix/?s=03

10 Virtual conversational assistants in tax administrations, principles, models, and recommendations, IDB, September 2019.

some of the problems with the traditional model of care to the taxpayer, through the provision of a permanent service —and more accessible, consistent and rapid— on a larger scale and with lower costs.

In this sense, AI presents a scenario of disruptive changes for TAS between the medium and long term, with significant consequences on business strategy, processes and personnel.

These authors conclude that if this trend continues to increase, virtual conversational assistants (VCA) will play a critical role in TA's efforts to increase voluntary compliance, increase tax collection, and improve the legitimacy of public finances.

Basically, VCAs guides users through simple tasks, providing specific and appropriate responses in real time that allow citizens to self-manage[11]. The most representative examples are Apple's Siri, Amazon's Alexa, Google's Assistant, or Samsung's Bixby.

By contrast, "chatbots"[12] are applications that use conversational interfaces to enable intuitive interactions between people, devices, and services; and on the other hand, there are "virtual tutors" that offer specialized knowledge and personalized tutoring, helping people solve problems and make decisions[13].

VCA could overcome some of the problems presented by the face-to-face model of taxpayer care, since they can provide permanent, faster, and affordable service, with lower costs and without physical contact vital aspect at this time of the pandemic.

In relation to the potential benefits for TAs of incorporating VCAs into the information and assistance function, the following have been highlighted[14]:

- Provide services to the taxpayer 24 hours a day, seven days a week, without interruptions.
- Provide consistent information, avoiding the risk of different or incomplete interpretations.
- Increase the user care productivity, as it is possible to handle more cases in the same period of time.
- This increased productivity allows for the release of some of the staff to perform other tasks.
- Eliminate waiting times (face-to-face and telephone) due to the unavailability of operators.
- Provide increasingly accurate responses and, consequently, increasing improvements in user satisfaction, as AI-based VCA collects data and learns from interactions

In relation to the most common problems in the use of VCAs, we highlight the difficulty of improvising, which can give wrong answers if VCA ends up lost in conversation (" lost in translation") and the difficulty of retaining the user since many people, for a cultural issue, prefer to always communicate with other people.

Regarding its use in the TAs, it is noteworthy that the AEAT of Spain developed a VCA using the Watson platform of cloud technology, which is able to answer the questions asked.

The welcome message to the user includes a warning about the legal consequences of the responses obtained, among other issues.

11 Antonio Seco, Andrés Muñoz - Virtual conversational assistants in tax administrations. IDB, September 2019.

12 Accenture (Accenture Federal Services, 2018)

13 See: https://www.randstad.es/tendencias360/retos-de-incorporar-asistentes-conversacionales-en-los-modelos-de-negocio/ distinguishes between Bots that run automatically and repeatedly, but do not involve maintaining a conversation. Chatbots and voicebots: the difference is that chatbots do hold a conversation, but the input and output response is via text, while voicebots it is via voice. Finally, virtual assistants able to maintain a fluid and open conversation.

14 See: https://blogs.iadb.org/gestion-fiscal/es/el-potencial-de-la-inteligencia-artificial-en-la-administracion-tributaria-el-caso-de-los-asistentes-conversacionales/

According to the Spanish newspaper “Expansión” (2018), since the implementation of the assistant, the Tax Management Department of the AEAT recorded an 80% reduction in the number of emails received: from 900 messages per week, to 165. For its part, queries through the virtual assistant increased tenfold: from 200 requests in the first week of use to a peak of 2000 in November 2018.

At the AEAT[15], the virtual assistant for VAT currently offers information on Foreign Trade, change of tax base and rectification of deductions, real estate transactions, invoicing and registration, subjection, and exemptions and also offers tax information on the immediate supply of Information (Books Registration of VAT through the electronic headquarters of the AEAT).

In Australia, the ATO (Australian Tax Office) developed the virtual system “Alex” to provide care to taxpayers, which recorded more than two million conversations in the first year of launch (2016). Its function is to assist individuals and companies with questions and queries related to taxes, property rights, income, and deductions, and tax returns filing. Alex provides direct access to the content that is being searched, in this way, the user saves time and generates a better browsing experience[16].

In the UK, the HMRC also launched a VCA, “Ruth”, which can answer simple questions and provide links to websites.

In Finland, “Vero Bot” provides all information concerning the country’s trade and labour taxes.

In Brazil, a VCA called Teresa[17] has been developed, which is available 24 hours a day, seven days a week and helps solve the most frequent requests of taxpayers.

In Peru, the SUNAT also put into operation a VCA, “Sofia” which provides information on the 2019 Annual Income Tax Return and the fourth category income[18].

In Guatemala, the SAT also launched a VCA, “Rita “ that resolves doubts immediately; it has the ability to solve 2500 questions[19].

These are just some of the VCAs used by the TAs that I have detected.

We anticipate that in the future, a VCA may be integrated with other digital services provided by the TAs, e.g., making payments and verifying tax files.

To do this, these integrated services must be available digitally, that is, we will only be able to integrate those services that are digital and where interoperability can operate.

Another possible development on the subject is that the tax VCA could also be integrated with other VCA within the TAs themselves or other agencies in the country to facilitate consultation in any public VCA and referral to another specialized VCA.

This technique is called “orchestration” and refers to the automatized configuration, coordination and management of computer and software systems.

5. ARTIFICIAL INTELLIGENCE AND TAX CONTROL

It can be stated that auditing is the action through which the TA seek to prevent taxpayers from incurring in tax evasion or fraud and, if they do commit such evasion or fraud, they seek to detect it, prove it and settle it.

15 See: https://www.agenciatributaria.es/AEAT.internet/Inicio/La_Agencia_Tributaria/Campanas/_Campanas_/Herramientas_de_asistencia_virtual/Herramientas_de_asistencia_virtual.shtml

16 See: https://observatorio-ia.com/12-chatbots-para-e-governments

17 See: https://blogs.iadb.org/gestion-fiscal/es/asistentes-virtuales-tributarios-continuidad-de-negocios-durante-coronavirus/

18 See: http://www.sunat.gob.pe/institucional/contactenos/virtual_asistente_Sofia.html

19 See: https://portal.sat.gob.gt/portal/soporte-chat/

Its objective is to maximize the subjective risk, meaning the probability of being controlled considering the magnitude of the sanction.

However, the percentage obtained as direct collection for audit actions does not exceed 2% to 3% of the total collection, therefore its objective is to generate risk, fighting tax fraud and modifying the behavior of taxpayers so that voluntary compliance is increasingly greater.

Generically, AI can be used to analyze relationships between taxpayers to identify hidden or simulated relationships or potentially high-risk tax non-compliance networks, which can generate new sources of information for selection rules that are not obvious.

In risk analysis processes, AI may analyze more complex tax credit applications or in Customs, to analyze import and export declaration forms.

AI can be applied in audits, which allows time reduction since there is real-time information.

By combining an audit with AI (which employs automatic learning and algorithms), the classification of transactions is done automatically, providing a detailed report of possible risks.

Going to the specific cases of its application, the Norwegian TA (NTA) uses data analysis and automatic learning techniques to improve efficiency in the selection of cases to be inspected[20].

The algorithm is trained with historical data to predict the possibility of errors in each VAT return. Each case is assigned a score and tax officials begin inspecting taxpayers with the highest scores.

The more declarations are audited, the more data the algorithm will obtain for use in the model, thus improving its accuracy. The percentage of successful inspections practically doubled in relation to the manual process.

In France[21], almost a quarter of the tax in2019 are the result of AI algorithms, where 11 billion Euros were collected after controls, an annual increase of 30% compared to 2018.

Chile's Internal Revenue Service (SII) is designing machine-built charts to map relationships between business participants, providing auditors with a new tool to analyze transactions and detect tax evasion. AI is being used to study the notes that SII employees take when they answer taxpayer questions and test which combinations are most likely to get a taxpayer who will be defaulting.

Also in Chile, the tax reform of 2014 innovated with different technological tools for the control processes, among them, the application of computer systems intended to connect directly with the accounting systems of taxpayers, regulations that have been complemented in 2020 (by the tax reform introduced by Law 21.210), establishing certain restrictions in the exercise of this faculty.

Since 2017, 119 taxpayers have been audited under this modality, connecting to their systems remotely to collect background information[22].

The SUNAT[23] of Peru is implementing initiatives for the electronic control of the General Sales Tax (IGV) among them in the issuance or receipt of payment vouchers, with the sending of alerts through text messages when invoices have been received for expenses or costs that AI systems consider unusual in the type of business that has made the purchase.

20 ICT as a Strategic Tool to Leapfrog the Efficiency of Tax Administrations. Page. 541 https://www.ciat.org/las-tic-como-herramienta-estrategica-para-potenciar-la-eficiencia-de-las-administraciones-tributarias/

21 See: https://www.20minutes.fr/economie/2848031-20200827-impots-intelligence-artificielle-permet-rendre-controles-fiscaux-plus-efficaces

22 ICT as a Strategic Tool to Leapfrog the Efficiency of Tax Administrations. https://www.ciat.org/las-tic-como-herramienta-estrategica-para-potenciar-la-eficiencia-de-las-administraciones-tributarias/

23 ICT CIAT book, pg. 326.

The IRS (USA) tracks data from inside and outside the agency for its compliance initiatives, as a recent effort to identify thousands of high-income individuals who did not file. The IRS criminal investigations unit uses Palantir Technologies, the data mining firm, to identify potential fraud cases for future investigations.

In Colombia, DIAN[24] aims to control tax evasion through a remodeling and modernization plan that seeks to reduce smuggling and irregular handling in customs matters. One of the most important points is the connection between national ports, through technology with AI systems and robots, to detect evasion and verify commercial operations.

In Costa Rica[25], through the use of Big Data, tax collection was improved. The predictive model designed with data mining techniques used by th e Ministry of Finance in Costa Rica detected the simulation of payments to third parties for more than $31 million.

In Brazil, SISAM[26]-System of Selection for Customs through Machine Learning: since 2014 it has been responsible for analyzing all import declaration forms (DI) submitted to customs. It is an AI system that learns from the history of the declaration forms and estimates the probability of about 30 types of errors that may occur in each line of each new import declaration form and calculates the expected value of revenue (in national currency) for each error detected.

In Spain, the AEAT uses a computer application called HERMES which consists of a system for risk analysis that generates standardized risk reports and facilitates the selection of taxpayers to carry out management, inspection, and collection actions. Thus, once each taxpayer is assigned a certain level of tax risk, the Tax Agency (AEAT) will proceed to determine the actions to be developed with the aim of achieving an improvement in the voluntary compliance of tax obligations.

In the United Kingdom. the HMRC has developed since 2017 the Connect system, a computerized data mining system of social network analysis software that cross-checks the tax records of companies and individuals with other databases to establish fraudulent activity.

The data comes from a variety of sources[27], including banks (information from over 60 countries) land registry, credit card transactions, owned or sold vehicles, UK tax documents city tax paid, VAT registration, last year’s tax return, any tax investigation, occasional employer income, company benefits, child benefits and support payments, online platforms, social media all public posts, web browsing and email records.

The software combines analytical tools and collects the information and implements predictive analysis similar to credit rating and has dynamic benchmarking. It seeks the correlation of income with lifestyle, comparing it with multivariate statistical models.

Finland began in 2017 to develop its first robots for tax audit processes, which will allow it-potentially - to reduce the workload of these tasks in 52 years of effort per person, as well as improving the quality of work and reducing errors[28].

In Canada[29], an AI solution was developed to support complex classifications that arise from the local tax system (for example, to assess whether a person should be classified as an employee or entrepreneur in a given business context). This innovative solution presents not only a response with its respective percentage of confidence, but also the reasons why this response

24 See: https://www.pulzo.com/economia/modernizacion-dian-con-robots-tecnologia-contra-evasion-corrupcion-PP726009

25 See: https://www.centralamericadata.com/es/article/home/Big_Data_para_combatir_la_evasin_fiscal

26 ICT CIAT book, pg. 207.

27 See: https://baranovassociates.co.uk/what-is-hmrc-connect/

28 See: https://www.pucv.cl/uuaa/vriea/investigadores-pucv-abrieron-discusion-sobre-uso-de-inteligencia/2020-07-14/155757.html

29 See: https://www2.deloitte.com/global/en/pages/tax/articles/artificial-intelligence-in-tax.html

was reached, i.e., the legal provisions, case law and comments that justify it.

There is also already experience of using AI in transfer pricing (TP) analysis. The manual nature of TP benchmarking presents a clear opportunity to apply information technology to improve a fiscal process. KPMG created a team of TP professionals, data scientists, and user interface programmers to incorporate AI into the benchmarking process. It is important to note that the “human in the circuit” makes all the final decisions about the suitability of the benchmark; the AI only makes recommendations, that is, it does not make final decisions[30].

6. ARTIFICIAL INTELLIGENCE, COLLECTION AND RECOVERY

The primary purpose of the collection is to apply the powers of the administration to ensure the effective achievement of the payment of what is due by the taxable person.

The correct identification of the situation of the different debts is vital (for example: suspended, pending resolution before courts, guaranteed, deferred, affected by bankruptcy or bankruptcy, etc.).

Also important is the segmentation of debtors and debts by criteria of importance, legal priority, collection possibilities and the application of risk analysis techniques.

In general, modern TAs seek to implement coordination measures that allow the collection action to be advanced before the delinquency occurs and the implementation of effective payment arrangements processes are an important factor in this matter, as well as a systematic and correct collection of assets information that allows greater agility in the execution of embargoes[31].

In this function too, digitalization has produced important advances.

Thus, for example, there are different methodologies for approaching the delinquent taxpayer, which are based on the need to have an updated database and procedures that lead to a quick and accurate location of the taxpayer.

The technological advances achieved by TAs allow us to have tools that perfectly fit the process under analysis. For example, the electronic file, the electronic signature, the electronic notices, electronic tax address which is already mandatory in many countries.

With this, more immediate contact with the taxpayer is achieved and the processing times of the processes are considerably reduced.

A widely used practice by many TAs taking advantage of modern technology is the prevention of arrears through preventive measures, for example, by sending reminder messages before the due dates of payment of a tax or a payment facility, or immediately after a late or unpaid payment.

Behavioural economics studies are also being conducted in many countries. This technique is called Nudge and aims, through letters or messages made especially for specific groups or classes of taxpayers, to convince them to pay their debts to the treasury. The tax administrations of the city of Rio de Janeiro, Guatemala and the United Kingdom are examples of the successful application of this technique[32].

30 See: https://news.bloombergtax.com/daily-tax-report-international/insight-disrupting-tax-processes-with-artificial-intelligence-technology

31 See page 27 of the book ICT as a Strategic Tool to Leapfrog the Efficiency of Tax Administrations. https://www.ciat.org/las-tic-como-herramienta-estrategica-para-potenciar-la-eficiencia-de-las administraciones-tributarias/

32 See page 103 of the book ICT as a Strategic Tool to Leapfrog the Efficiency of Tax Administrations. https://www.ciat.org/las-ticcomo-herramienta-estrategica-para-potenciar-la-eficiencia-de-lasadministraciones-tributarias/

ICTs through data analysis and AI are also used in many countries to improve the selection and maximize the recovery of receivables.

A field where AI has many possibilities of application is in the prediction of revenue. In Brazil[33], the Ministry of Finance of the State of Piauí (Brazil) is currently developing prediction models for the collection of the circulation tax of goods and transport services (ICMS), based on the last five years of collection data and local, national and international economic variables.

This system uses time series models and neural networks in a computer platform based on the "R" language that specializes in statistical and graphical analysis, as well as is integrated into specialized packages.

At its current stage, the tool allows direct access to authorized officials, who can select evaluation periods and compare the results of the different prediction models and their respective margins of error.

In Mexico[34] to strengthen its mechanisms for compliance with tax obligations, the SAT uses AI which allows collecting a large volume of data from electronic invoices.

The SAT has the potential to exploit the most sophisticated algorithms of AI, in order to improve oversight and raise Gross Domestic Product (GDP) collection by 3%.

In the case of Big Data, the SAT already solved three main problems before implementing AI: 1. Creation of algorithms. 2. Convert data into structured information. 3. That information is accessible in real time.

The Digital Collection (CoDi in Spanish) can also represent an effective alternative to make it easier for taxpayers to pay taxes.

7. ARTIFICIAL INTELLIGENCE AND CUSTOMS

The WCO talks about the concept of "Digital Customs" and organizations such as the European Commission, IATA and IMO have invested significant resources in e-Freight[35], One-stop shops, and other far-reaching initiatives.

The digitalization of Customs means using modern ICTs to collect and safeguard customs duties, control the flow of goods, people, means of transport and money, and protect cross-border trade from crime, including international terrorism, which continues to loom around the world.

Today many Customs already have computed tomography equipment that allows the visualization of the merchandise with 3D technology to know the contents of the shipments without the need to open them.

This equipment, unlike scanners, "performs automatic controls via AI to automatically perform image training-based detections". To give an example in the AFIP of Argentina they joined in March 2019[36].

In Brazil, in 2016, the detection of foreign trade frauds using AI was implemented[37].

33 Whitepaper Artificial Intelligence in Tax Entities. Microsoft-PWC.

34 See: https://www.eluniversal.com.mx/cartera/sat-va-por-mas-recaudacion-con-inteligencia-artificial

35 E-freight is an industry-wide initiative involving carriers, ground operators, carriers, customs brokers, and customs authorities. E-freight aims to build an end-to-end paperless transportation process for air cargo through a regulatory framework, modern electronic messaging, and high data quality.

36 See: https://www.iproup.com/innovacion/3615-afip-puerta-a-puerta-innovacion-tecnologica-Aduana-usa-tecnologia-3D-e-inteligencia-artificial-para-agilizar-procesos#:~:text=Innovaci%C3%B3n%20%7C%20Tomograf%C3%ADa%203D,Puerta%20a%20puerta%3A%20la%20Aduana%20usa%20tecnolog%C3%ADa%203D%20e%20inteligencia,UU

37 See: https://tradenews.com.ar/aduana-blockchain-impresion-3d-internet-de-las-cosas-drones-inteligencia-artificial/

Normal control and audit procedures are a costly and time-consuming task for staff members who are responsible for verifying thousands or even millions of operations.

The use of AI for fraud detection was designed in Brazil in 2008. The system allows to detect various types of fraud by identifying “outliers” by helping officials to identify potential suspicious transactions.

In the same sense, the Argentine Customs has been working with data mining, which is the intelligent use of information for the early detection (preventive) of suspicious operations, sending “alerts” to officials in charge of control.

In a recent article[38] highlighting different aspects of the digitalization of Customs in Argentina among others, the modernization of controls in the primary zone, the organization and establishment of the regime of Single Window for Foreign Trade –Argentine VUCEA-, the regime OAS –Authorised Economic Operator, the digitalization of the destinations of export by the pilot scan on the file of the customs declaration in those destinations of exports for consumption and the summary procedure abbreviated that implements a process using summary proceedings for certain violations of customs.

AI is used is in facial recognition systems in airports.

The first to be released was in Tocumen, Panama, in 2011 the government of this country partnered with the U.S. to test a pilot program of the company Face First in order to prevent illicit trafficking. And it was such a success that they expanded it to other terminals.

Currently, all Canadian international airports use a facial recognition system. Australia and New Zealand use a frontier one called Smart Gate, which automatically compares the traveler’s face with the data in their electronic passport.

In the United States, the Department of Borders and Customs (CBP) has approved the installation of cameras with facial recognition in all airports in the country[39].

Until now, these cameras were being used in the test phase in 15 North American airports, but in the next 4 years this technology will be extended to all airports in the country.

Facial recognition uses AI to identify a person based on their traits. AI is able to recognize faces in a photo, with all that that entails in terms of privacy and freedom, if this information is used for purposes beyond what is advertised.

Facial recognition is being used to identify everyone leaving the United States on a commercial flight to see if someone has spent more time in the United States than their visa allows.

The system works by taking a picture of the passengers as they approach the boarding gate. An AI compares the photo to the one on the passport and visa, so you can know, first, if you are the person you claim to be, and second, if you have spent more time in the country than your visa marks.

In the 15 U.S. airports where it is already in place, the system has inspected more than 15,000 flights and scanned more than 2 million passengers. He managed to detect 7,000 visa violations.

38 See: http://c1311835.ferozo.com/la-necesidad-de-la-digitalizacion-de-la-aduana-frente-al-covid-19/

39 See: https://computerhoy.com/noticias/tecnologia/reconocimiento-facial-ha-llegado-aeropuertos-410655

8. ARTIFICIAL INTELLIGENCE AND TAXPAYERS' RIGHTS

In order to protect the rights of the taxpayer, many countries have issued taxpayer charters or statutes setting out the rights of the taxpayer in relation to TAs.

These statutes or charters also enshrine the duties of taxable persons as a balance between or balance between obligations and rights.

Already in the charter of "Minimum Attributes for a Healthy and Effective Tax Administration", approved by the CIAT General Assembly, held in Santo Domingo, Dominican Republic, in 1996, one of those requirements was established to "GUARANTEE THE TAXPAYERS' TRUST" for which it is required:

An administration that guarantees the fair, reliable and transparent application of tax policies and laws, access, reliable service and consultation with taxpayers.

That the administration ensures the prompt processing of taxpayer requests (refunds, extensions, etc.) resolution of appeals and timely and accurate response to their queries.

That the administration and the rest of the Government collaborate to create tax awareness, making taxpayers aware of their tax obligations through the implementation of a comprehensive communications strategy that includes forms, guides, public information, education and assistance in which simple language is used.

That the administration guarantees the rights of taxpayers, spreading among them and among their officials and ensuring that they are respected.

In the CIAT model of Tax Code (2015) deals with the figure of the Defender of the taxpayer in article 76 "Will be able to create the figure of the Defender of the taxpayer, as a public entity independent of the Tax Administration, in order to ensure the timely attention, the respect for the rights of taxpayers and users customs and fairness in the assistance and actions in the exercise of their statutory functions by the Tax Administration".

Accordingly, bodies and / or authorities have been established to protect these rights. Some of these people and institutions retain independence from TA, i.e., they are autonomous, but interact with them, and others are part of them.

According to information available regarding 2015 in a document entitled Facilitating compliance: taxpayer services, cooperative compliance and tax simplification[40], the TAs in 78.4% declare to have established a document that formally regulates the rights of the taxpayer. However, there are some significant differences regarding the existence of a formal body to deal with complaints (75% of high-income TAs; 47% in low-income countries) and, in general, the number of TAs where this body is autonomous and external falls dramatically (only 28.8 on average).

The work of the Observatory for the Protection of Taxpayers' Rights of the IBDF is particularly noteworthy[41]. It says a clear and undeniable relation is present between human rights and taxation, with human rights that directly influence different facets of the tax relationship materially and formally.

Human rights materially influence the concept of "fair" taxes to balance the effective enjoyment of fundamental rights of individuals, in conditions of freedom and dignity (such as education, health, work, etc.) against the adequate financing of state activity directed at the procurement of essential public services. Human rights facilitate the formal recognition of the taxpayer's position on tax claims and, therefore, their right to participation

40 Facilitating compliance: taxpayer services, cooperative compliance, and tax simplification ISORA data on tax certainty and tax administrations by Santiago Díaz de Sarralde Miguez-October 2018 CIAT.

41 See: https://www.ibfd.org/Academic/Observatory-Protection-Taxpayers-Rights

and defence in administrative and judicial proceedings related to the assessment of tax liability.

It also concludes that globalization and the growing internationalization of tax law have added more complexity to the analysis. The current political climate and response to calls for" tax justice "has led to the growth of TAs' investigative powers with the aim of addressing both tax evasion and avoidance, as well as so-called "aggressive tax planning".

Such enhanced powers must be balanced with the provision of timely and effective protection to taxpayers' rights.

The purpose of the research is to establish the current principles, minimum standards, and best practices that ensure the exercise of these taxpayers' rights (within the scope of human rights).

The Observatory on the Protection of Taxpayers 'Rights (OPTR) identifies principles, minimum standards and best practices for the effective protection of taxpayers' rights and also allows permanent monitoring of global compliance with such minimum standards, as well as their amendment and development in different regions of the world (defining whether that can qualify as a universal or regional standard).

In terms of digitalization and use of new ICTs such as AI by TAs, I understand that it will continue to grow in the future, which is why it is vital that in all their actions they respect the rights and guarantees of taxpayers.

A first point is that taxpayers need to know that their information is secure. TAs have financial and other information on taxpayers.

Comprehensive laws are required to protect the security and confidentiality of information.

These laws must specify who assumes the risks and responsibility for system failures, for example when information leaks occur as a result of actions by cybercriminals or the actions of the human resources of the TAs.

It is also important that, due to the digital complexity, the new tax laws of each of the countries are consistent both with other national laws and where national and international laws cross.

Many of the IT applications developed by TAs are complex, which is why it is key to work to promote simplification, the reduction of compliance costs and transparency in the tax taxpayer relationship.

The timeless principles of taxpayer protection and existing rights frameworks in each country should be adapted to digital disruption.

It is key that this is done as soon as possible, since the trust of a society in the fairness of the tax system is key to improving voluntary compliance as explained in the corresponding section.

The activity of TAs as a result of international collaboration/cooperation to address tax evasion through information exchanges inevitably leads to new risks and challenges in terms of data security.

For example, when the CRS was launched, the OECD was very concerned that any data leak could lead to major problems with identity fraud and fuel other criminal activities, such as kidnapping, corruption, blackmail and extortion.

To counter the risks, the OECD designed procedures to ensure the highest levels of security and support the secure transfer of data under the transparency agenda.

TAs must work hard and in coordination on the security of and use of their data, as it is clear that taxpayer confidence will decrease if there are cases of data leaks or theft.

It is key that TAs use information and new ICTs such as AI to meet their strategic goal of increasing voluntary compliance levels.

We highlight the comments of Dr. Adolfo Iriarte Yanicelli[42] who says that in the fourth industrial revolution, the main revolution will happen by the use of algorithms that create new value-added information, product processing, relationship, integration of large amounts of data, from various sources, even being able to predict future actions such as fraud and aggressive tax planning, hidden revenue, information that can be exchanged.

This author says that faced with this reality, it is important to solve the rights of taxpayers, according to new rights that must be part of the Statutes or Charters of Taxpayers, Rights that must adapt to the new reality.

In the age of knowledge, the main right that the taxpayer will have will be this one, the right to know how AI finds its conclusions, perhaps controversially, and the right to challenge the new value-added information generated.

Dr. Adolfo Iriarte Yanicelli says that the taxpayer should have the following rights and guarantees that must be integrated into the Statutes or Charters of the Rights and Guarantees of Taxpayers:

a. The taxpayer would have the right to be notified about the conclusions issued by the IA, prior to the issuance of any act, order of inspection, inspection, verification, or tax settlement.

b. The right that the new value-added information issued cannot be used as a presumption: the TA should have the independent evidentiary channels necessary to prove the tax debt or the elements of tax evasion.

c. The right to know any provision of the information made by Artificial Intelligence on its economic capacity, operations, transactions, businesses and taxable events completed, other than those declared by its person.

d. The right to appeal the act of communication of the algorithmic information received.

e. The right to request information on the use that the Contracting States will make of the algorithmic information generated with added value.

f. The right for States to protect value-added algorithmic information received from the other State with which they have exchanged information and to notify the taxpayer of its usefulness.

g. The taxpayer's right to appeal a settlement dictated on the basis of algorithmic value-added information generated.

For its part, the Tax Technology Committee[43] considers the following vital issues to explore in relation to the flow of information as part of the digital transformation:

- Maintain the privacy of the taxpayer's data.
- Data storage.
- Cybersecurity and personal data protection.
- Digitalization development resources: the availability of sufficient staff and capital funds for both tax administrations and taxpayers.
- Administrative and investigative powers of the tax administration.
- Data analysis, especially when outsourced to the private sector.

Concerns arising from data collection by TAs are compounded by the automatic and requested exchange of data between national TAs. That is why they say that there is a need for a digital charter and a protocol for data protection in cross-border exchange.

42 Transformations and Challenges of Tax Law in the Era of Robotization and the Digital Economy: Aspects Related to the Digital Tax Legal Relationship.

43 See: https://taxadviserseurope.org/blog/portfolio-items/cfe-opinion-statement-ttc-1-2020-on-tax-administration-data-collection-practices/

The Technology Committee calls on the European Union and the Member States to carefully consider procedural safeguards when implementing the DAC6 Directive as a matter of national procedural tax law, as well as the withholding period and robustness of data storage.

The collection of data by TAs raises concerns about the cybersecurity of data, what are the best means to secure it, how and where it will be stored, who will have access to it, and what about confidentiality and privileges, both regarding cross-information.

In relation to how Artificial Intelligence (AI) will affect tax administrations, Cristina Garcia Herrero Blanco[44] says that the benefits that can be achieved through the use of AI are many and, in our field, and should favor better tax compliance, in the sense of easier and fairer compliance for taxpayers, in a world with fewer errors on the part of tax administrations. It is true that this is the vision of AI from a clearly optimistic perspective.

Faced with this concept, however, there are also risks of what could be a misuse of AI, which requires an appropriate assessment from an ethical perspective and the adoption of a series of principles that should preside over administrative action.

Firstly, the principle of **prudence**, whereby the complexity of the algorithms or the scope of the projects in which it is used is avoided, progress being made on the basis of results being assured, or pilot programmes being put in place to test results concretely and provisionally and introducing caution before their widespread application.

Secondly, the principle of **non-discrimination**. As is known, algorithms are nourished by hypotheses developed by scientists, which implies the risk that human errors or their biases can be transferred to the algorithm itself, conditioning the validity of new hypotheses and their results.

Thirdly, the principle of **proportionality**, by virtue of which the degree of interference with taxpayers ' rights and guarantees by decisions resulting from AI-based programmes must be assessed. The use of presumptive statistical techniques, as well as the use of AI tools, can serve as an indication for certain actions of the Administration, but not as only evidence.

Fourthly, the principle of **transparency** implies the adoption of measures that allow taxpayers to know why a decision has been taken, without limiting their right of defence.

Finally, the **data governance** is relevant to ensure security, for which the TAs are responsible, respecting privacy and confidentiality. In addition, TAs should also take responsibility for data quality, encouraging the integration of all information.

9. IDEAS FOR INCORPORATING ARTIFICIAL INTELLIGENCE INTO TAS

As a first point it is essential that TAs become familiar with its operation[45], since AI relies on machine learning to identify patterns from data, this is the engine that gives power to information and works from data and algorithms.

Skills are often lacking and there is what is known as data illiteracy. That is why it is very important for TAs officials to know how to ask questions based on data and how to answer them using AI techniques, reaching what is known as data standardization.

The implementation of big data analysis and AI-based systems can be implemented through market products and free software packages.

44 The use of Artificial Intelligence by tax Administrations, a matter of principle-CIAT Blog 3/3/2020.

45 Whitepaper Artificial Intelligence in Tax Entities. Microsoft-PWC.

AI solution development typically involves different platforms, models, and integrated algorithms depending on the problem type and domain (specific sector) of the solution.

Those institutions that choose to develop solutions internally should advise and strengthen their teams in both the number and type of profiles, creating for this purpose a group with experience in the management of free software, as well as in skills related to AI techniques.

For a proper AI function, TAs[46] must be equipped with human and technological assets with the capacity to:

- Organize and provide all the data saved by the administration in a uniform format.
- Activate the corresponding intelligence cycles, in order to transform this data into useful information for decision making.
- Manage feedback regarding disseminated information, to activate subsequent processes.

While data governance and data quality, as well as access to them, are key to the future success of AI in public organizations, it is key first of all to analyze the context in which each TA operates and to incorporate technology only, if necessary, i.e., not technology as fashion, since there are many experiences that have not been positive in this regard.

It is advisable to analyze the best practices of the field and then see what problem we need to solve in order to identify which manual work can be eliminated or increased through AI, and what additional information can be generated from the machine.

As with any ICT project to increase the chances of success, the highest authorities of the TA must be involved from the very beginning and carefully follow its implementation.

Management's commitment to AI is key to ensuring the development of AI solutions and new technologies. It is especially important that this commitment of management at all levels of leadership.

A no small issue is the resources needed or sources of funding for AI mainstreaming projects.

Within the TAs, there was always a debate between buying ICTs, developing them internally, or outsourcing the process.

There is no uniform opinion on the subject and the answer will depend on the type of TICs to incorporate.

But there is full agreement among experts that taxpayers' data should not be transmitted to third parties.

Some key aspects should be carefully analysed, such as implementation times, costs, personnel management (recruitment, training), the need for own infrastructure, flexibility to make modifications and maintenance of product quality.

It is always recommended to start with small universe test projects to measure results prior to generalization.

It is important to have spaces for experimentation of new services and new controls, which allow validating hypotheses of new management models without harming the current operation.

In AI, as in any computer system, maintenance and update processes are critical. Therefore, a good practice is to have specialized external advice to ensure the appropriation of advances by the institution's team, such advice can be given through agreements with universities or contracts with specialized companies.

46 ICT as a Strategic Tool to Leapfrog the Efficiency of Tax Administrations. - CIAT. pg. 209. https://biblioteca.ciat.org/opac/book/5731

A robust AI ecosystem is very important to ensure innovation, collaboration, and knowledge sharing.

As the Public Sector operates under regulated conditions and limits, the importance of strategic partnerships to foster innovation is vital to the successful development of AI by the sector.

Innovation centres and knowledge centres, including the academic, private and public sectors, are key to fostering innovation and sharing best practices.

A no minor aspect is the regulatory changes to be developed, for example, what value against the tax legal system of the country will have the exposed provided by the Virtual Conversational Assistants.

In many countries the digitalization of TAs is progressing rapidly, but not all countries have a simultaneous regulatory approach.

Directly linked to this issue is the fact that in AI as in all ICTs that are incorporated, the protection of the rights of taxpayers must be guaranteed.

The issues of computer security are essential, as well as the issue of cybersecurity and protection of taxpayers´ data.

It is also necessary to see whether or not the modification of the structures of the TAs is required to incorporate these ICTs, such as creating areas of unified data analytics at the central level, innovation centers, etc.

As in any process human resources are also vital, see the new profiles of officials required and especially the digital skills that must be gathered.

This means that there is a need to hire new talent, but they also recognize the importance of developing in-house AI skills and knowledge.

To ensure internal engagement and use of newly developed AI solutions, it is important that employees are actively involved in the process.

By inviting internal stakeholders to develop new AI solutions, employee engagement and understanding of AI increase.

External stakeholders, such as citizens and businesses, are also invited to play an active role in creating new AI solutions for public services.

10. CONCLUSIONS

Today many TAs around the world already use AI for multiple functions and its use will continue to increase over time.

I am convinced that AI is here to stay and in the coming years will be used increasingly in the various functions of TAs and in many other aspects with a view to improving their efficiency.

The use of AI, like the rest of ICTs, by TAs presents multiple benefits and opportunities for them to be more efficient and effective in their central task of improving voluntary compliance levels.

The efficiency of the TAs today more than ever is strongly associated with the proper use of ICTs and the quality of IT services, which is why it is essential to manage them properly since the activities of the TAs are increasingly dependent on the processing of data and information, which is why data governance becomes strategic.

Data is the vital input for modern technologies such as AI to successfully fulfill their mission.

AI aims to transform data into an asset of knowledge and impact tax and customs management, as well as achieve the intelligent use of such data to transform TAs and the way they interact with taxpayers.

AI presents a scenario of disruptive changes for TAs between the medium and long term. Digital transformation involves not only structural but also cultural changes. TAs need to understand how technology impacts their functions and develop the skills needed to use it efficiently.

I understand that we must never lose sight that ICTs are tools to obtain better results, that is to say they are not an objective in itself, the technology "as fashion" is useless but it must always be asked which will be the strategic objective of its incorporation.

As we saw in the present, AI also involves risks, for which specific regulation is required, especially for the adequate protection of the rights and guarantees of taxpayers.

It is vital that in the design, development, application and audit of algorithms, the fundamental rights of citizens are always respected, thus avoiding all biases or discrimination that their use may produce.

At this point, it is clear that AI does not work by itself but depends on how it is "trained or programmed" by humans, which is why they are and will be responsible for its proper functioning.

The Public Administration will have a significant role to play in ensuring that individual freedom and equality are not undermined by the advancement of AI automation.

This whole process of digitalization of TAs, including the adoption of new technologies such as AI, should not be carried out in isolation, but should be integrated into the digitalization of countries, within the concept of digital government.

Governments must work together with the different actors involved to ensure the proper use of AI, in an ethical and equitable way, protecting the fundamental rights of citizens and always seeking to ensure that ICTs are an integrating element with the human resources of TAs.

AI should not focus on replacing public competencies but should increase or complement human capabilities so that people can add value to their tasks while improving the quality and efficiency of public functions for citizens.

Digitalization opens up new possibilities and opportunities for countries and their citizens, and those countries that better take advantage of the “train” of digitalization will undoubtedly have better opportunities to develop and provide a better quality of life for their citizens.

It is vital to place citizens at the center of the technological development and innovation in the Public Sector can ensure that public services are developed for all the segments of society and thereby increase accessibility and social inclusion.

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TAX CONTROL OF CRIPTOCURRENCIES BY THE IRS

and the opportunities that this may offer to Latin America for regulating their use

Jorge Luis **García Obregón**

SYNOPSIS

The aim of this article is to highlight the regulation currently established by the IRS (*Internal Revenue Service*) of the United States of America, on the use of cryptocurrencies and the various economic actors involved in these activities. As well as, to provide Latin American countries with existing methods for the implementation of a timely fiscal control for the development of a regulatory framework adapted or homogenized to international standards and above all to one of Latin America's largest commercial allies, the United States of North America.

Keywords: Taxation, Cryptocurrencies, Crypto-assets, IRS.

CONTENT

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INTRODUCTION

Cryptocurrencies in recent years have represented a great challenge for tax administrations, but, especially as far as liberal economies are concerned, which seek to be a driving force for new businesses and different forms of wealth generation, in what is now known as the *"orange economy"* (Howkings 2001, Creative Economy).

In this article it is about giving a closeness to the incipient regulation that in the United States has been given to cryptocurrencies. In the same document, many challenges are addressed, not yet overcome in the first regulations and especially the regulatory opportunities that in Latin America could be exploited according to the experience that has been given in the great country of the north.

From 2020 to the present day, as a result of the pandemic, we have been able to see the exponential growth of the digital economy, where borders in the trade of services are increasingly thin and the dynamism of the different logistics chains blur mostly the ordinary and conservative controls that in the trade of goods had been structured.

This does not escape in the least to financial services and means of payment, which have evolved from the use of derivative and composite financial instruments, such as the *forward* or the *swap*, even electronic money, digital currencies and cryptocurrencies. The latter, due to its characteristics, is one of the options most used today, due to its universality and convertibility, sometimes very far from exchange, fiscal and regulatory controls.

1. TAX CONTROL ANTECEDENTS

Before the appearance of the famous **Foreign Account Tax Compliance Act (FATCA)** become "something tangible" in the early 2000s, the **Internal Revenue Service (IRS)** he made many "fishing expeditions" to understand what and what the diversity of methods and typologies were that US Income Taxpayers used to hold funds abroad, where in some cases they were used to evade taxes. It is important to note that funds abroad are not always used to evade taxes, because it is important to mention that, in this country, the " Option Economy", is valid and even recognized by the Supreme Court of Justice, for the optimization of the tax burden, allowing the establishment of *Family Offices* abroad or accept in their state jurisdictions those coming from other countries. As a result of the aforementioned "fishing expeditions", the U.S. Federal Government, through the Department of Justice (DOJ) and the IRS, managed to nurture and learn from money flows abroad and emerged with the FATCA Act in Congress in 2010.

Currently, with the rise of cryptocurrencies and virtual currencies, the IRS is focused on getting to understand what they call "*this dark enemy*", which is out of their radar and is reducing their income, but to understand it must first adapt to the ecosystem of virtual currencies and cryptocurrencies in order to subsequently achieve, fulfill its mission, which **is identify variations in taxpayers´ wealth in order to determine increases in their wealth,** to be able to assess the corresponding tax.

The United States is not only seeking to research, analyse and study the use and taxation of these technology-based financial instruments. From July 21-22, 2018, the G-20 finance ministers and Central Bank governors of those countries met in Buenos Aires, Argentina, to discuss a number of international taxation issues, including the rise of cryptocurrencies and the need for regulation by Governments. The approach was given in function similar to that of the **Financial Action Task Force (formerly FATF)** to clarify the standards applicable to "crypto assets". France, New Zealand, the UK, Israel, and many other countries are strengthening their understanding of virtual currencies and cryptocurrencies, as well as their legal and tax consequences, respectively. The Organization for Economic Cooperation and Development (OECD) for example, has initiated a working group to assess cryptocurrencies and their impact on corruption and fraudulent activities. Similarly, companies are increasing their use of cryptocurrencies. For example, *Facebook* at one point, planned to issue his own crypto-based payment system (dubbed the "Libra Project"), but the fact that the ecosystem was not yet ready, for a virtual currency without banking regulation, momentarily slowed momentum. However, this makes us rethink the future of these currencies once the issues of *compliance* and traditional banks manage to understand how to get into the pie and stop being an obstacle.

Thus, the "call" made by the IRS and the US Congress after having nurtured and understood the activities related to the application of cryptocurrencies is similar to the situation that occurred when the FATCA investigation began. On July 2, 2018, the IRS announced a campaign to gain understanding of virtual currencies[1] and then enforce the individual compliance of each taxpayer. One year later, on July 26, 2019[2], to educate and persuade taxpayers with unreported or unpaid taxes related to cryptocurrency transactions to voluntarily comply with the law, the IRS issued a press release titled "**Virtual currency transaction report**"[3]. The release provides three examples of letters (**IRS Letter 6173, IRS Letter 6174 and IRS Letter 6174-A, which are known to many as, the "IRS Letters"**) whose purpose is for taxpayers to understand their U.S. tax and federal reporting obligations. Opening sentence in IRS Letters alone reminds of FATCA-like doubts:

"[We have] information that you have or have had one or more accounts that contain virtual currencies, and you may not have met U.S. tax filing and filing requirements. U.S.A For transactions involving virtual currencies, including cryptocurrencies and non-crypto virtual currencies".

According to the press release[4], in late August 2019, the IRS sent more than 10,000 letters to taxpayers suspected of earning income from cryptocurrencies and not having declared them during fiscal years 2013 to 2017. The warning came from a passive audit, where they invited them to self-correct their tax returns, but it is worth warning of what is to come; an audit and probable adjustment, where if it is possible to demonstrate fraud or concealment on the part of the taxpayer, it is possible to proceed through the federal crimes of tax fraud.

For sure, with a caveat like that, due to the seriousness of tax crimes in the United States, it is best to correct and declare any corrections in income, resulting from cryptocurrencies, before the IRS contacts them.

However, in order to comply with IRS guidelines, there are more doubts than certainties, and that is where several *tax loopholes* can arise that must be taken advantage of, clarified, or elucidated by practice, legislation, or IRS pronouncements.

2. CRYPTOCURRENCY BACKGROUND AND KEY ASPECTS

Cryptocurrencies, which the IRS has conceptualized as virtual currencies, have been the subject of growing interest from government regulators, among which we can list several countries, such as Spain, Argentina, Ukraine, South Korea, Portugal, Mexico, China, Canada, and of course the protagonist of this article, the United States, through federal agencies, such as the IRS, the Treasury Department, the Securities and Exchange Commission, the Department of Justice and the Federal Bureau of Investigation, among others.

The dynamism of the market, the absence of taxes, its easy transferability, the volatility, and the interest of investors in the *cryptos* have been so striking, that they have not only opened important opportunities for investors, but they have also managed to become a target of tax authorities and other stakeholders, due to the massive diversion of capital from traditional and regulated players, such as banks, stock market centers, among others, which have thus aroused a zeal in that dark area, which the *cryptos* bring, therefore, for the most anarchists, the valid thesis is that these virtual currencies do not grow due to the blockages of the

1 See: https://www.irs.gov/businesses/irs-lbi-compliance-campaigns-july-2-2018

2 See: https://www.irs.gov/newsroom/irs-has-begun-sending-letters-to-virtual-currency-owners-advising-them-to-pay-back-taxes-file-amended-returns-part-of-agencys-larger-efforts

3 See: https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies#:~:text=Virtual%20currency%20transactions%20are%2taxable,transactions%20on%20their%20tax%20returns

4 See: https://www.irs.gov/newsroom/irs-has-begun-sending-letters-to-virtual-currency-owners-advising-them-to-pay-back-taxes-file-amended-returns-part-of-agencys-larger-efforts

Banks, however, the more conservative proclaim that there are many grey areas in this type of investment that makes them dangerous and requiring a mandatory regulation. But, in any case, what is true is that at the discretion of the IRS, the inclusion of federal and state taxes on cryptocurrencies is necessary.

When we talk about cryptocurrencies (*e.g., Bitcoin, Ethereum, Litecoin or any other*) we are talking about an electronic payment system that is based on cryptographic tests, which allow the parties to exchange it between themselves using the *blockchain* technology They do not require a "*clearing house*" as a third party to validate the transaction (e.g., a bank). **A blockchain in accounting terms it is similar to a decentralized "ledger" of all transactions on a network.** The **Blockchain** technology allows network participants to confirm transactions without the need for a trusted third party (thus killing any fees that may arise for these third parties, but at the same time bringing up the risk factor that regulators limit by having broad, regulatory control over regulated entities, such as Central Banks or Financial Institutions). This ledger is distributed through the *Blockchain*, and it allows each participant in the network to simultaneously access and view the information in it, in real time, without any possible alteration. Cryptography allows a guarantee, integrity, and security in the unique information. Participants are autonomous in the validation of changes in ownership or substance of currencies, therefore an independent third party is a surplus. Users who contribute cryptographic information to a network for the creation of new currencies are called "miners". Alternative currencies are created through the "mining" activity, in a process where state-of-the-art servers may be able to design hash[5] encryption algorithms that allow new blocks of algorithms to be inserted into the *blockchain*.

Just as an illustration, although TV series and newspapers worldwide have repeated it as Psalm 91, it is meritorious to mention that Bitcoin, is a peer-to-peer electronic money system, it was first introduced in 2008 by an unknown person or a group of people who used the pseudonym Satoshi Nakamoto. What motivated them, according to many media releases, was frustration with the inadequate response of central bankers to the collapse of the financial market and the related global recession at the time, and that is why several financial technology innovators set out to create Bitcoin as an alternative form of money to solve the problem of lack of trust in central banks.

To better understand the monitoring of cryptocurrencies, it is imperative to first review and land concepts. For example: the terms "cryptocurrencies", "virtual currencies "and" digital currencies " according to the "**Letters from the IRS**" we will refer to them as synonyms (*please do not confuse these terms with Digital Money, which is a platform that has an authorization from the regulator, where Real Money transactions are carried out, such as the Digital Yuan and Digital Euro projects*).

A "digital currency" is an Internet-based medium of exchange with characteristics similar to physical currencies. "Virtual currency" is a subcategory of digital currency, and the European Banking Authority[6] defines it as:

"Virtual Currency: a digital representation of value that is not used by a central bank or a public authority nor necessarily linked to a fiat currency, but that is accepted by individual or legal entities such as (...)".

The term "**cryptocurrency**" it is a subcategory of virtual currency in which encryption techniques are used to regulate the various generations of currency units and verify the transfer of funds. A "*wallet" or e-wallet*" refers to a platform where acquired cryptocurrencies can be exchanged for other cryptocurrencies and stored in what are denominated *e-wallet*, which in turn stores a public/private key (i.e., a digital address) that allows the owner to access, use or transfer the bitcoin. A *wallet* virtual currency is similar to a bank account, except that it lives in a numeric address. The most common virtual currency is the bitcoin. However, there are many others, called "*altcoins*", which include *Ethereum, ripple,*

5 See: https://latam.kaspersky.com/blog/que-es-un-hash-y-como-funciona/2806/

6 See: https://www.eba.europa.eu/

Litecoin, dash, etc. We also have future bitcoins, or Bitcoin Future, which are similar to a *forward* or a *swap*, where a future acquisition date of a currently fixed price is fixed. On the other hand, we have the *hard forks*, which is nothing more than, a change in the underlying protocol that divides the cryptocurrency in two (for example, where bitcoin is divided into bitcoin cash). A *hard fork* creates in two base currencies blockchain. Equally, it is important to understand what is an *airdrop* of cryptocurrencies? This refers to when a *blockchain* distribute tokens or coins to the crypto wallet community as a matter of protocol (i.e., without consideration). In general, in order to receive these coins, the taxpayer must already own cryptocurrencies from the relevant blockchain (i.e., bitcoins or Ethereum). Finally, an initial coin offering (*ICO*) refers to developers, companies, and individuals who use *ICO* o sales of *tokens* to raise capital. Buyers can use fiat currency (e.g., US dollars) or virtual currencies to purchase coins or *tokens* virtual.

A *bitcoin exchange* allows users to buy and sell virtual currencies or cryptocurrencies with other virtual currencies or fiat currency. A cryptocurrency exchange is an online exchange platform that facilitates trading between cryptocurrencies, fiat currency and other virtual currencies (e.g., *bitcoin* in exchange for US dollars or *Ethereum* in exchange for bitcoins). The *exchange* connects respective buyers and sellers to their "*bid*" (offer) and "*ask*" (demand). Users deposit fiat money in the exchange process by sending funds (including money orders, bank transfers, payments with *PayPal* or credit cards) to exchange before the execution of their operation. The *exchange* charges a transaction fee for X% of the transaction value.

The attraction of *bitcoin* as a virtual currency is derived from its self-verification function where users can instantly transfer funds to another person with a *bitcoin* wallet as if they were paying cash. There are several businesses in the United States that accept bitcoins to buy goods (for example, overstock.com) or services such as **Miami Dolphins** that offer to the attendees to the games this option of buying from their home the entrance tickets.

3. TAXATION OF CRYPTOCURRENCIES IN THE UNITED STATES

- **IRS guidelines**

In March 2014, the IRS published the **Notice 2014-21**[7] (known in American tax slang as ***"The Notice"***), which is considered to be the only guidance the IRS has published before issuing the cryptocurrency taxation letters. By way of introduction, the IRS analyzed whether a cryptocurrency should be classified as a currency or property for U.S. income tax purposes.

In general, a **"virtual currency"** is defined as **"digital representations of value that function as a medium of exchange, a unit of account and/ or a storage of value"**. A convertible virtual currency is defined as a subcategory of a digital currency or a **"having an equivalent value in real currency or acting as a substitute for real currency"**. Therefore, it is likely that the Notice does not contemplate taxes on other forms of cryptocurrencies, such as those that have **smart contract characteristics (Ethereum)**. A "**smart contract**"[8] refers to a computer protocol that automatically executes the terms of a bilateral or multi-party agreement without an intermediary.

The following is a summary of topics relevant to the taxation of cryptocurrencies.

a. Taxation of virtual currencies

At the level of timely tax treatment, the IRS has made it clear that, for federal income tax purposes, *cryptos* should be treated as property. The general tax principles applicable to property transactions applies to transactions using virtual currency. Therefore, the rules applicable to currency transactions under the *subchapter J of the Internal Revenue Code* are NOT applicable and, therefore, virtual currencies cannot generate gains or losses for the purposes of U.S. federal income tax.

7 See: https://www.irs.gov/pub/irs-drop/n-14-21.pdf

8 See: https://academy.bit2me.com/que-son-los-smart-contracts/

Thus, let us suppose that a taxpayer receives as payment for any good or service, a virtual currency. Therefore, it must include in its gross income the fair market value of the virtual currency measured in US dollars from the date the virtual currency was received. The basis of the virtual currency that a taxpayer receives as payment for goods or services is the fair market value of the virtual currency in US dollars from the date of receipt. This will serve to determine the taxable base for Federal Income Tax purposes in the US. That is, all transactions with virtual currency must be reported in US dollars from the date of payment or receipt.

When a taxpayer receives a virtual currency that exceeds its adjusted base, the taxpayer must recognize the taxable profit. Similarly, the taxpayer recognizes the loss if the market value of the property received is less than the adjusted base of the virtual currency. In general, **§1012**[9] states that the taxpayer's base on the property is its cost. The **Section 1016**[10] provides rules regarding cost adjustment (i.e., stock divisions, stock dividends, corporate reorganizations, etc.). In the context of virtual currencies, when determining the basis or cost at the time of sale, a careful review of the basic allowances for deductible expenses is warranted.

The profit or loss character will depend on whether the virtual currency is a capital asset (*e.g., stocks, bonds and other investment properties*) taxpayer property. Alternatively, a virtual currency that is not treated as a capital asset will produce ordinary gains or losses for the taxpayer on its sale or exchange. Inventory and other properties held for sale to customers or in a business **are treated as properties that are not a capital asset**[11].

b. Taxation of mining activities

A taxpayer who «mine» the virtual currency earns gross revenue upon receiving the virtual currency at fair market value and on the date of receipt. In addition, if the «extraction» of a virtual currency by a taxpayer constitutes a trade or business, and the taxpayer does not perform mining activity as an employee, the **Notice**[12] requires the net earnings from self-employment (gross income less allowable deductions) as a result of those activities to generate self-employment income subject to self-employment taxes. Similarly, when an independent contractor performs services that constitute self-employed labor income and receives virtual currency for the provision of services, the fair market value of virtual currency received for services rendered as an independent contractor, measured in USD at the date of receipt constitutes employment income, subject to tax on self-employment. The Notice fails to indicate whether ordinary and necessary commercial expenses according to **§162**[13] associated with mining must be deductible.

c. Application of Wash Sale Rules according to §1091

The application of **Wash Sale Rules** under **§1091**[14] to cryptocurrencies is uncertain. In general, a *Wash Sale* it is a transaction in which an investor sells shares or securities at a loss and then repurchases the same shares or identical securities within 30 days. Congress, to ensure that a taxpayer cannot claim a loss essentially for a phantom loss that has been created without any change in economic substance, enacted the **§1091** to reject the loss. In addition, for the application of the **§1091**, the loss must be that of "**shares or assets**" and

9 See: https://www.irs.gov/pub/irs-utl/notice_2002-21.pdf

10 See: https://www.irs.gov/pub/irs-drop/rr-20-05.pdf

11 See: https://www.irs.gov/pub/irs-irbs/irb14-36.pdf

12 See: https://www.irs.gov/irb/2014-16_IRB#NOT-2014-21

13 See: https://www.irs.gov/pub/irs-drop/rr-99-7.pdf

14 See: https://www.irs.gov/pub/irs-pdf/p550.pdf

related contracts or options to acquire or sell "**shares or assets**". In the context of cryptocurrencies, it is difficult to assess the application of the washout sales rules since the classification of a cryptocurrency or virtual currencies for the purposes of these rules remains open and subject to debate.

d. Application of Straddle Rules under §1092

First, as **Straddle Rules**[15], we can infer-superficially-that it is an anti-avoidance rule that prevents the due deferral of Income Tax or the conversion of ordinary income or short-term capital gain into long-term capital gain by not allowing the premature deduction of a loss on the sale or disposal of a tranche of a combined position while retaining the other buy or offset position. Example: A promise to sell can be offset by a promise to buy. However, this practice is largely restricted by the requirement that gains and losses on product transactions should be reported on the basis of their value at the end of the year.

In terms of cryptos, the rules of section **§1092** address offsetting positions in actively traded personal property. The Code defines offsetting positions as "**positions with respect to personal property if there is a substantial decrease in the taxpayer's risk of loss of holding any position with respect to personal property due to having one or more positions with respect to personal property**». The rules of the section 1092 they can be applicable to cryptocurrencies provided that:

- a virtual currency is treated as personal property for which an established market exists.
- there are offsetting positions that can result in a substantial decrease in the risk of loss for that property.

In the context of virtual currencies, tiered rules can provide planning opportunities by deferring recognition of losses and modifying the tenure period of the alienated property according to the rules.

e. Accounting (inventory) method rules related to virtual currencies

To date, the IRS has not provided any guidance regarding the appropriate accounting method for the sale of cryptocurrencies. A taxpayer can choose from three acceptable methods for calculating gains and losses, namely: **first in, first out (FIFO), last in, last out (LIFO) and specific identification**[16]. In the absence of regulatory guidance, a taxpayer must ensure confirmation of documentation detailing each cryptocurrency transaction.

f. Treatment of similar exchanges before TCJA

Cash for exchanges terminated after December 31, 2017, non-recognition of gains or losses in "**similar exchanges**"[17] is only permitted in the exchange of immovable property held for productive use in a trade or business or for investment if such immovable property is exchanged solely for immovable property. Before the promulgation of the **Tax Cut and Jobs Act (TCJA)**[18]**,** the **treatment 20 §1031**[19] was available for the exchange of one virtual currency for another virtual currency. For example, a taxpayer may have traded Bitcoin for Ethereum and vice versa.

Section 1031 is a non-recognition provision that provides an exception to the rule that all real earnings must be recognized. The underlying principle for a "similar" exchange is that the exchange of one asset for another does not generate any economic benefit. Assets are essentially traded.

15 See: https://www.irs.gov/publications/p550

16 See: https://taxmap.irs.gov/taxmap2012/pubs/p538-001.htm#TXMP126bbacf

17 See: https://www.irs.gov/businesses/small-businesses-self-employed/like-kind-exchanges-real-estate-tax-tips

18 See: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.htm

19 See: https://www.irs.gov/pub/irs-news/fs-08-18.pdf

Since virtual currencies or cryptocurrencies have been classified as "property" under the Notice, the provisions of §1031 may be applicable to exchanges of virtual currencies prior to TCJA. The only limitation to the provision as provided in the regulations is that the definition of "*similar type*" refers to "*the nature or character of the property and not its grade or quality*". However, there are some nuances in the statute. For example, real property located in the United States and real estate properties located outside the United States are not considered "similar". In the commodity context, the exchange of silver bars with gold bars does not meet the requirements of §1031; however, gold bars may be exchanged with gold bars. The IRS has not provided guidance on the treatment of cryptocurrencies in the context of "similar" exchanges prior to the enactment of the TCJA. However, taxpayers who maintain a "similar" exchange position in the context of cryptocurrencies should ensure that they comply with information and disclosure requirements, including filing Form 8824[20], Exchanges of similar type.

g. Tracking capital gains and losses with cryptocurrencies

Another pending task of the IRS is to address the way of tracking capital gains and losses calculations (basis and fair market value) in the context of virtual currencies «**convertible**». As virtual currency «**convertible**» (for example, a bitcoin) we understand that it is one that can be freely exchanged into another virtual currency without any regulatory oversight. When a virtual currency is used to purchase goods or services, a transaction occurs in which the parties must track the **fair market value (FMV)**[21] currency at the time of the transaction. The cost or basis of the taxpayer will determine whether a gain or loss has occurred, as well as its duration (short-term or long-term transaction).

Some experts in the field have given some suggestions, such as simplifying onerous record-keeping requirements, which are necessary to calculate gains and losses of virtual currency, by applying tracking methods **§1012 under FIFO, LIFO or the specific identification method** similar to the way shares are sold through an exchange. In addition to the above, some professionals have suggested that the IRS should provide a **minimis rule**[22] for taxpayers who may have a minimum amount of transactions in virtual currency or small transactions (for example, buying coffee), since this does not cause any latent damage, for the moment, to the treasury.

h. Valuation methods used to value cryptocurrencies

According to **Notice 2014-21**, transactions with virtual currency must be reported in US dollars. In addition, taxpayers will be required to determine the FMV of the virtual currency in U.S. dollars from the date of receipt. The IRS has stipulated that:

"If a virtual currency is traded on an exchange and the exchange rate is established by the supply and demand of the market, the fair market value of the virtual currency is determined by converting the virtual currency into dollars (...)".

However, the IRS does not consider how taxpayers should value, for example, tokens issued by companies that are not listed on an exchange at an established exchange rate. In addition, the IRS does not address the fact that there are numerous published exchanges and the values reported on those exchanges fluctuate. For example, **CoinDesk, Blockchain, Xapo, Google, Gemini, Winkdex, Bitstamp** and **Kraken**, all report the price of bitcoin with slight variations. Some members of Congress have written to the IRS Commissioner hoping to get additional guidance on this limited consultation.

20 See: https://www.irs.gov/pub/irs-pdf/f8824.pdf

21 See: https://www.investopedia.com/articles/investing/050914/easy-way-measure-bitcoins-fair-market-value-doityourself-guide.asp

22 See: https://www.irs.gov/government-entities/federal-state-local-governments/de-minimis-fringe-benefits

i. Charitable donations, gifts, trusts and properties and their application in the context of cryptocurrencies and tokens

It has already been established that the treatment of virtual currencies should be as property for federal income tax purposes. However, there is one big element that needs to be widely considered and that is the volatility and valuation with the determination of the Fair market value (FMV) of a cryptocurrency. The vast majority of asset planners and trustees who exercise the "**prudent investor rule**" have hesitated to structure cryptocurrency assets (*transfer in trusts or as gifts*). Consultations on valuation, determining how to claim lost tokens, and how to report cryptocurrencies on a wealth tax return, among others, remain outstanding issues. In addition, the IRS has not provided more robust guidance in terms of transferring virtual currencies in the context of charity or donations, according to the Report Fidelity Charitable 2018[23], Bitcoin donations made to Fidelity Charitable increased to $69 million in 2017, almost ten times more than the previous year. However, in the absence of IRS guidance, investors who have made charitable contributions to an **organization §501 (c) (3)**[24] they may face capital gains taxes for the cryptocurrencies they collected. The investor can also "give away" the cryptocurrency directly to the charity without first charging the asset and deducting the value of the donation, provided that the assets have been held for more than a year.

Very generally, we could indicate that a limited exception that applies by "**easily valued property**"[25], such as publicly traded shares, a charitable property contribution valued over $5,000, will require a qualified appraisal from a qualified appraiser, as well as a letter of appreciation from the charity and a **Form 8283**[26] full, non-monetary charitable contributions. In the context of cryptocurrencies, such as bitcoins, the IRS requires a taxpayer to provide valuation as provided in established markets. However, because cryptocurrencies are relatively new, there are no established markets to offer an accurate valuation, they fluctuate enormously in terms of price and value on a given day. Professionals have suggested a rule that would allow taxpayers to rely on an average of two established virtual currency markets and the substantiation requirements of §170 (f)[27] however, the IRS has not provided any specific guidance to date on this score. In the absence of reliable guidance from the IRS, however, taxpayers must follow the rules for donated property.

j. Taxation of initial coin offerings (ICO)

It has been a general rule that in Crypto matters, a company may issue tokens for:

- raising capital or,
- use the company's platform to purchase goods and services,
- for marketing purposes, a company can set as a strategy to give away tokens to publicize its platform

We can infer that some *tokens* may have equity-like characteristics, such as the right to dividend-like payments based on the issuer's predefined performance targets. The underlying utility of some tokens may be blurred between debt and equity and the investor's purpose (redeeming for use on the company's platform or maintaining value appreciation).

While the 2014-21 Notice provides guidance regarding the IRS's views that virtual convertible currency is treated as property, and not as currency, for tax purposes, the IRS is yet to define the tax treatment that should apply to cryptocurrency issuers.

23 See: https://www.fidelitycharitable.org/insights/2018-giving-report.html

24 See: https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-501c3-organizations

25 See: https://www.irs.gov/irm/part4/irm_04-072-008

26 See: https://www.irs.gov/forms-pubs/about-form-8283

27 See: https://www.irs.gov/pub/irs-drop/rr-03-28.pdf

The tax treatment of ICOs is also unclear. Emissions of *tokens*, also known as ICOs, had an unprecedented increase recently around the world. An ICO is a very useful capital raising tool, without issuing debt or traditional capital and using the *tokens* to buy goods and services. Each token it has its own specific feature and functionality (i.e., authorized as a payment system for the purchase of goods and services). In addition, some *tokens* have characteristics similar to shares that allow their holder to pay dividends based on the preference or objectives of the issuer.

The treatment of the federal income tax of *tokens* depends on the location of the issuer, internal or *offshore* as well as on the initial structure of the *tokens*. The IRS has stated that it sees a convertible virtual currency as property (and not currency) for tax purposes. However, it still has to provide guidance on the tax treatment of a cryptocurrency issuer. **The first query is to analyze whether a token cryptographic is treated as debt or equity for federal income tax purposes. The second query is to determine whether the issuing company is a domestic or foreign corporation**. If the issuing company is a foreign corporation, careful analysis is warranted with respect to federal income tax rules related to the taxation of a **controlled foreign corporation**[28] (CFC Rules), a **Passive Foreign Investment Company**[29] (PFIC) and the international fiscal nuances promulgated in the TCJA.

For example, a foreign offshore corporation with U.S. owners that meets the requirements of the CFC rules may be faced with Subpart F and **global intangible low tax income (GILTI)**[30] including US taxable income of any direct or indirect US shareholder. According to the TCJA, U.S. shareholders of a CFC must include U.S. taxable income in their annual proportional interest in GILTI. In the context of issuing tokens by a foreign corporation that meets the requirements of a CFC, a professional must estimate the amount of GILTI that a CFC will produce in a token sale and analyze the requirements of §951A (a).

A *hard fork* occurs when there is a change in the underlying protocol that divides the cryptocurrency into two (for example, where bitcoin is divided into *bitcoin cash*), resulting in two blockchain currencies. As a result of a *hard fork*, the taxpayer gets a new currency (for example, bitcoin cash) in addition to the original currency. The government has not addressed the tax treatment of *hard fork* in the context of cryptocurrency. However, some tax professionals have compared the treatment to that of a stock split or stock dividend. **On March 19, 2018, the Tax Section of the American Bar Association requested the IRS to issue temporary guidance on "hard forks"**[31] including the provision of a safe harbor for taxpayers whose cryptocurrencies mutated or divided into different currencies.

k. Loss of private key or password

One of the main *assets* of the *cryptos* is their anonymity, however, this has a not-so-pleasant look, such as the private digital key which is unique and secured by a password that only the owner knows. If this is lost, the virtual currency is lost, too. With respect to federal taxes, non-corporate taxpayers are allowed a deduction for certain losses arising from fires, storms, shipwrecks, or other casualties, or for theft, incurred with respect to property that is not used in a trade or business or maintained in a transaction made for profit. However, for the 2018-2025 tax periods, personal losses from personal damage and theft that are otherwise deductible from a person are generally deductible only to the extent that they are attributable to a Federally declared disaster. Prior to the enactment of the TCJA, accident losses under **§165**[32] they were permissible. While the IRS and the notice have not provided any guidance on

28 See: https://www.irs.gov/irm/part4/irm_04-061-007

29 See: https://www.irs.gov/instructions/i8621

30 See: https://www.irs.gov/pub/newsroom/5-foreign-dividends-965-14103-gulti-951a-14201_508.pdf

31 See: https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=5615&context=flr

32 See: https://www.irs.gov/businesses/small-businesses-self-employed/faqs-for-disaster-victims-casualty-loss-valuations-and-sections-165-i

this issue in relation to virtual currencies, it is unlikely that the IRS will allow a deduction for incidental losses prior to the TCJA in respect of virtual currencies for the simple act of losing a private key.

I. Tax implications in case of theft

In 2014, a virtual currency exchange platform called **Mt. Gox**[33] lost millions of dollars in cryptocurrencies for their investors. A few years later, nearly 120,000 bitcoins were stolen from customers' accounts in **Bitfinex**[34], an exchange platform in Hong Kong. The IRS has not provided guidance on whether taxpayers could deduct virtual currencies that would meet the requirements of §165[35] before TCJA or for years before 2018. As with theft of other financial assets, if the virtual currency were acquired in a transaction made for profit, a loss from theft would be deductible.

In addition to the ambiguities set out in the examples above, it would be useful for the IRS to provide guidance on the tax consequences of cryptocurrencies in the context of funds and, more specifically, trading, investing and mining cryptocurrencies. For example, *is fundraising recognized as income? What is the difference between stock offerings and the sale of goods and services? What is the treatment of restricted tokens provided to employees in stock options mode? Should they be treated in a manner similar to receiving restricted actions treatment?* The IRS has not provided any guidance on these inquiries other than the general principles set forth in the Notice.

4. TRANSACTIONAL SUPPORTS

In general, the **§6001**[36] provides the minimum requirements for automated record keeping for income tax purposes. In this sense, each person is required to maintain adequate records, as it seeks to corroborate positions of income, losses, and tax bases. In the context of virtual currencies, a payment made with virtual currencies is subject to reporting. A critical report for accuracy is keeping proper records to accurately measure revenue related to each virtual currency.

Consider the following example. A person who in the course of a business or business makes a payment that is treated as a fixed and determinable income (i.e., types of income similar to **FDAP**[37] (including rents, wages, wages, premiums, annuities and compensation) using virtual currency with a value of $ 600 or more for a non-exempt U.S. recipient in a contributory year to report the payment to the IRS and the beneficiary. Virtual currency payments must be reported in Form **1099-MISC**[38], Miscellaneous income, using the fair market value of the virtual currency in US dollars at the date of payment.

All federal insurance contributions, including taxes **Federal Insurance Contributions Act (FICA)**[39] should be declared in the **Form W 2**[40], Declaration of wages and taxes. Payments made with virtual currency are subject to back-up withholdings to the same extent as other payments made on the property. A payer must apply for a **taxpayer identification number (TIN)** from a beneficiary. In the absence of a TIN, a payer must support a payee's withholding prior to payment

33 See: https://www.coindesk.com/company/mt-gox

34 See: https://www.bitfinex.com/

35 See: https://www.irs.gov/businesses/small-businesses-self-employed/faqs-for-disaster-victims-casualty-loss-valuations-and-sections-165-i

36 See: https://www.irs.gov/businesses/automated-records

37 See: https://www.irs.gov/individuals/international-taxpayers/fixed-determinable-annual-periodical-fdap-income#:~:text=Tax%20at%20a%2030%25%20(or,gains%2C%20profits%2C%20or%20income

38 See: https://www.irs.gov/forms-pubs/about-form-1099-misc

39 See: https://www.investopedia.com/terms/f/fica.asp

40 See: https://www.ssa.gov/employer/

if the payer receives notice from the IRS that support is required. **Therefore, employers' payments with virtual currencies as a form of payment for services constitute wages for labor tax purposes and are subject to federal tax withholding**.

On the other hand, credit card intermediaries are also subject to specific information reports if, in a calendar year, more than 200 transactions are settled for the merchant and gross revenue payments made to the merchant exceed $20,000. These **third-party settlement organizations (TPSO)**[41] must report payments made to a merchant in the **Form 1099-K**[42], Payment card and third-party network Transactions, if the above conditions are met. Notice 2014-21 states that payments made in connection with bitcoin or other virtual currency transactions may be reported on Form 1099-K. For reporting purposes, the value of the virtual currency is the fair market value of the virtual currency in US dollars at the date of payment.

However, the notice does not consider reporting requirements for virtual currency transactions in exchange for ownership or cash that cannot be reported on Form 1099-K. Instead, it provides a general provision where taxpayers will be subject to penalties for non-compliance with tax laws, including transactions in virtual currency. It also states that insufficient payments attributable to transactions in virtual currency may be subject to penalties, including penalties related to accuracy according to §6662. Failure to correctly report transactions in virtual currency may also subject the taxpayer to information that reports penalties under **§6721**[43] and **§6722**[44]. However, the Notice provides relief under reasonable cause for failure to file an information statement.

To avoid the above penalties, taxpayers who participate in transactions in virtual currency should ensure that they have a registration system to track the basis and profit or loss of each transaction. In particular, it would be prudent to track all acquisition and sale dates, and any other cost-base information. It is not clear, at this time, whether taxpayers will have to record all transactions in Annex D, **Form 8949**[45] Sales, and other disposals of capital assets.

For example, virtual currency issuers may wish to create a tracking or inventory system for each issued currency. Similarly, retailers who accept virtual currencies must keep documentation about the amount of their sales. Documentation must be stored to provide justification or verify the value of the virtual currency at the time of the transaction in US dollars.

It is also not clear at this time whether U.S. people are required to notify gifts of virtual currency from a non-U.S. citizen, or distributions from a non-U.S. entity, or trusts and receipt of certain foreign gifts.

Generally, taxpayers must report cash payments in excess of $ 10,000 received at a trade or business in the **Form 8300**[46], Report cash payments over $ 10,000 received in a trade or business. Cash payments are defined to include U.S. currency. UU., Foreign currency, cashier's cheques, money orders and other similar instruments. Since Notice 2014-21 states that virtual currencies are not currencies, presumably the Form 8300 report does not apply to virtual currencies.

41 See: https://www.irs.gov/payments/third-party-network-transactions-faqs

42 See: https://www.irs.gov/businesses/understanding-your-form-1099-k

43 See: https://www.irs.gov/irm/part20/irm_20-001-007r

44 See: https://www.irs.gov/government-entities/federal-state-local-governments/increase-in-information-return-penalties

45 See: https://www.irs.gov/pub/irs-pdf/f1040sd.pdf

46 See: https://www.irs.gov/pub/irs-pdf/f8300.pdf

5. INTERNATIONAL EXCHANGES OF INFORMATION ON CRYPTO ASSETS

The 2014-21 Notice does not provide any guidance on whether virtual currency owners should comply with international reporting requirements. In general, U.S. citizens, lawful permanent residents, or persons with a substantial presence in the United States (i.e., U.S. persons) must present a **Foreign Bank Account Report (FBAR)**[47] in the **Department of the Treasury Financial Crimes Compliance Network (FinCEN)**[48] where the U.S. person has a financial interest in or authority over any financial account outside the United States when the maximum aggregate value of any account exceeds 10K at any time during the calendar year.

For FBAR, a "financial account" reporting requirements include the following:

- Bank accounts (e.g., savings accounts), checking accounts, time deposits any other accounts held with a financial institution
- Securities accounts such as brokerage or escrow accounts
- Commodity futures or options accounts
- Insurance policies or annuity contracts
- Mutual funds or common funds; and
- Some pension funds and retirement accounts

A US citizen has a "financial interest" where:

- the US person is the beneficial owner of the account or has the legal title to the account.
- the account holder is a person acting as an agent, nominee, attorney, or other person acting on behalf of the U.S. person about the account.

The IRS has not provided guidance at this time on whether a taxpayer who owns cryptocurrencies on a cryptocurrency exchange abroad (*for example, Xapo.com or Binance.com*) or in a foreign *e-wallet* (e.g., *Blockchain.com*) must report an account in an FBAR in the sense of the above account types. **However, based on the language contained in the Letters, it seems evident that taxpayers holding cryptocurrencies in a foreign currency or wallet will be subject to the same type of FBAR reporting**. Under the heading "Virtual currency transaction report", IRS Letter 6174 states that the obligation to report all sales, exchanges, and other provisions of virtual currency "**applies regardless of whether the account is held in the United States or abroad**". Therefore, taxpayers who have, their cryptocurrencies outside the United States should revisit their positions to ensure they comply with all international tax reporting obligations, including FBAR.

In addition to the above, U.S. citizens must also provide a **Form 8938**[49], "**Declaration of Specified Foreign Financial Assets**", annually with their income tax return with respect to a "specific foreign financial asset".

The financial assets to be reported on Form 8938 are broader than those to be reported on an FBAR

47 See: https://www.irs.gov/newsroom/understand-how-to-report-foreign-bank-and-financial-accounts

48 See: https://www.fincen.gov/

49 See: https://www.irs.gov/forms-pubs/about-form-8938

and include, among other categories, **"any financial account. . . held by a foreign financial institution "and" any interest in a foreign entity"**.

That said, a taxpayer who has cryptocurrencies in physical form (i.e., not in cash), in a foreign virtual currency exchange (*p. E.g., Xapo.com*) or an e-wallet (*p. E.g., Blockchain.com*) presumably they would have to report the accounts of purposes of the **Form 8938** since the taxpayer has a financial account (*the e-wallet*) held by a foreign financial institution (the exchange). In addition, a reporting requirement of the **Form 8938** may apply to the extent that a U.S. person holds "an interest [the cryptocurrency] in a foreign entity [an exchange or *e-wallet* of cryptocurrencies that are formed under the laws of a foreign country]". Again, relying on language in IRS letters, a taxpayer holding a cryptocurrency in a foreign virtual currency is well informed to report their interest in Form 8938.

Compare these examples with, for example, virtual currency exchanges formed in the United States (E.g., Coinbase.com, Gemini.com) where those assets would not be classified as "specific foreign financial assets" and therefore are not normally subject to Form 8938 reporting.

At this time, the government has not provided guidance on whether taxpayers who own (i) an account on a foreign digital exchange, (ii) a foreign e-wallet, or (iii) a foreign private key should report any of these interests on an FBAR and Form 8938. However, according to the language in the IRS Letters, it appears that the government intends to enforce the reports for taxpayers who hold cryptocurrencies abroad.

6. OPPORTUNITIES FOR LATIN AMERICA

Latin America has currently outlined small but significant steps to regulate the use of crypto assets and also due to the acceleration of the digital economy, increased by virtue of the pandemic, it is necessary to be able to start to carry out a significant regulation, beyond conceptual aspects.

Among the opportunities that arise for Latin America, we find:

- The opportunity to establish in its current positive law, harmonized concepts that avoid differentiated treatments of crypto assets within this orange economy. This can only be achieved with an inter-jurisdictional consensus.

- The opportunity to replicate systems or control processes that have been widely tested by more developed countries, through cooperation between countries or international organizations dedicated to the subject.

- Implement a tax policy attractive to investment, through competitiveness, through updated tax regulations, which avoids financial losses for companies due to differences in tax concepts between jurisdictions. For this, it will be necessary to create dialogues or international working groups.

- Establish homogeneous and diverse standards for the establishment of specific accounting regulations for activities related to crypto assets. The accounting professional associations and duly authorized guilds play an important role here.

- To be able to strengthen the supporting elements for the conclusion of treaties to avoid double taxation, including clauses for the exchange of tax information. For this, it will be necessary to establish groups and international working groups that bring as an objective the signing of agreements or recognition of guidelines to the current problems of Latin America.

7. CONCLUSIONS

We can conclude the following:

- Cryptocurrencies are here to stay. The IRS regulations to enforce the payment of taxes for cryptocurrencies have just begun; they are far from over and as this is well known, almost always the regulations that are implemented in the United States, due to its geopolitical and economic position, ends up being replicated or a guide for implementation in other countries.

- Given the growth and breadth of virtual currencies, governments and tax administrations should provide additional guidance to taxpayers to avoid non-compliance with tax obligations due to lack of information.

- Some countries such as Panama opted to regulate or submit bills with a simplified taxation regime for both territorial and offshore earnings, for crypto assets. There are countries like Spain that retain their business income regime for companies and choose to treat them fiscally as a common business activity. The most important element is not the tax treatment that can be given, but to start regulating these activities as soon as possible to avoid pushing the taxpayer into the informal economy.

- For countries that have a tax policy to attract capital investments with tax benefits and/or exemptions, partial or total, which typically have a tax system based on the territoriality of the income, the greater challenge will be able to first have an extensive network of treaties for the avoidance of double taxation with major trading partners, so that investors can apply these tax credits in their jurisdictions or where they are taxed, either for personal income or corporate income. Next, to have a conceptually harmonized regulation in objective and subjective assumptions of the regulation with the jurisdictions from which they receive most foreign investment, because such a simple concept as the treatment of assets or currency to crypto assets can generate a considerable tax problem, especially in the income from financial products or assets.

- For countries that have a fiscal policy to attract capital based on the legal security and a world income taxation, the challenge will be to build an infrastructure of control and tax intelligence widely versatile that allow facing cases of erosion of the tax base through pernicious schemes, where a widely important factor is also a network of agreements to avoid double taxation with the inclusion of a clause on tax information exchange, or simply tax information exchange treaties, so that they can validate abroad, the use of corporate structures through which its taxpayers generate income offshore. Likewise, in this case the most important element, more than a conceptual harmonization of activities related to crypto assets, is access to information.

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COVID AND SDG, present and future of taxation in LAC

Ubaldo **González de Frutos**

SYNOPSIS

This article presents an analysis of tax policy options at the crossroads posed to finance ministers by the COVID pandemic. The emergency measures of 2020 must give way to reconstruction policies but, in the meantime, should a new emergency arise, we need to solve macro-fiscal imbalances, something that will lead many to materialize tax increases. As a guide to the reflection, this work examines the existing tax resources and the process to adapt the tax policy to the solution of the important challenges in the region, which the U. N's Sustainable Development Goals (SDGs) define quite well.

Keywords: Tax Policy, Tax Administration, SDGs, Sustainability.

CONTENT

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The views expressed by the author are in his personal capacity only and do not necessarily represent those of the Inter-American Development Bank, its Executive Board or the countries they represent.

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INTRODUCTION

The analysis of tax policies in LAC today is unthinkable outside the context of COVID-19 because the mobility restrictions imposed have greatly reduced tax receipts. As the pandemic continues, the countries' fiscal situation becomes more complicated, and policymakers look at the revenue system for answers. At the same time, much hope is placed on the tax system as a policy tool to leverage a post-pandemic[1] economic recovery and in passing, achieve a robust, sustainable, and inclusive growth, thereby contributing to solving the challenges of the region, which the United Nations Sustainable Development Goals illustrate quite well. Consequently, the starting vision for the LAC fiscal systems in this analysis is that of a tool that countries can use in the short term to get on the path of fiscal sustainability, avoid putting more debt pressure, and at the same time capable of following spending policies to generate robust, green and inclusive growth. In this context, two questions arise: is it necessary to undertake tax reforms? And if so, where should they be directed?

1. CURRENT SITUATION

The low tax collection and the extraordinary expenses – health and social—imposed by the COVID-19 crisis are leaving acute imbalances in the region's public finances. Countries intervened with fiscal support[2] programs to avoid a more severe economic crisis and a further deterioration of employment, but these extraordinary expenses, coupled with the fall in tax revenues due to the decline in activity, have raised deficits and public debt to unprecedented levels.

In 2020, public deficits averaged 11.7 per cent of GDP in advanced economies, 9.8 per cent in emerging economies and 5.5 per cent in low-income developing countries (FMI, 2021). For poor countries, this represents a five-point increase in GDP, from -0.5% in 2019 to -5.4% in 2020, a gap that must be financed with debt or resort to the Central Bank and generate inflation. In Latin America, fiscal deficits increased in 2020 by 5.3% of GDP on average, from 3.0% in 2019 to 8.3% in 2020 (BID, 2021). In the medium term, fiscal deficits can be expected to contract as the pace of recovery accelerates and better spending policies are put in place, but there is a risk that the crisis will spread into the financial system if the pandemic continues beyond 2021.

As a result of the public accounts mismatch, public debt reached a record global average of 97 per cent of GDP in 2020 and is projected to grow somewhat further in 2021 and stabilize at around 99 per cent of GDP (FMI, 2021). In LAC, the stock of public debt is lower, 72% in 2020, but it grew in a year 14 points of GDP, from 58% of GDP in 2019, and in a central scenario, neither very optimistic nor very pessimistic, it will continue to increase until reaching 76% in 2023 (BID, 2021). If we achieve a solid recovery and introduce structural reforms, the debt could stabilize at around 72% and then gradually fall, but major changes in spending and income policies will be necessary. A little worse still is the situation in economies dependent on tourism because the global nature of the crisis leaves them with a debt of 80% of GDP in 2020, 17 points more than in 2019. In countries dependent on tourism such as the Bahamas, Barbados or Belize, in the central scenario the debt could increase to 87% of GDP by 2023.

1 For doubts about the spelling of pandemic, or post-pandemic, see: https://www.fundeu.es/recomendacion/poscoronavirus-pero-pos-covid-19-pospandemia-post-pandemia/

2 Although "fiscal" in Spanish has traditionally been used to designate public revenue policy, today the influence of English, where it is used to designate the two sides of public finance, revenue and expenditure, has made it a polysemic term.

In some countries, financing large deficits is proving problematic in view of limited market access and limited scope for short-term revenue growth. These countries would need assistance through grants, concessional financing, or, in certain cases, debt restructuring (FMI, 2021). For all in general, a plausible strategy would be to take advantage of existing low interest rates internationally to reduce the amount of debt service, seek more financing from multilateral financial institutions and thus reduce payments or replace the more expensive debt (BID, 2021).

The fiscal emergency is huge, because the deterioration of public balance sheets makes it extremely difficult to sustain fiscal stimuli for a long time (BID, 2021), with the consequent risk of deepening the crisis. This is very relevant in a scenario where vaccines are not arriving as quickly as thought, and where the almost constant appearance of mutations of the virus opens up uncertainties based on effective collective immunization and, therefore, the duration of the crisis.

In this scenario, it is essential that LAC countries increase their tax collection in the short term. The hope is for a rapid economic recovery that will bring more income, especially from VAT, excise duties, tariffs and to a lesser extent social contributions and personal income tax, without great hope in the Corporate Tax because the accumulated losses will hinder the collection of this tax for a long time. Unfortunately, it seems that the recovery will not occur in 2021; the macroeconomic outlook is too uncertain. Although at the beginning of the year we expected a growth of 4.1% after the fall of 7.4% the previous year, the many uncertainties associated with the pandemic and the risk of contagion of the crisis to the financial system place the most pessimistic prospects at 0.8% (BID, 2021). If this path of automatic recovery does not succeed, countries may have to assume discretionary increases to mitigate the risk of excessive deterioration in public finances leading to a debt or inflationary crisis. The next few months will be critical in deciding whether to implement tax reforms in 2022.

a. Fiscal support measures during the pandemic

In the initial stages of the crisis in 2020, the fiscal measures adopted were aimed at alleviating the treasury difficulties of companies, to maintain employment and avoid the destruction of the productive fabric. It was a lesson learned in the previous international financial crisis, when it was found that it is more difficult to rebuild the economy if we allow the lack of liquidity to turn into insolvency. Another block of fiscal measures aimed at supporting the households, more through direct transfers and free access to social benefits than with tax relief, because the level of informality and the high-income tax entry threshold existing in the region means that tax incentives in the personal income tax do not reach the citizens most in need[3].

In advanced economies, fiscal stimulus measures in 2020 reached 19% of GDP on average, although emerging markets and especially low-income developing countries obviously implemented more modest packages, corresponding to their smaller fiscal capacity (FMI, 2021). In LAC, however, the size of the response was very significant; the total fiscal packages of the region reached USD 485 billion —more than the annual GDP of Colombia, the fourth economy of the region-with an average fiscal package of 8.5% of GDP, although unevenly distributed, with greater injections in the Andean and Southern Cone countries, while two thirds of the countries provided much more modest stimulus packages, of the order of 3% of GDP, reflecting the narrowness of the fiscal space available (BID, 2021).

3 This is a very valuable lesson for reforms beyond the pandemic: social measures are more effective if we implement them in the form of direct spending than through tax incentives. In spite of this, LAC's personal taxation systems are plagued by social benefit measures that reduce their tax collection potential without empirical evidence of having achieved the policy objectives that underpin them.

A year later, some of these measures have been extended and others have been modified; and countries have already begun to implement policies to stimulate economic activity and support recovery (OCDE, 2021). The 2020 measures –to support lower income families and viable businesses with transitory financial difficulties– were temporary by their very nature and cannot be sustained for a long time for three reasons: first, the reduction of fiscal space limits the real possibilities of continuing to implement these policies; second, many businesses are moving from illiquidity to insolvency, so it is illogical to continue to sustain jobs and businesses that are going to perish anyway. Finally, some stimulus measures in 2020 were deferrals, such as tax payments, and those deferrals are maturing. For these reasons, the tax stimulus in advanced economies has been reduced by two thirds (from 19% in 2020 to 6% in 2021) (FMI, 2021) and it is expected to further decline in 2022. It is therefore imperative to move from the containment phase to the recovery phase, although this will be much more difficult if the health situation does not improve substantially.

The solution that some governments have already put in place to finance the extraordinary expense of prolonged emergency support is to raise taxes, a decision implemented by many countries in the second half of 2020 and early 2021 (OCDE, 2021). Among the types of taxes affected, some trends that we saw before the crisis continue, such as the taxation of fossil fuels or the taxation of carbon, which are, by the way, the most frequent tax increases in the OECD and G20 countries (OCDE, 2021). In addition, although some of these climbs are temporary, most are permanent. However, other tax increases mark a new trend with respect to the pre-crisis stage, as several countries have introduced personal tax increases to the highest capacity income earners, increasing the maximum rates of personal income tax (British Columbia-Canada, Colombia, Czech Republic, Korea, New Zealand, Spain, Russia, and the United Kingdom by 2023). In addition, Russia and the Czech Republic have abandoned their proportional income tax in favor of a progressive one (OCDE, 2021).

Indirect taxes are, undoubtedly, an effective collection mechanism due to the high productivity of VAT, as well as excise duties due to their low-price elasticity, but this route is not without problems. One is the regressive nature of indirect taxation, as the proportion of income devoted to consumption is inversely proportional to the level of income. The remedy to alleviate it is to exempt food from the basic basket and other goods or services of basic necessity. This attenuates the regressivity, but because it is a general incentive, it ends up benefiting mainly the higher deciles of income. Up to 70% of VAT tax benefits in LAC go to people who are not poor and is therefore a very inefficient way to transfer resources (BID, 2021). An alternative is VAT-P, a personalized VAT that makes compensatory transfers to the poorest deciles of the population. This scheme would have two elements: the first is to reduce or cancel VAT exemptions, respecting the generality of the tax, which also avoids distortions. The second is to transfer the VAT paid to the population in greatest need, which requires, in turn, very good administrative registries, fed by tax and labor information, and on consumption through electronic invoicing. The increase in VAT collection should be more than sufficient to finance the costs of VAT-P transfers. Another problem with increasing the VAT rate is that it has negative effects on consumption and investment, and a widespread increase in VAT could slow growth, which, apart from slowing the recovery, would be counterproductive for tax collection purposes because the reduction in the base (consumption and investment) neutralizes the rise in rates without providing significant additional revenue.

In the same vein of increasing progressivity and reducing inequalities, a great interest has been aroused around wealth taxes, especially after the proposal of US Democratic Senator Elizabeth Warren to impose a tax on large fortunes, of 2% of wealth for assets over 50 million and of 3% when they exceed one billion dollars, including robust anti-avoidance measures to give it credibility. The IMF is also proposing raising the income tax on the highest incomes, and suggesting imposing a wealth tax to the super-rich, either on a permanent basis, or as a transient "solidarity" charge, and the IDB has analyzed the options of design and implementation of a wealth tax in Latin America and the Caribbean, discussing the difficulties of effective implementation and considering the imperfect alternative that are the taxes on property, existing in many countries of the region, but at rates so low that they collect only 0.4% of the GDP, while in the OECD countries they collect 1.2%.

b. Post-pandemic support measures

Once the socio-health situation stabilizes, the task of fiscal policy will be to support robust growth aligned with achieving the Sustainable Development Goals, helping to achieve a green, digital and inclusive transformation of the economy. For this purpose, structural reforms to improve the dynamism of the economy will be necessary, accelerating especially the digital transformation, seeking environmental sustainability with holistic packages looking at, in addition to the energy taxation, smart cities, non-polluting transport systems, promotion of telework and other forms of social organization that reduce the carbon footprint, rural development projects and circular economy, and other patterns of development capable of generating quality employment for all kinds of workers, including those who have less formal education or live in rural areas, thus helping to reduce inequality.

Structural measures, including some of a tax nature that we will discuss below, will initially coexist with long-term support measures, but increasingly focused on the most severely affected companies and households, especially if the economic recovery remains slow; although additional stimulus measures must, in any case, be temporary and focus on areas where the fiscal multiplier is highest, especially those that support the recovery of the labor market and the recapitalization of companies, coordinating fiscal stimulus with other policies and ensuring that such measures are aligned with longer-term environmental, health and social objectives (OCDE, 2021). In this sense, investment cannot be neglected, since the multiplier is higher and the environment of low-interest rates reduces the cost of undertaking green public investment, if the fiscal space allows it and, if not, through PPPs.

A very important element will be the diagnosis of the stage in which each economy finds itself because a premature withdrawal of fiscal support would slow recovery, while a late withdrawal of stimulus measures would hamper growth and increase fiscal imbalances.
Medium-term fiscal frameworks will also be crucial for balancing public finances and restoring fiscal buffers. Fiscal rules are important in this area. Countries should review the adequacy of their design, otherwise their boundaries would have to be recalibrated to ensure a credible adjustment route. In terms of LAC fiscal institutions, 11 countries with fiscal rules have an escape clause, and 10 of them have applied that flexibility during the pandemic. The average deviation from the primary deficit stipulated in the rules was about 3.4 per cent of GDP. Most countries have an explicit goal to return to the fiscal rule in 2021, and a few plans to return in 2022 and beyond (BID, 2021, pg. 34)

2. THE NEXT GENERATION OF TAX REFORMS

As the economic slowdown deepens, the more necessary it becomes to strengthen social safety nets and begin to restore fiscal balance. If we add to that medium-term fiscal stability, including building fiscal buffers to cushion future crises, and the social and investment spending needed to achieve the Sustainable Development Goals, it is clear that tax reforms will have to be addressed at national and international levels, especially as the recovery gains momentum. These measures could be implemented in LAC countries in a global package or in a phased manner.

The starting consideration in this context is whether in LAC there is room for revenue growth. In principle, the region's tax revenues are relatively low, with an average of 22% of GDP, offering a growth margin of 12 points compared to 34% in the OECD (OCDE, CEPAL, BID, CIAT, 2019). However, the comparison cannot be so linear. Some authors have questioned the methodology because in LAC there are mandatory contributions to private (actuarial) Social Security regimes that do not exist in the OECD. These will need to be included in the calculation if we want to have homogeneous magnitudes (Rojas & Morán, 2019). Applying this approach, the equivalent tax burden (PFE) in LAC reached 25.2% in 2018, reducing the potential revenue gap to 8.5 percentage points of GDP. A further thought is heterogeneity, as some countries have levels of fiscal pressure relatively high, such as Argentina, Barbados, Belize, and Uruguay (between 29% and 34% of the GDP) and others quite low, such as Dominican Republic, Guatemala, Panama, Paraguay, Mexico, and Peru (between 16% and 12% of the GDP). Therefore, what serves one may not serve others.

Even so, there remains a potential gap of 8.5 points of tax pressure on average, which should give enough room for maneuver for well-targeted tax increases. Measured in terms of fiscal effort, that is, as the percentage of actual tax collection expressed as a percentage of GDP, relative to potential tax collection, the region's fiscal effort is about 60%, much lower than the 77% collected by advanced economies. If the region could match the fiscal effort of advanced economies, revenues would increase by about 7% of GDP (BID, 2021) and we would be technically on the same level.

However, for expectations to be realistic, we must also consider that the differential in per capita income prevents a repetition in LAC of the same distribution of the OECD tax mix. Certainly, if income tax and social contributions are, to a large extent, a tax on the middle class[4] as the lower deciles have bonuses and other benefits, while the higher deciles can channel their income through companies, collective investment bodies, or other benevolent legal forms, or directly expatriate their sources of income, then the income tax and social contributions depend on the density of the middle class because, given the progressive structure of personal income tax rates, the contribution grows progressively as the purchasing power of its members is greater.

If we define the middle class, following the OECD, as the people who receive as income between 75% and 200% of the national average, we find that in the US this range is between 23,416 and 62,442 dollars per year, while in Mexico they are between 3,757 and 10,019 US dollars, adjusted in purchasing power parity (OCDE, 2019, pg. 20). Obviously, the contribution for personal income tax and social contributions has to be higher in the US than in Mexico, but not only in absolute terms, also in relative terms, given the progressive structure of the rates. Specifically, direct taxes on income, profits and capital gains in LAC account for an average of 27.4% of tax revenue, compared with 33.6% in the OECD. The same is true of social contributions, which represent on average 16.5% of the collection in LAC, compared to 26.2% in the OECD. In other words, these two "direct" pillars of the system contribute to the OECD almost 60% of the collection, while in LAC they do not reach 44% (OCDE, CEPAL, BID, CIAT, 2019).

The inescapable reality, therefore, is that the poor do not pay direct taxes, and in many countries in the region their numbers are too high, putting simplistic comparisons in perspective. The personal income tax falls on individuals in the formal sector and with high salaries, located in the deciles of highest income, and it is estimated that almost 90% of the population of Latin America is exempt from paying this tax.(Rojas & Morán, 2019).

4 In OECD countries the middle class is responsible for two thirds of income from personal income tax (OCDE, 2019, p. 29).

In summary, there is a differential fiscal effort in the region with respect to more advanced economies and exploiting this deposit would support a robust recovery and guide the achievement of the SDGs. But what kind of reforms would make it possible?

Raising the tax rates seems not to be the solution. The rates in LAC are at levels comparable to the OECD in the income tax of individuals, where in addition the rates also have fairly progressive structures. In the corporate income tax, the rates applied by LAC countries are even higher than the OECD average, with the region averaging 27%, much higher than in advanced economies (22.6%) (BID, 2021). If we add other forms of corporate taxes, including labor contributions and other taxes, “effective” taxes on corporate profits are even higher, as much as 60% in LAC, compared to 40% in advanced economies and 30% in Emerging Asian countries, according to the PWC-World Bank Paying Taxes database. Raising the contribution to the formal economy actually aggravates the problem of informality, one of the region’s endemic problems, along with high tax expenditures.

a. Reducing informality

About 58% of workers in the region are in the informal sector, compared to less than 20% in advanced economies and about 50% in some Asian countries (BID, 2021). The region has the second highest average rate of informality in the world, only below Sub-Saharan Africa, where it is 90 per cent. In LAC, 80% of workers in the poorest decile are informal. There are three main reasons for the high informality in LAC: (1) the low level of skills among the lowest deciles hinders their access to the formal labor market; (2) payroll taxes, averaging 28%, discourage formal hiring; and (3) social protection programs for informal workers, such as Progresa in Mexico and Bolsa Familia in Brazil, although well-intentioned, act as a brake on formalization.

Reducing informality requires a combination of well-aligned incentives and control measures. Later it is discussed how the technological revolution could allow a giant leap in the control of the underground economy. Big data and artificial intelligence will allow a lot of fine-tuning in the construction of public records of people at risk of exclusion, better focusing on tax policy measures (for example, the personalized VAT that has been discussed above) or social spending. At the same time, the dual approach of traditional control measures together with innovative nudge or behavioral economics, will allow us to move decisively towards greater formalization. From the political side, the challenge is to smooth the gap between absolute informality and participation in the system, linking social benefits with effective contribution, but without ceasing to protect the people who need it, and considering that any increase in effective taxation on the lowest incomes will generate more informality.

In the United States they found a solution to this paradox in 1975, when they created the Earned Income Tax Credit (EITC). It functions as a negative income tax, that is, a transfer that complements wage income. When a person who was receiving the living allowance formally starts working, he does not lose all the benefit, but receives a part of it in the form of negative income tax. If the social benefit is close to the minimum wage, there are no monetary incentives to work, and people prefer to remain in the welfare program receiving their subsistence allowance, with a loss of overall economic efficiency and problems of marginality at the individual level. On the contrary, if a fraction of the social benefit is added to the salary, in this case as negative income tax received as EITC, everyone wins: the worker because he has a real economic incentive to leave the welfare, and the State because it faces lower costs, since the EITC is less expensive than the living income subsidy. The balance in the US is very positive. Transfers by EITC significantly increased formal employment and reduced poverty, reaching about 28 million workers with an expenditure of only 0.3 per cent of GDP, particularly favouring single mothers, the group that previously faced the greatest disincentives to work. In 2018, the EITC lifted about 5.6 million people out of poverty, including about 3 million children, supplementing the income of low-wage workers and incentivizing work. It also reduced male participation in the informal sector by 5.8 to 7.3 percentage points. Similar programmes exist in at least 18 developed countries, including Canada, New Zealand, the United Kingdom, Sweden and South Korea, with budgets ranging from 0.3% to 2.1% of GDP. These systems could be adapted to the reality of Latin America (BID, 2021).

b. Review tax expenditures

An effective way to raise revenue without touching the tax rates is to widen the bases. As we have seen above, in the Corporate Tax, statutory rates in the region are almost five points higher than in the OECD (27% versus 22.6%) and yet the revenues are practically the same, 3% of GDP, due to the smaller bases in the region (BID, 2021). Taken together, tax expenditures in LAC amount to about 3.9% of GDP. Tax expenditures are not only distorting and favoring some activities to the detriment of others; they also have a negative impact on income redistribution, due to their generally regressive nature. (BID, 2021) In addition, tax incentives rarely have a cost-benefit analysis to justify them, and the level of transparency about them is low.

The problem is of such magnitude that Colombia recently convened a commission to specifically examine tax incentives. Its conclusions were exhaustive: the wide deployment of tax expenditures damages the tax base, further complicates the highly complex system, discourages business initiatives and investments, facilitates tax evasion and avoidance, and also slows down the country's economic development. Moreover, the tax system has also failed to address inequalities in income and wealth distribution. The Commission therefore recommended reforming tax exemptions and rebates. But it went further: in addition to designing new tax rules, it also demanded a major change in the way national politicians and legislators conceive, draft, and implement tax policy. The report stated that Colombia "has developed the habit of overusing tax expenditures, trying to overcome structural social and economic problems, which require reforms that are not within the scope of the possibilities of the tax system" and recommended ending this approach.(OCDE - DIAN, 2021) To the extent that this way of doing politics is quite widespread in the region, this is a lesson for all. The unfortunate implementation of this reform has also taught us other lessons, both in terms of the form or, if desired, the process, by highlighting the importance of prior social dialogue, because it makes it possible to explain and reach a consensus on reforms, and in terms of substance, by focusing on the necessary social protection, since an expansive policy would be more appropriate than restrictive policies, to avoid increasing inequalities or the suffering of people at risk of exclusion.

c. Improving fiscal control

If the collection gap is largely due to informality and low tax morale, tax administrations face the challenge of leveraging new technologies to improve tax control. It is not that the TAs of LAC are lagging behind in the use of technologies; on the contrary, a large number of them are at the leading level in the use of technology, even leading worldwide the adoption of services and technologies, such as electronic invoicing, that facilitate tax control and compliance with obligations by taxpayers; and that promote not only greater efficiency, but efficiency improvements that reduce transactional costs. According to the *International Survey on Revenue Administration* (ISORA), the progress shown by our tax administrations in digitalization is comparable or even superior to those of other middle-high income countries, in aspects such as electronic declaration, payment through digital means and electronic invoicing. The shortcomings would be, rather, in the development of deeper and more comprehensive digital solutions, limiting the installed systems to fulfilling basic functionalities. Therefore, we see in the tax administrations of the region levels of coverage of the assistance and control processes so low that they cannot solve the high levels of tax evasion.

More than half of the potential Corporate Tax revenue is volatilized due to tax fraud. ECLAC has studied the evasion rate of 12 significant countries in the region[5] and they found that the average rate of Corporate Income Tax evasion is 51.6%, causing a revenue loss of 3.25 percentage points of GDP. In some countries, fraud even exceeds two-thirds of tax capacity (Guatemala 80%, Panama 72.7%). Even the best performers (Mexico with 20% and Chile with 31%) still suffer from a high level of regulatory disobedience. Similar levels of fraud are observed in personal income tax, with an average evasion rate of 44% and 3 percentage points of GDP lost, and in VAT, where the incidence of evasion is somewhat more moderate, but still reaches 30%, failing to collect 2.5 points of GDP(CEPAL, 2020). The evidence shows that the collection could be much higher, were it not for the high level of non-compliance (Gómez Sabaini and Morán, 2020). While countries like Uruguay or Mexico have rates of VAT fraud typical of advanced countries, Guatemala, Peru, Panama and the Dominican Republic practically double that rate. What is surprising, beyond the heterogeneity, is that the global average level of fraud has remained at around 30% in LAC, while in the European Union, by contrast, there has been a moderate and sustained decline. In just five years, it fell from 17.8% (in 2012) to 11.5% (in 2017) (CEPAL, 2020, pg. 97).

Even e-invoicing, where the region is a leader, needs a boost. Countries that do not have it must implement it, because it reduces compliance costs while strengthening regulatory and control dissuasive mechanisms (Gomez Sabaini y Morán, 2020, pg. 39) and those that have it, to better exploit their potential in auditing, limited by capacity issues in computer systems and weak data and innovation strategies in TAs. Electronic invoicing (EI) has been used to consolidate transactions by taxpayers and to verify compliance with their reporting obligations, as well as the amount of such reporting and payment, but its results in combating tax evasion are the subject of debate.

The first published impact study on the implementation of the EI, conducted by the Monterrey TEC, found significant impacts on the Income Tax caused (although not necessarily on the tax collected) of between 11% and 16% on the discontinuity threshold. It also documented increases in VAT caused by between 2.2% and 7.1%. (Fuentes Castro, 2016). The reason, explains the study, is that EI makes the act of evasion difficult by generating information on transactions in real-time while increasing the possibility that the TA discovers the evader because it improves the quality of audits by obtaining enough evidence in less time. Subsequent work has supported the relevance of electronic invoicing in tax compliance. Bergamo, Ceni and Sauval have estimated that the EI in Uruguay increased VAT payments by 3.7% in the six months after its implementation, (Bérgolo, Ceni, & Sauval, 2018) and Ramírez Álvarez, Oliva and Andino have shown that in Ecuador electronic invoicing increased sales and VAT passed on by 17% in the second year and by 24% in the third year after implementation(Ramírez Álvarez, Oliva, & Andino, 2018).

Clearly, EI increases tax compliance because it induces formalization, cross-control, and taxpayer perception of risk. It is not, therefore, a question of the sign of the effect (clearly positive) but of its intensity. Ramírez Álvarez, Oliva and Andino themselves describe the

5 Argentina, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Mexico, Panama, Peru and Uruguay.

electronic invoice system as "a necessary but not sufficient condition to close the gaps between the filing of the declaration and tax control," concluding that EI by itself is not a method of intensifying control. What it does is potentiate the subjective risk effect that all third-party information systems produce on taxpayers (ibid., pp. 1-2).

The increase in sales and VAT figures passed on as a result of the EI does not necessarily translate into a greater collection, because these invoices issued are VAT credits for their recipients. The weak step, which determines VAT collection, is not the intermediate operations between companies but the final delivery to the consumer.

Hernandez and Robalino have thoroughly examined five cases[6], and they have not found solid evidence between the implementation of the EI and the variables related to the collection. In short periods, substantial increases are seen, however, as time passes the effects are reduced (Hernández Romero & Robalino Herrera, 2018). In a specific study on Peru, the IMF calculated the effect of e-invoicing on sales, purchases and value added, but concluded that the impact on revenue was not significant, perhaps because at the time of the study (2017) SUNAT had not made changes to its risk management strategy to leverage the flow of information generated by the e-invoicing system. (Bellon, y otros, 2019). Nor has the EI produced a significant increase in collection in Chile, where VAT evasion has been stalled in a band between 21% and 23% since 2009, even though in the last 10 years electronic invoicing information has been available in almost 100% of VAT-subject operations. According to Trujillo Puentes, "EI has not translated into significant reductions in VAT and Income Tax evasion... as it was supposed to. Those who predicted that fraud by false invoices would end with electronic invoicing were clearly mistaken, figures such as falsification of invoices, impersonation of taxpayers, or duplication of documents were the majority of frauds. The reason for this may be that taxpayers adapt quickly and those who see spaces for fraud find the gaps and mechanisms to keep committing fraud."(Trujillo Puentes, 2020, pg. 30).

Consequently, TAs of LAC would need to implement risk assessment systems based on data mining, big data, and machine learning to be more effective. It is possible to use the available information, rich in quality, quantity and opportunity, for the detection of non-compliance and to generate effective control processes capable of inducing substantial changes in behavior in taxpayers, process the information with predictive models of tax behavior or for the early detection of VAT fraud that generate massive control actions, although this requires a greater computing capacity and teams of data scientists to design the algorithms. This is the message of the recent CIAT publication *ICT as a Strategic Tool to Leapfrog the Efficiency of Tax Administrations* (CIAT, 2021). What CIAT proposes is to take a giant leap (*leapfrog*) using technology and bringing the region's TAs to the level of the most advanced in the world, reinforcing big data with advanced network analysis systems and artificial intelligence solutions to predict non-compliance and act in real-time using behavioral economics techniques.

d. Fiscal policy of the Digital Economy

Everything indicates that the G20 will reach a consensus solution in July 2021 to reform the current international tax system, after the withdrawal of the "safe harbor" exception by the US, which will trigger reforms in corporate tax, both within national legislation and materialized in international agreements. Estimates of the impact of these measures on collection are still very uncertain. The OECD has estimated that additional

6 Argentina, Sao Paulo-Brazil, Ecuador, Mexico and Uruguay

revenue from Pillar 1 (attributing bases to market countries without physical Permanent Establishment) will amount to between US $ 5 billion and US $ 12 billion per year for the whole world. It is not a particularly stimulating scenario for LAC, although it substantially improves the current situation in which the collection of this amount is zero. Pillar 2 (a global minimum tax, the GloBE), which could contribute between 42,000 and 70,000 million USD annually, seems a little more fruitful, but this is for everyone, including capitalist countries and market countries (OCDE, 2020, pg. 28).

Beyond corporate income tax, the tax system has to adapt to the digitalization of the economy. This is especially important in VAT, where the supply of goods and remote services is not always effectively taxed, despite the fact that there is an international consensus around the principle of taxation at the destination. There is a lack of precise definitions in the laws to see when this consumption is understood to be carried out in the country and effective mechanisms to enable the correct taxation of entrepreneurs who are not established in the territorial area. The OECD, the World Bank, CIAT, and the IDB have created a toolkit to help LAC countries level the playing field and make the subjects of the digital economy contribute equitably to traders in the traditional or analog economy. Estimates of additional collection vary. Lost revenue in the region due to the boom in e-commerce could reach 3,000 million dollars a year.(González & Pineda, 2021) Jiménez and Podestá have evaluated digital VAT revenues in the region, estimating tax revenues for this concept that are between USD 20 and USD 120 million per year per country, according to the size of the digital economy of each of them, which is equivalent to a value between 0.02% and 0.04% of GDP. However, in some cases, as in Chile, there may be underestimation because these values correspond to the first months of VAT application, and in the collection of a full year this indicator would approach 0.08% of GDP. In the case of the European Union, collection gains in the first year of operation of the simplified compliance regime exceeded 3,000 million euros in 2015, as a result of the implementation of the international VAT guidelines (Jiménez & Podestá, 2021).

This process to update VAT with emerging technologies has already been carried out in more than 70 countries around the world. In e-commerce, the OECD recommendations for the successful VAT on online sales of goods, services, and digital products mean that a VAT reform is important for this tax. In addition to generating significant revenues, it minimizes distortions of competition between online merchants and traditional businesses, a need to be even more important after the pandemic of COVID-19 and the resulting increase in online shopping and the increasing demand for digital products and online services. The Toolkit also contains guidelines for designing and implementing an appropriate VAT response to the phenomenon of the shared economy (Uber, Airbnb) and the provision of occasional services of the *gig economy*.

e. Crypto assets

A recent and booming phenomenon is that of alternative digital money, such as Bitcoin, because the market capitalization of virtual currencies has increased dramatically, reaching more than 1.8 trillion US dollars as of April 1, 2021 (OCDE, 2021). This parallel and unsupervised financial system will pose increasing fiscal problems, including perhaps macro-fiscal risks of a parallel financial system without regulation or supervision. From the tax point of view, the risks are that the activities related to these assets are not included in the tax laws, and therefore the level of compliance is minimal or nonexistent; in addition, crypto assets help by their opacity to tax evasion and the concealment of income from, money laundering, terrorism financing and other financial crimes. In this regard, a major hole is emerging in the OECD's framework for transparency and exchange of tax information, as acknowledged by its Secretary-General in the Report to the Finance Ministers and Central Bank Governors of the G20, in

April 2021 (OCDE, 2021) and it would be necessary to extend the coverage of the Global Forum of Transparency and Exchange of Information rules to these activities, a challenging task because many of the subjects involved in this market do not have a clear link with specific territories. Added to this is the need to protect consumers and investors in this market/regulation of intermediaries. On this path, the leadership is led by the EU, which has created a study group specifically focused on investor protection, but very interesting for tax purposes because it has a wide area of intersection: transparency. The issue is far-reaching because central banks are getting into crypto assets (Central Bank Digital Currencies or CBDCs), calling into question the very future of paper money and currency. Research in this field is being led by the Basel Central Bank for Payments. The regulations in Latin America and the Caribbean are uneven and incipient, and they could benefit from regulatory reviews that generate more favorable conditions, as happens in other countries of the world, according to a report presented by the DIDI Project (Digital Identity for Inclusion), promoted by the IDB Group innovation laboratory (BID Lab) and the NGO Bitcoin Argentina.

To ensure that these new assets are taxed in the country of residence of its owners, it is necessary to inform the tax authorities, to develop a new framework of tax information on crypto assets to prevent the progress made in fiscal transparency and the elimination of bank secrecy over the last decade from being undermined by these new assets.

f. Fiscal policy and climate change

The progressive transition to net zero greenhouse gas emissions by mid-century is an inescapable goal for mitigating climate change. The target was set in the Paris Agreement (limit global warming to 1.5° -2° C) and reduce greenhouse gas (GHG) emissions to net-zero by 2050.

Countries are aligning to that goal through nationally determined contributions and legislative measures, even in the midst of the COVID-19 crisis. To meet the goals, governments need to drive fundamental transformations in the functioning of the economy through specific climate policy packages, including fiscal policy, because it is an effective way to put a price on greenhouse gas emissions. There are, in this regard, two basic mechanisms for pricing GHG emissions, namely: taxes, either on CO2 emissions, for example in power plants, either as excise taxes on fuel or, alternatively or complementarily, an emissions trading system. In addition to their effectiveness as a climate measure, pricing in any of these forms generates significant revenue, although prices are currently well below the levels required to drive decarbonization and prevent dangerous climate change (OCDE, 2021).

According to the OECD, 55% of energy-related CO2 emissions pay no price in advanced and emerging economies today. Free permit allocation rules provide an advantage to carbon-intensive technologies and, although prices are slowly improving, the G20 and OECD countries are nowhere near setting a carbon emissions price with an appropriate benchmark. Not only this, the imposition of effective costs on carbon emissions is further weakened by fossil fuel subsidies. Underlying barriers include the real and imaginary adverse impacts of pricing on vulnerable households and concerns about carbon leakage and business competitiveness, for example in the transport sector. There are some international recommendations for designing fossil fuel subsidy reforms (Elgouacem, 2020). For the countries of the region, there is a long way to go, and we will have to closely monitor developments in international forums. In this regard, the G20 will hold a Tax Symposium on taxes and the environment in July 2021 to facilitate the policy dialogue among major GHG emitters on emissions pricing, identify reform needs based on current pricing patterns, and propose comprehensive approaches to address the concerns on political economy.

g. Fiscal policy and gender gap

Women have been disproportionately affected by the COVID-19 crisis, experiencing more pronounced falls in hours worked and in their participation in the labor market in many countries. At the same time, the amount of unpaid work has increased disproportionately for women. In this context, the biases implicit in the tax system, which may deter women from entering the labour market, are particularly important. While tax policy measures play a crucial role in supporting individuals and businesses to navigate the crisis and recovery, it will also be important for governments to include the impact of taxes on gender as a key policy dimension in their tax policy responses to COVID-19 (OCDE, 2021).

h. Administrative cooperation and exchange of information

Since the re-founding of the Global Forum on Transparency and Exchange of Tax Information in 2010, much progress has been made in eradicating bank secrecy, promoting tax transparency, and international cooperation between tax administrations. Most countries in the region are members of the Global Forum and are undergoing peer reviews for on-request or even automatic exchanges, a powerful tool to fight evasion. In 2019, countries automatically exchanged information on 84 million financial accounts worldwide, representing total assets of 10 trillion euros. In this regard, the processes of implementing the Automatic Exchange of Information on Financial Accounts are not progressing efficiently, especially in Central America and the Caribbean.

Recognizing the relatively slow progress in the region, in November 2018, the Ministers of the Latin American countries met on the sidelines of the plenary meeting of the Global Forum, which took place in Punta del Este, Uruguay, and signed a declaration known as Punta del Este, setting goals to implement the international standards of the Global Forum on tax transparency and exchange of information (EOI) to address cross-border tax evasion, corruption, and other financial crimes through closer regional cooperation and more intensive use of all the tools of exchange of information (EOI) are available, in order to deter, detect and prosecute tax evaders. This Declaration aims to ensure that jurisdictions in the region can fully and quickly benefit from transparency and EOI for tax purposes.

i. BEPS

The era of effervescence around BEPS (2013-2020) was of a moderate intensity in LAC. Just over half of the countries in the region are members of the OECD Inclusive Framework and have undergone revisions to the minimum standards of said Framework. In others, the incidence is lower, for example in the participation of the scheme of exchange of individual administrative rulings (Action 5), or the country-by-country reports exchanges (Action 13). Nor have most countries of the region signed the Multilateral Instrument to implement the BEPS measures that demanded reforms to the existing treaties.

What is undeniable is that, in all countries, there is a perception that it is necessary to incorporate BEPS recipes to prevent aggressive tax avoidance by multinationals. The OECD reports on implementation indicate that this is an avenue that countries should continue to consider. In terms of treaty abuse prevention, the Multilateral Convention to Implement Tax Measures to prevent tax base erosion and profit shifting (MLI) covers more than 1,700 bilateral tax treaties and 65 jurisdictions have ratified the MLI, which has 95 signatories. There have been more than 35,000 exchanges on previously secret tax rulings. More than 2,700 bilateral relations for the exchange of country-by-country reports have also been established, and nearly 300 preferential tax regimes facilitating tax avoidance have been modified or abolished worldwide.

The future adoption of the GloBe, a global minimum tax under Pillar 2 of the OECD proposal, will change the importance of first-generation anti-BEPS measures to the point that it is known as BEPS 2.0. This is another trend that will mark future Corporate Tax reforms in LAC.

3. CONCLUSIONS

With a five-point fall in GDP, in 2020 alone - much more serious than the global financial crisis of 2009 - and an increase in public debt of 14 points of GDP on average for the region, many countries, especially those with less room for indebtedness and those heavily dependent on tourism, will have to adopt tax measures to ensure fiscal sustainability and prevent a deepening of the crisis, particularly if the health emergency continues into 2022.

Tax policy reforms cannot, in general, be based on tax rates hikes because they are already quite high and also high rates push towards informality, something that LAC governments cannot encourage. By contrast, there is sufficient scope to widen the tax bases, plagued by exemptions and expenditures, well-intentioned but generally ineffective, if not regressive. In addition, TAs have the opportunity to exploit the wealth of information from electronic invoicing through advanced technologies and thereby achieve significant advances in voluntary compliance and in the containment of informality and tax fraud. In addition to these two large reserves of revenue, new trends in taxation, especially in the areas of digitalization of the economy, mitigation of climate change and prevention of tax avoidance by multinationals, offer expectations for a siezable volume of additional resources, which should be coordinated with holistic policy packages aimed at reducing inequality, increasing resilience, sustainability and achieving the United Nations Sustainable Development Goals.

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RELEVANT ASPECTS OF THE COMMERCIAL LEASING AGREEMENT

Analysis of its treatment according to IFRS and applicable tax legislation

Lilian Patricia del Rosario
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SYNOPSIS

In Guatemala, analyzing the Leasing contract is relevant due to its recent inclusion in the legislation; this Law was approved without analyzing in-depth the technical provisions related to accounting and the regulations of Value Added Tax, Income tax, and special Taxes, Stamps and Special Sealed Paper for Protocols. Contradictory provisions were detected in the study, which creates difficulties for the management of the payment by the taxpayer, as well as the exercise of control by the Tax Administration.

Keywords: Leasing Treatment, Commercial Contract.

CONTENT

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INTRODUCTION

It is becoming more and more common for companies to search for efficient sources of financing that represent a lower financial cost, in order to obtain income that will allow them to develop their operations and have more working capital.

In large numbers, financial and commercial operations have had their origins in expertise and habit, constituting part of the law that is used in large cities, thus the maturity process of commercial law has been based on the verification of the practices of the merchants, the modalities and particularities of the businesses that are held, as well as the innovations that have been introduced throughout history, according to the new forms and the advancement of commercial operations. Consequently, tradition becomes the original source of banking, financial and commercial operations, with leasing being one of the operations that is born in this way, from tradition, mainly from the experience of owners of capital goods and merchants.

Leasing has been around for decades, however, it acquired importance in the industrial revolution, when large industries appear that require capital goods, investors and better products to compete in the market. In this stage of history there is a marked economic, social and technological growth, which goes from the handwork industry to the use of machinery for industrial manufacturing, to the transport of goods and passengers, giving great advances in trade., finance and banking.

Leasing has taken the financial aspect that is known today, when merchants cannot sell their products and offer them on lease in exchange for a consideration; Its surge is also attributed from a banking operation requested by a merchant who, since he cannot have more bank financing to increase his productive capacity, proposes to his bank to sell his machinery in exchange for cash, proposing to pay a consideration for its lease and buy it back in a certain time.

The scenarios for the emergence of leasing and its use occurred due to the difficulties of companies in obtaining sufficient financing for operating capital, as well as in the current time due to the advancement of commercial, industrial and manufacturing techniques. Companies require the use of machinery and equipment with advanced technology to keep up with the times, in order to compete with similar suppliers so as not to be left out of the market.

Leasing is an alternative for those who demand working capital, without increasing the company's capital stock. It allows to minimize risks in their operations, without admitting new partners or carrying out operations that result in higher expenses that may negatively affect results, as well as going to the stock market, with the uncertainty that these operations entail.

In the operative version, the owner of the capital is not linked to the company but uses those funds to acquire goods to lease them, and that operation constitute a financing alternative.

In Guatemala, this study is relevant because this contract has been recently included in the legislation. On many occasions it was necessary to apply to this contract the leasing regulations in the commercial and civil fields, when in reality it is a matter of two distinct legal figures. Likewise, when studying the existing regulations, the absence of consideration of the technical accounting provisions is evident, which makes their treatment difficult.

The leasing contract can be presented in two forms: as a financial lease or as an operating lease. In both cases, although the word "arrendamiento" (lease) is used, however it is not the contract regulated in the Civil Code.

Financial leasing is an instrument to finance the acquisition of goods and therefore has its own nature, characteristics and effects. On the other hand, the operating lease is an instrument to finance the acquisition of goods for terms agreed by the parties, usually for industrial purposes, therefore, it is not a typical civil rental either. In most legal systems, this contractual form is special and although there are a series of normative provisions that have developed it in different aspects, this figure is not specifically defined, both in its legal and accounting effects. Currently in Guatemala, the regulation regarding leasing is recent, however, it would be necessary to see if it is complete and identifies specific aspects of the management of this legal business, what this study is trying to identify.

In this type of contract, one of the points that generate discrepancies is the way in which the applicable technical accounting standards develop their treatment, both from the point of view of the lessor and from the lessee's viewpoint, and the legal regulations that in tax matters regulate the way in which the taxpayer must apply the deductions of the related costs and expenses. These tax consequences affect the rights of taxpayers in relation to the payment of tax obligations arising from leasing operations.

This aspect, where the obligations and rights come to generate controversies between the Tax Administration and taxpayers, as well as between the parties to the contract is the object of this study. The following controversies will be dealt with in a timely manner, some of them not derived properly from obligations, but from the context of the contract:

1. Expenses for depreciation of the leased assets.

2. Notary and tax expenses derived from the acquisition of the property, insurance, and guarantees required by the leasing company.

3. Admissibility of paying the Single Property Tax, which in other tax terms are called property taxes.

4. Interest expenses associated with the lease.

5. Insurance and maintenance expenses associated with the goods.

In Guatemala, the Leasing Law has recently been approved. It was submitted for discussion by the Economic and Foreign Trade Commission for its study and corresponding opinion.

This Law is considered an accessory regulation, therefore as long as it is not an express or imperious prohibitive normative, it gives the parties the power to agree on the terms and conditions that are most convenient for them.

This normative establishes that the issues that are not subject to agreement between the parties or individually for the lessor and lessee are those related to the accounting operation and those that have tax effects, since they are rules that are intended to carry out leasing operations with transparency for the benefit of the parties, and the third parties that have agreements with them regarding the goods under the contract.

The aforementioned highlights the importance of this study because, when the law enters into force, it mentions that with regard to the accounting record and tax treatment, the parties must comply with what is regulated, therefore, the legal provisions that affect the aforementioned contract and the International Financial Reporting Standards pertaining to the subject must apply.

1. DOCTRINARY ASPECTS

Leasing is doctrinally defined as:

Leasing or financial leasing is a financial product consisting of a lease with an option to purchase, whereby a person or company called the lessee requests the lessor to acquire ownership of an asset and subsequently transfer its use in exchange for the payment of periodic rentals, for a specified term, and at the end of which the lessee has the option to purchase the asset from the lessor.

The lessee agrees, by signing the contract, to make periodic payments. At the end of the agreed term, by means of a symbolic payment, the lessee becomes the owner of the property.

The lessee is the one who negotiates with the provider, regarding the characteristics of the asset, technical conditions, and price, among others.

Assets subject to leasing

Source: http://www.arrendleasing.com/gt/servicios/leasing/

2. THE LEASING IN COMMERCIAL TERMS

Contract according to the Civil Code of Guatemala

In accordance with articles 1517 and 1518 of the Civil Code, a contract exists when two or more subjects agree to create, modify or extinguish an obligation. The contracts are fully created by the simple consent of the parties, except when the law establishes a certain formality as an essential requirement for their validity.

In accordance with article 1519 of the aforementioned legal body, from the moment a contract is in force, it obliges the contracting parties to comply with the agreement, provided that it is within the legal provisions related to the business carried out and must be executed in good faith and according to the common intention of the parties. Any person can contract and be bound by 1. By a public deed; 2. By private document or by an act signed before the local mayor; 3. By correspondence; and 4. Verbally

Article 1577 of the aforementioned legal body establishes that contracts expressly qualified as solemn must be recorded in a public deed, an essential requirement for these contracts to be valid. Likewise, article 1578, regulates that the extension, ratification or modification of a contract must be recorded in the same way that the law indicates for the granting of the contract itself.

In Commercial Terms

With respect to the definition of contract, we can say that it is determined as: a pact or agreement between parties who are bound by a specific matter or thing and to whose compliance they can be compelled. In a legal definition, it is said that there is a contract when two or more persons agree on a common declaration of will, intended to regulate their rights (Manuel, 2020). Capiant defines it as an agreement of wills, between two or more persons, with the purpose of creating between them bonds of obligations.

Commercial contracts are not subject, for their validity, to special formalities. Whatever the form and language in which they are held, the parties will be bound in the manner and in the terms that appear that they wanted to be bound. The contracts entered into in Guatemalan territory, and which are to take effect therein, will be issued in the Spanish language (Guatemala, Decreto Número 2-70, Código de Comercio, 1970). The contract may be executed by means of a Public Deed or in a Private Document with Legalization of Signatures, even simply in a Private Document, depending on the type of legal business contained therein, which, in the case under analysis, both the factoring contract and the discount contract must be documented in written form, which includes annotations in the account. (Guatemala, Decreto 1-2018, , 2018)

[Commercial law] Financial leasing contract, which is based on North American contractual models and by virtue of which a leasing company, authorized by the Ministry and registered in the Special Registry of the Bank of Spain, temporarily transfers the use and enjoyment of an owned asset to the other contracting party (user), who pays as consideration a periodic fee with an increasing or constant annual amount, with the peculiarity that, at the end of the term of use and possession, the user may exercise a purchase option right whereby, by paying a residual price (similar to the rent paid in the last term), he becomes the final owner of the property. (Rogers, 2020)

From the Guatemalan legal point of view and the related doctrine, the Leasing Contract is the contract by which the lessor acquires goods for use by the lessee in exchange for a rent or fee for a specified term; the Leasing contract includes the financial type and the operational type.

FORM AND REQUIREMENTS

a) **The lessor:** is the person, autonomous patrimony or the entity that delivers the property or assets in lease, to one or more lessees.

b) **The lessee:** is the individual or legal entity who takes the asset subject to the lease with purchase options as previously agreed or at maturity the asset can be returned to the lessor.

As for the formalization of the contract, it must be in writing, which is commonly entered into for a forced term, with the understanding that the lessee assumes the obligation to pay all the installments or rents established for the fulfillment of the contract for both parties.

In any leasing contract, both the lessor and the lessee assume obligations and rights, within which the following are mentioned: (Guatemala, Decreto Ley 2-2021, 2021).

Lessor

Obligations

i. Inform the lessee if the leased asset has encumbrances, annotations, limitations, or defects that may affect the lessee's rights.

ii. Obligation to deliver the good object of the contract free of liens, annotations, limitations, or judicial and/or administrative contingencies.

iii. If the property is subject to security interests, this modification must be added in the Register of movable properties.

Rights

i. He or she may sell or negotiate all or part of the credit rights that correspond to him by virtue of the contract entered into. A negotiation that according to the initiative of law 4896 of the Legislative Directorate of the Congress of the Republic of Guatemala, is not affected by taxes.

ii. Faculty to register the contract in the Registry of Movable Guarantees if the property or assets to be leased are real estate.

Lessee

Obligations

i. Pay the rent and any other fee agreed in the contract, in the agreed form, term and place.

ii. Responsible for the loss, destruction, and deterioration of the asset, from the moment the leased property is delivered.

iii. He is the only party criminally or civilly liable for any damage and/or harm caused to third parties or their property, on the occasion of the use, enjoyment, and/or possession of the property.

iv. If he does not exercise the purchase option, he must return the property to the lessor in a state of service and with reasonable deterioration according to its use.

v. Unless otherwise agreed, all ordinary, extraordinary and necessary expenses for the conservation, use and all those generated by the possession of the property shall correspond to the latter.

vi. To subscribe an insurance policy covering the insurable risks inherent to the nature and use of the goods covered by the contract.

Rights

i. Obtain the use or enjoyment of the good obtained in lease.

ii. With the express consent of the lessor, the lessor may sublease the property, assign the right of use or any other right to which the lessor is entitled under the contract.

The legal nature of commercial leasing contracts are as follows:

a) **It is solemn**, therefore for its effect it must written, (Decree Law 106, 1963) ,

b) **It is principal**, the leasing contract subsists by itself,

c) **It is bilateral**, due to the reciprocity of the parties,

d) **It is onerous**, because benefits are recorded between the parties,

e) **It is commutative**, due to the equivalence that each part contributes,

f) **Of successive treatment**, due to the possibility of extending the leasing contract between the participants,

g) **It is of adhesion**, leasing contracts are printed and with clauses by the giver or lessor of which the policyholder or lessee must adhere and is free to accept or refuse to sign the contract.

3. THE TREATMENT OF LEASING ACCORDING TO THE INTERNATIONAL FINANCIAL INFORMATION STANDARDS

Current accounting standards establish that leases can be classified into two large groups: 1) capitalizable, and 2) operational. To distinguish the accounting of leasing operations, as capitalizable or operational, it is important to pay attention to the economic substance of the operation and not based on its legal or fiscal essence.

1. International Accounting Regulations

Lease accounting is regulated in the International Financial Reporting Standards (IFRS, for its acronym in English) and Generally Accepted Accounting Principles in the United States of America (US GAAP, for its acronym in English). These specific rules are called:

- IFRS 16: “Leases” (IFRS).
- ASC 840: “Accounting for Leases” (USGAAP).

The International Accounting Standards Board - IASB for its acronym in English, (International Accounting Standards Board) published the new leasing standard, International Financial Reporting Standard No. 16, which entered into force on January 1, 2019, affecting all entities that carry out activities that are related to leasing contracts.

The new standard aims to redefine the financial measures that were commonly used by these entities, in the changes introduced the standard almost completely excludes the current accounting recognition of operating leases and redefines many of the financial measures used, among which is the percentage of leverage or EBITDA, which seeks to improve the comparability of the Financial Statements, however, it will also affect credit ratios, interest costs and the form of recognition in the financial statements.

In this sense, the recently approved standard requires the lessor to recognize the leases in the Statement of Financial Position, including the right to use the asset for a period of time, as well as the obligations associated with the payments of the contract made.

As already mentioned, leasing works as a form of financing increasingly used by many entities worldwide, this allows them to use property, plant and equipment without incurring large cash outlays.

The lease also allows the lessor to operate the risks of impairment and residual value of the assets.

In accordance with the International Financial Reporting Standard Number 16, the lessor will operate in accounting a lease as operating or financial, based on certain rules, the result of which is that the asset is recorded or not in the Statement of Financial Position, as that will depend on the management of the risks that it handles of the assets granted through the lease, according to the contract entered into with the lessee.

Likewise, within the most important aspects that IFRS 16 regulates is that the lease expense will be replaced by depreciation and interest expense, as in the income recognition method by both parties to the contract, which significantly affects the tax effect that the way of operating will bring, which will be part of the analysis in this study.

The entities that will be most affected by the provisions of IFRS 16 will be those that have leased assets of high value, such as real estate, sophisticated equipment, vehicles, aircraft among others. On the contrary, lessees with numerous leases of little value, such as computers, office equipment or others, will not be greatly affected, as the IASB included exemptions in the application of the standard for assets with a value of less than USD 5,000.00.

One of the aspects that is relevant in this study, and that affects the tax treatment, is the definition of the lease, since in accordance with IFRS 16, it is necessary to assess whether leases, services or both are agreed upon in the contracts. Since the standard does not place much emphasis on the distinction between operating and service leasing, because normally this distinction does not change the accounting, the evaluation begins with determining if the contract meets the definition of a lease, that is, that the client has the right to control the use of an identifiable asset for a period of time, a model that replaces that of risks and benefits, the lessees having to recognize an asset and a liability at the beginning of the lease, in accordance with the contract entered into.

To illustrate the aforementioned, the following example is presented, which was presented in the PWC Study - Technical Alert - IFRS 16 Leases - Is your company prepared?

Leasing vs. Service

Entity "A" signs a 3-year contract with the operator of a sports complex (supplier) to use a space to sell its products. The contract establishes the size of the space and that it could be located at any of the entrances to the complex. The provider has the right to change the location of the space assigned to Entity A at any time with minimal costs to the provider associated with the change. Entity A uses its own kiosk to sell its products and can be easily mobilized.

There are multiple areas in the complex that are available and that meet the specifications indicated in the contract.

The contract does not contain a lease because there is no identifiable asset. Entity A controls the kiosk. The contract is for the space in the sports complex, and this space can be changed at the provider's discretion. The provider has the right to substitute the space used by Entity A because:

a) The provider has the ability to change the space used by Entity A at any time and without its approval.

b) The supplier could gain financial benefit from replacing the space.

The previous example shows that for there to be a lease, there must necessarily be an identifiable asset that, when used by the lessee, can benefit and be sold or leased separately, it is also necessary, to comply with the standard, that each of the components is assigned a price that can be reliably measured and that appears in the contract, an assignment that must be made based on the individual sale price. "The lessee can benefit from the use of the asset by himself or in conjunction with other resources that are available to him. Available resources are goods or services that are sold or leased separately (by the lessor and other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events; and the underlying asset does not depend on or is highly interrelated with the other underlying assets" (Coopers, 2018).

In accordance with the International Financial Reporting Standard No. 16, paragraph 12, in contracts that constitute or contain leases, the entity shall account for each lease component of the contract as a lease, separately from the contract components that do not constitute a lease.

The primary objective of clearly identifying what the standard regulates in terms of recognition in the Statement of Financial Position and in the Statement of Income, is due to the way in which the accounting records will affect the determination of Income Tax during a fiscal year. Therefore, the way in which the lessor and the lessee should affect their financial statements is mentioned below, in order to later identify the effects of the accounting records for the payment of taxes.

From the perspective of the International Financial Reporting Standard, the Lessor will classify the lease as either an operating lease or a financial lease.

A lease is classified as a financial lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Whether a lease is a financial or operating lease depends on the economic substance of the transaction and not on the form of the contract. Examples of situations that, alone or in the aggregate, would normally lead to a lease being classified as a finance lease are as follows: Whether a lease is financial or operational will depend on the economic substance of the transaction and not on the form of the contract. The following are examples of situations that, alone or jointly, would normally lead to classifying a lease as financial:

a) the lease transfers ownership of the asset to the lessee by the end of the lease term.

b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than fair value on the date the option is exercisable so that, on the lease commencement date, it has certainty reasonable that it will exercise such option.

c) the lease term covers most of the economic life of the underlying asset, even if ownership is not transferred.

d) at the commencement date, the present value of the lease payments is at least equivalent to practically all of the fair value of the underlying asset; and

e) the underlying asset is of such a specialized nature that only the lessee can use it without major modifications.

Other indicators of situations that could lead, alone or jointly, to the classification of a lease as financial, are the following:

a) in the event that the lessee can cancel the lease, the losses suffered by the lessor as a result of such cancellation are assumed by the lessee,

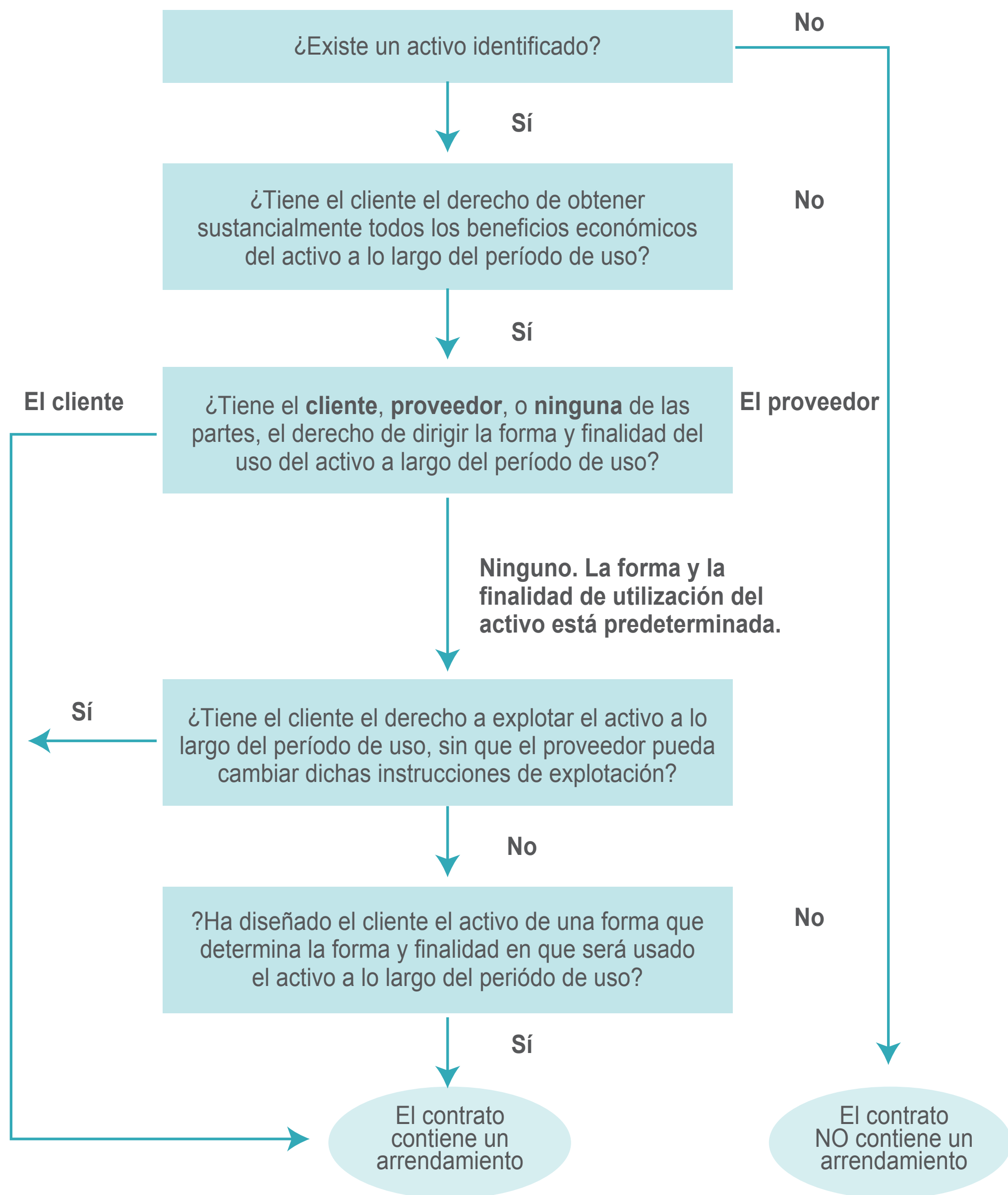
b) gains or losses arising from fluctuations in the fair value of the residual amount are borne by the lessee (for example, in the form of a decrease in rent equivalent to the majority of the proceeds of the sale at the end of the lease), and

c) the lessee has the possibility to extend the lease for a second period, with a rent substantially lower than the market rate.

If it is clear from other characteristics that the lease does not transfer substantially all the risks and benefits inherent in owning an underlying asset, the lease will be classified as operating.

For example, this may be the case if ownership of the underlying asset is transferred at the end of the lease for a variable payment that is equal to its fair value at that time, or if there are variable lease payments, as a result of which the lessor it does not transfer substantially all of those risks and benefits.

Diagram of the standard to help determine whether a contract is a lease or contains a lease



Source: Deloitte IFRS 16 Leases, What you need to know about how leases will change, February 2016 (Deloitte, 2016).

Classification of the lease will be done on the commencement date and will be reviewed only if the lease is modified. Changes in estimates (for example, changes in estimates of the economic life or residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), will not result in a new classification of the lease for accounting purposes.

Likewise, the International Financial Reporting Standard defines the way in which the Lessee must proceed to recognize the lease, which will be on the starting date.

The lessee will recognize a right-of-use asset and a lease liability. On the commencement date, the lessee will value the right-of-use asset at cost.

The cost of the asset per right of use will include:

a) the amount of the initial measurement of the lease liability, as described in paragraph 26.

b) any lease payment made on or before the commencement date, less any lease incentive received.

c) any initial direct costs borne by the lessee; and

d) an estimate of the costs that the lessee will incur in dismantling and disposing of the underlying asset, rehabilitating the site where it is located, or returning said asset to the condition required in the terms and conditions of the lease, unless incurred such costs for the production of stocks. The lessee will have the obligation to bear these costs, either from the commencement date, or as a consequence of having used the underlying asset during a specified period.

The lessee shall recognize the costs described in paragraph 24, letter (d), as part of the cost of the right-of-use asset when it acquires the obligation to bear these costs.

The lessee shall apply IAS 2 Inventories to the costs incurred during a given period as a consequence of having used the right-of-use asset for the production of inventories during that period. The obligations with respect to those costs accounted for applying this standard or IAS 2 will be recognized and valued applying IAS 37 Provisions, liabilities and contingent assets.

The international financial reporting standard develops the initial valuation of the lease liability as follows:

On the starting date, the lessee will account the lease liability at the present value of the lease payments that are not paid on that date.

Lease payments shall be discounted using the interest rate implicit in the lease if that rate can be readily determined. If it cannot be readily determined, the lessee shall use the incremental interest rate of the lessee's indebtedness.

On the commencement date, the lease payments included in the valuation of the lease liability will comprise the following payments for the right to use the underlying asset during the lease term that have not been paid on that date:

a) fixed payments (including essentially fixed payments, as described in paragraph B42), less lease incentives receivable.

b) variable lease payments that depend on an index or a rate, initially valued at the index or rate on the commencement date (as described in paragraph 28).

c) the amounts the lessee is expected to pay for residual value guarantees.

d) the exercise price of a call option if the lessee is reasonably certain that it will exercise that option (which will be assessed in light of the factors described in paragraphs B37 - B40), and

e) the payment of penalties for termination of the lease if the term of the lease reflects the exercise by the lessee of the option to terminate the lease.

Variable lease payments that depend on an index or a rate, as described in paragraph 27, letter (b), will include, for example, payments linked to a consumer price index, payments linked to a rate of benchmark interest (e.g., LIBOR) or payments that vary as a result of changes in market rental prices.

Finally, it is important to mention that Article 7 of the Leasing Law provides that the accounting records of individuals, legal entities, autonomous patrimonies or entities that carry out leasing activities, must reflect all operations of leasing, as well as those derived from said acts. In any case, the lessors must keep their accounting in accordance with the International Financial Reporting Standards or the International Financial Reporting Standards for Small and Medium Enterprises (SMEs), for the preparation and presentation of Financial Statements in Guatemala in accordance with the provisions in this law.

Article 46 of the aforementioned Leasing Law establishes that, in everything not regulated in this, the Guatemalan Commercial Code and applicable commercial laws, Law of Movable Guarantees, Book I of the Updating Law are applied in a supplementary manner. Tax, Value Added Tax Law, Civil Code, Law Against Money Laundering and other assets, which, according to this article, must be interpreted in congruence with the principles that govern the Leasing Law.

4. THE LEASING AND ITS TAX TREATMENT

Leasing contract

In Guatemala, the Leasing Law has been recently approved, and said law has been under study for a long time and was cause for expectation, both for the entities that carry out this type of operations, and for the Tax Administration that has a collection interest on the income generated by the lessor entities and the effects that such contract entails for the lessee.

The law makes the difference between Financial Leasing and Operational Leasing, as two different contracts. Therefore, it mentions that a subject can engage in operations related to one or the other contract, or both contracts.

As for the subjects involved, it establishes that both individuals, legal entities and entities of legal imputation that can perform these operations can carry out this contract in accordance with Guatemalan legislation. Thus, a microfinance institution, a savings and credit cooperative, a bank or an individual, may carry out leasing operations on a regular or isolated basis.

With respect to leasing, the law regulates that the rent to be paid is an amount agreed by the parties, which cannot be divided for purposes of the contract. Thus, the lessor assumes the obligation to pay such rent and the amount invoiced will be subject to Value Added Tax and Income Tax, with specific rules to be applied by the lessor for the determination of the gross rent.

In relation to the amount to be paid in case the purchase option is exercised, Article 20 of the Leasing Law establishes that the lessee acquires the ownership of the goods through the exercise of this option once he pays the value that the parties have agreed, that represent the value of the sale. In the case of real estate leasing, the residual value is the value with respect to which the tax on the sale is paid. In the event that the residual value is less than the value that said asset has in tax registration, the latter is taken as the value of the asset for the sole purpose of its registration for such value in the Property Registry and in the corresponding municipal cadastre.

Likewise, article 20 of the Law establishes that, if the property object of leasing was previously transmitted and, by virtue of said transmission, either by sale, donation, exchange and other, the Value Added Tax was taxed, the exercise of the purchase option is subject to the Stamp Duty, which is calculated on the residual value.

An analysis of the provisions of the Leasing Law shows some situations that could cause different treatments between the regulations of the Leasing Law and the Value Added Tax Law and the Income Tax Law, as follows:

- In the case of real estate leasing, the residual value is the value with respect to which the tax on the sale is paid. In the event that the residual value is less than the value that said asset has in tax registration, the latter is taken as the value of the asset for the sole purpose of its registration for such value in the Property Registry and in the corresponding municipal cadastre. What happens with this provision contained in the Leasing Law is that the real estate value will be undervalued, the sale value will be below its fair value and the value at which it is registered in the Property Registry will not be its real value affecting for purposes of the payment of the Single Property Tax and for the payment of the Solidarity Tax, if the taxable base to be used by taxpayers in case of being obliged is net assets.

- The Value Added Tax Law establishes as affected the first purchase, sale or exchange of real estate, therefore, if an asset had been previously transmitted by donation, without having been subject to sale, despite having paid for the donation The Value Added Tax that the law establishes, at the time the lessee exercises the purchase option, he must pay this tax and not the Tax on Tax Stamps as the Leasing Law regulates, which causes a contradiction between both laws, making it difficult for the taxpayer to comply with the tax obligation and for the control and collection of the corresponding tax by the Tax Administration.

- Article 25 of the Leasing Law establishes that, if the lessor assigns the credit rights that correspond to him, by virtue of one or more leasing contracts, this assignment is exempt from the payment of any tax because it is an assignment of credit rights and is governed by the provisions of the discount contract and applicable law. Indicating in its last paragraph that, for these purposes, leasing contracts have the same treatment as credit titles.

  From the foregoing, it is necessary to mention that, regarding the Value Added Tax, article 26 of the Law of Factoring and Discount Contracts, establishes that the **provisions referred to in numeral 6 of article 7 of the Value Added Tax Law will be applicable to the assignment of credit rights made by the debtor in favor of the discounter, by virtue of the factoring contract or discount contract** regulated in this, as well as the assignment of collateral rights, and when considering what regulates this last article, **the exemption established is specific for this case, to the credit instruments**, *not to the generality of the documents that incorporate credit rights*, and by virtue of which these are considered as movable property and that the contract factoring and discount is considered a sale. It is estimated that the transfer of ownership of credit rights that do not weigh on credit titles that are not classified as such, in accordance with the provisions of the Commercial Code in articles 385 and 386, are not exempt and must pay the Added Value tax at the time of the transfer or assignment of said assets.

- Article 35 establishes that the lessor must record the assets held under lease in the balance sheet and present them as an account receivable amortizable over the term of the lease. The lessor must invoice the rent or installment agreed in the contract and calculate the Value Added Tax on the total invoiced. (The VAT incidence for the tax authorities is positive.) In this regard, it is important to comment that the technical standard related to accounting, indicates that the lessor must account for the underlying assets as a collection right, calculated at the present value of the lease payments, as well as the residual value, calculated at the present value of any residual value accrued by the lessor, with a different treatment given to accounts receivable, therefore, it must be clear when making the accounting entries and the effect that this may produce.

- Another important effect that must be mentioned regarding what is established in article 36 of the Law in question is what is regulated in literal c., which mentions that, in those cases that the lessor decides to put the returned or recovered property up for sale, it must be treated as an inventory in extraordinary assets until its sale, and any gain or loss that is generated in this operation is treated as profit or loss from normal operation of the lessor's line of business. This provision generates a different treatment than the one regulated in the Tax Update Law, which establishes that when the line of business is not to trade with real estate, the gain on the sale of real estate must be declared separately as a capital gain, if it is treated as inventory, the cost that the lessor will register will be the one it has in the accounting and the value of the sale the residual value from where it is concluded that it could not generate any tax.

- Finally, it is considered important to point out that, if the assets are not valued at their fair value or their market value, it may be considered necessary to adjust in the accounting, in order to give transparency to the information reported in them with their respective effects.

Likewise, in the case of real estate, it is expressly established that, in order to respect what is regulated in the corresponding regulations, the total amount declared by the parties will be the value of the real estate for the purposes of paying the Single Property Tax; In the case of movable property, however, the sale will be for the residual value or value of the purchase option (amount on which the tax levied on this transmission is paid).

The regulations related to contracts of this type require that the agreements between the parties be documented in writing, in any form, even electronically. There is no obligation to adopt a specific form, the parties will agree on the form that is most convenient for them, the law only requires that it be documented in writing in order to establish what has been agreed, in the absence of said agreements, the provisions of civil law will be followed and commercial.

Likewise, the law provides for a clear relationship with the Registry of Real Estate Guarantees, in order to avoid hidden encumbrances to third parties. Thus, in the case of leasing of movable property or rights related thereto, such contract must be registered with the Registry of Movable Guarantees, in order to make public the reason why the lessee has possession of said property and thus safeguard the lessor's property rights.

In the case of real estate, the lease must be registered in the General Property Registry.

Therefore, the Leasing Law regulates this contract by applying the following principles:

a. For the lessor, the leased assets, because they are his property, must be included in his balance sheet as assets under financial lease, since their intention is not to keep them if they are not part of an operation;

b. For the lessee, the goods cannot be entered into his assets until they become his property; as long as this occurs, the rents payable are accounts payable;

c. The goods must be amortized during the term of the leasing contract, so that it is not before or after, thus they are amortized when leaving the lessor's accounting;

d. The rents or fees that are paid as leases pay value added tax, which must be established in the corresponding invoice;

e. These rents or fees are deductible for the lessee of his income tax on the final amount that remains after deducting operating expenses;

f. Once the goods become the property of the lessee, the latter may apply the depreciations in accordance with the income tax law.

Article 34 of the Law regulates that, as a result of a leasing contract, interest, price differentials, factoring and other financial charges will accrue, which will be accounted for by the lessor as usual income and by the lessee as deductible expenses, in different items. to the rent or agreed leasing fee. However, when defining this article, the lawmaker forgets that for tax purposes the specific law must be addressed and this does not allow that some costs associated with the leasing contract, regardless of whether these are clearly defined in it, can be declared deductible by the established regulations and by the requirements that must be met for this purpose.

The leasing law in its article 35, establishes that the total amount invoiced for rents or fees less the amortizable amount of the asset, constitute gross income affected for the purposes of Income Tax in the tax period that is accrued. The total amount invoiced will pay Value Added Tax, but will not pay the Income Tax, because when analyzing this provision, this last tax will be paid based on the difference between the aforementioned values, that is, the total amount invoiced must be subtracted the amortized value and this is what will constitute taxable income for the lessor; However, article 31 of the Law establishes that the value of the rents or rental fees agreed in the contract and invoiced by the lessor, are recorded by the lessee as a deductible expense from their gross income for the calculation of Income Tax (PIT) of the corresponding fiscal period, during the term of the contract.

For its part, article 4 numeral 3 of the Tax Update Law, Decree 10-2012 of the Congress of the Republic of Guatemala, recognizes the applicable treatment, for income tax and complementary purposes, to lease contracts, regulating that constitute capital income, the interests or income paid by individuals, legal entities, entities, estates or entities that are residents or have permanent establishments located in the country, derived from:

i. Money deposits;

ii. investing money in financial instruments;

iii. credit operations and contracts, such as the opening of credit, discount, documentary credit or money loans;

iv. the possession of credit titles such as promissory notes, bills of exchange, bonds or debentures or the possession of other securities, in any case, issued physically or through book entries;

v. the price differentials in repurchase agreements, regardless of the name given by the parties, or other income obtained from the transfer of own capital;

vi. financial leasing, factoring, asset securitization;

vii. any type of credit, financing, capital investment or savings operations.

It is important to mention in this context that the tax regulation recognizes financial leasing or leasing as a single type of contract, which will have only one tax treatment.

For its part, article 21 of Decree 10-2012 of the Congress of the Republic of Guatemala, which is related to deductible costs and expenses of the Income Tax, establishes that deductible costs and expenses are considered, provided they are useful, necessary, pertinent or indispensable to produce or preserve the source of taxable income, among others:

Interest, price differentials, financing charges or returns that are paid derived from:

i. Financial instruments;

ii. the opening of credit, documentary credit or money loans;

iii. Credit Issue of Securities;

iv. Repo transactions 4;

v. financial leasing; factoring, asset securitization or any type of credit or financing operations.

All interest to be deductible must originate from operations that generate taxable income to the taxpayer and its deduction is established in accordance with the article referring to the limitation of the interest deduction established in this book.

Considering that the financial leasing or leasing contract is a type of leasing contract, any type of contract, regardless of its name, that meets the definition of financial leasing or leasing, will be applicable for tax purposes, as established in numeral 3 of article four of the cited legal body.

Although the law does not express it clearly, the financial lease must comply with the requirement that in economic essence it complies with the definition of a financial lease contract as established by the accounting technique. Similarly, in order to refer to accounting, the indications are established in the tax regulation.

Considering the above, it should be noted that IFRS 16 establishes that: "A lease will be classified as financial when it substantially transfers all the risks and benefits inherent to the ownership of an underlying asset." Additionally, IFRS 16 establishes, among others, that:

Whether a lease is financial or operational depends on the particularity of the agreement and not on the form of the contract. Scenario models that, specifically or in combination, would regularly lead to classifying a lease as financial are:

(a) The contract stipulates the transfer of ownership of the property to the lessee at the end of the lease term.

(b) The lessee has the option to buy the property (s) obtained in lease at a price that is expected to be lower than the market value at the time the option is exercised.

(c) That the term of the contract covers most of the useful life of the asset even when the transfer of ownership is not completed at the end of the lease.

Consequently, the property must be the property of the leasing company, the right of ownership that it will retain until the lessee exercises the purchase option. Likewise, it should be understood that the cost of the leased asset will be amortized during the term of the contract, generating the respective profit, which will be affected by the Income Tax in any of the categories in this law established, according to the registration made. by the taxpayer obligated at the beginning of their operations.

Therefore, it is possible to understand that only until the purchase option is exercised will there be a transfer of the real right of ownership, generating that this is not a requirement for the legal business to be understood as a financial lease or leasing, in which case which is the obligation to pay the Value Added Tax, by virtue of what is regulated in article 2 numeral 1, 3 numeral 1 and 4 numeral 1, as established by Decree 27-92 of the Congress of the Republic of Guatemala, of the Income Tax, upon materializing a capital gain for the lessor, in accordance with the provisions of 83, 84, 85, 88, 89, and 90 of Book I of Decree 10-2012 of the Congress of the Republic of Guatemala.

Treatment of value added tax

The law levies Value Added Tax on the installments of interest collected, for which the lessor must issue the respective invoices, likewise the transfer of ownership or option to purchase exercised by the lessee at the end of the contract, according to the law, is considered a purchase and sale, an action that originates the obligation to pay this tax, and the notary that executed the respective deed must certify the testimony of the payment made.

Likewise, this law is clear when it indicates which are the generating events and when they materialize and pay the tax, which according to notice, has contradictions with the Leasing Law, by establishing different rules regarding the tax that is generated in the transfer of ownership when the purchase option is exercised and the taxable base on which it must be calculated, although this tax will be charged in the installments paid by the lessee.

Treatment of leasing in income tax

In accordance with article 31 of the Leasing Law, the value of the rents or rental fees agreed in the contract and invoiced by the lessor are recorded by the lessee as a deductible expense from his gross income for the calculation of the taxable income and subsequent determination of the Income Tax to be paid for the corresponding fiscal period, during the term of the contract.

Likewise, article 32 of the aforementioned law establishes that when, as a result of a leasing contract, interest, price differentials, factoring and other financial charges accrue, these are accounted for by the lessor as habitual income and by the lessee as deductible expenses, in items other than the rent or agreed leasing fee.

Although the Leasing Law does not regulate it, it is important to take into consideration that the costs and expenses that a lessee may deduct will be those that according to article 21 of the Income Tax are useful, necessary, pertinent or indispensable to produce or preserve the source of taxable income. In numeral 13) of this article, it is established that the costs and expenses that comply with the legal regulations are deductible from the taxable income in the Regime on Profits from Lucrative Activities provided for in article 19 of the Law, which is not limited to possessing the verification documents of a transaction carried out by the entity.

In this context, it should be noted that, in article 22 of Book I of the Tax Update Law, specifically paragraph 4 establishes that for the costs and expenses incurred by an entity to be deductible, it must comply with the requirement of having the supporting documents and means, understood among others as such as those regulated in literal c), that is, invoices and documents issued abroad.

Additionally, it is important to cite the provisions of article 23 of the referred tax, which regulates that deductible costs and expenses cannot be considered those that have not originated in the business, activity or operation that gives rise to taxed income. Likewise, *costs or expenses not supported by the corresponding legal documentation, or that do not correspond to the tax period that is settled, cannot be considered deductible either*.

What is important is that when recording costs or expenses, the taxpayer or tax responsible considers that, to consider it deductible from their income, they must comply with the requirements established by law, which in summary they are the following:

- That the cost to be deducted is a necessary cost to produce or conserve the source of taxable income.

- That the costs and expenses are useful, necessary, pertinent or indispensable for the development of the operations of the entity and that generate taxable income.

- That the costs are actually incurred,

- That the costs and expenses are duly supported with the corresponding legal documentation.

- That the cost and expense correspond to the tax period that is settled.

- That the documents comply with the requirements established in the Law and Regulations of the Value Added Tax Law.

- That the holder of the deduction has complied with the obligation to withhold and pay the tax set by the law that regulates it.

Conditions without which you cannot deduct the taxable income.

Likewise, the law allows the person in whose name the property is leased, whenever the transfer of ownership has not been carried out, to deduct the fees for depreciation or wear and tear of the property that is being used by the lessee, which according to the accounting technique has caused controversy with the Tax Administration and subject to adjustments of the figures reported in the returns presented by the taxpayer, by virtue of the fact that according to international financial reporting standards, the asset may be derecognized of the accounting records in accordance with the specifications of the contract, every time all the risks involved in the possession of the property have been transmitted, even if it is not owned by the lessee but by the lessor.

Regarding the tax costs derived from the acquisition of the asset, insurance and guarantees required by the leasing company.

The Tax Administration, on different occasions, has submitted to analysis what is related to the costs incurred by the lessee, as mentioned previously, as well as the obligations that the lessee assumes and that are assigned by the leasing company.

As there is no rule that regulates these aspects, it is necessary to resort to the definition contained in article 25 of the Tax Law Update, which regulates that the depreciations and amortizations whose deduction is allowed are those that correspond to fixed assets and intangible assets that are the property of the taxpayer or the authorized entity during the term of the contract, a right of ownership that will be retained until the lessee exercises the acquisition option and pays its value.

As the leasing company is the owner of the property, until the lessee makes use of the purchase option, this will be the party called to assume the tax and notarial obligations that are caused at the time of the acquisition of the property.

As a general rule and practice, it is the lessee who must be responsible for the payment of the respective taxes and even the charges for valuation that the real estate may suffer, in this case, however, it is to clarify that, with respect to the single tax on real estate, commonly called IUSI in Guatemala or any other cost directly linked to property ownership, the taxable person is the owner or possessor of it.

Between these two subjects a joint and several obligations is recognized for the payment of tax obligations. So, in that case the lessee is simply a user who obtains a benefit of use, but not his possession or ownership.

Considering the above and the contractual clauses in which the parties express their will, it is admitted that the parties assume obligations related to tax costs at the time of the acquisition of the property by the lessee, which means that the Tax Administration will not accept certain deductions, which, although it is true, fall on the lessee for the right to use the property, even when these are stipulated in the contract and because the property is not owned by the lessee, the law will not accept as admissible for its use the costs related to the right to use the assets obtained in lease, although they may be considered linked to the income-generating activity and although the Leasing Law stipulates that they are deductible.

Among the costs associated with the use of the property, we can mention the obligation to contract insurance on the part of the lessee, by virtue of the risks associated with the property obtained in lease, which could entail a significant amount. We can also mentioned among the related costs, maintenance services, updates or other costs, whose purpose is to keep the asset in perfect state of maintenance, whether the lessee exercises the purchase option or not.

The lessee in most cases will be obliged to contract other expenses, since, although the owner is the leasing company, and it has a direct interest in ensuring that their investment is insured, it must be the lessee who takes charge of these obligations, since the exercise of the use and enjoyment of the goods fully justifies that they must assume those costs.

Due to the aforementioned, it is considered pertinent that, if the lessee can demonstrate the payment of the costs related to the lease, it may affect the determination of the taxable income of the Income Tax, on which the tax rate will be applied, in relation to all the costs associated with the contract, that is, depreciation, maintenance, insurance and interest, among others, for the purposes of paying the tax, by virtue of which they generate taxed income and are pertinent, necessary and indispensable for the development of their normal operations.

It is also important to point out that, for the Tax Administration to accept the change in the amortization method in the sense that it will not attend to a straight-line method or that is directly related to the useful life of the asset, but rather to the term for which it was determined the lease, the entity will be obliged to present a letter or memorial requesting a change in the depreciation or amortization method, an example of which is presented in Annex 2 of this study.

5. CONCLUSIONS

1. Currently there is a conflict between the Leasing Law and the laws that specifically define the tax-generating events, such as the sale and purchase, the transfer of rights, capital gains and surcharges that are contemplated in the lease contracts.

2. In accordance with Book I of Decree 10-2012, in relation to Income Tax, the Tax Administration does not accept as deductible the costs that the lessee must assume for the goods that he receives in lease, however, the Law of Leasing establishes that all these costs are deductible from the gross income for the lessees, a situation that lacks legal certainty regarding the application of the law, as there is a contradiction between the two.

3. Consistent with the principles of justice and tax equity established with mandatory observance, if the lessee is obliged to assume the ordinary, extraordinary and necessary costs and expenses for the conservation, use and for all those that are generated on the occasion of the possession of the property, associated with the lease, and these allow to generate taxable income and comply with the characteristics established by law, that is, if they are pertinent, necessary and indispensable in the ordinary activity, their deductibility is appropriate once they are duly verified.

4. By regulating the Leasing Law, which, when exercising the purchase option in the case of real estate, the residual value is for which the tax levied on the sale is paid, the collection of the Single Property Tax will be seriously affected.

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Guatemala (2012) Decreto

Número 10-2012, Ley de Actualización Tributaria

7. ANNEXES

Annex 1
PROPOSED LEASING CONTRACT

In…………….., on ….………………..........., 20…. MEETING, On the one hand, ……………………………………….. in representation and in its capacity as …………………….…. with address at ……………….….., street ……….……….. No. …… with Tax Identification Number ………………….…, (the lessor) And on the other …………………………… on behalf and in their capacity as ………….….. ……, with address at ………………….. ..., street ………….……. No …. With Tax Identification Number ……………………. (Hereinafter, the lessee).

Both parties mutually recognize each other with sufficient legal capacity to intervene in this act, as well as the character and representation with which they respectively do so and, to that end, EXPOSE the lessor is the owner of the (good) designated in this contract and is professionally dedicated to the leasing of these (hereinafter, leasing). For the provision of its services, it has the organizational and technical means necessary for its performance. That the lessee is interested in receiving from the lessor the provision of said services under the terms and conditions designated in this contract, leasing the property described in Annex I (hereinafter, the property), with the option to purchase these once the term of this contract has expired, and its residual value has been paid. That the lessor has an interest in assigning the use and enjoyment of its property to the lessee, basing said legal relationship on the financial leasing model (hereinafter, leasing). Being the supplier of the good (hereinafter the supplier) 2 In accordance with the above, both parties by mutual agreement subscribe this LEASING CONTRACT, in accordance with the following, CLAUSES **I. PURPOSE** The purpose of this contract is to regulate the relationship between the parties when establishing the terms of the lease with purchase option and in which the lessee has an interest to use it in (INDICATE THE PURPOSE FOR WHICH THE GOOD IS TO BE USED), in exchange for an economic consideration, as established in the terms of this contract, the option to purchase said computer assets being open to the lessee once this contract has ended, the purchase option is exercised after the payment of their residual value. **II. OBLIGATIONS OF THE LESSOR** The lessor guarantees that he is the sole and exclusive owner of the property, all the complements that could be leased are original, being exempt from charges or encumbrances of any nature or kind. The lessor undertakes to deliver the property in perfect condition and all its accessories, documentation, as well as all those defined in Annex I of this contract. The lessor grants the lessee the right to purchase the property once this contract ends. At this time, the lessee may choose between the return of the property (if this were possible) or its acquisition, after the payment of its residual value. The lessor will transfer ownership of the property to the lessee under the conditions established in this contract in the event that the latter decides to exercise the purchase option after the period established in this contract has elapsed and provided that no default has been incurred. of any of the agreed quotas. **III. OBLIGATIONS OF THE LESSEE** The lessee undertakes to comply with the economic conditions established in this contract as consideration for the service provided by the lessor. The lessee will allow the lessor access at all times to provide the service as many times as necessary for the verification and verification of compliance with this contract, as well as for the transfer, where appropriate, of the property at the end of this contract. 4 the lessee has the right to exercise his right to purchase option provided that there has been no non-payment of the installments at his charge. For the possible exercise of said purchase option, the parties establish the amount of ……Q (…… quetzals) as residual value that will be effective at the time of exercising the option. The lessee will provide the lessor with all the information necessary for the latter to provide his services, exempting him from all responsibility in the event of delays caused by the lessee. The lessee undertakes to respect and protect the property, which belongs to and is the property of the lessor throughout the duration of this contract, establishing for these the necessary organizational and technical measures, and not to assign, sublet, facilitate or allow access by any means to any third party without the prior express written consent of the lessor. In no case will the lessee make an abusive use, which objectively will facilitate its deterioration or that for any circumstance would be different from the typical purposes described in this lease. The lessee is exclusively responsible for all damages, losses or liabilities that may occur or derive from said activities. The lessor is solely responsible for modifying the property, so the lessee will refrain from carrying out any act of modifying them without the express written consent of the lessor. The lessee agrees to pack and leave the property ready for transfer at the time of termination of this contract in the event of not wanting to pay the residual fee for the equipment necessary for its acquisition, allowing the lessor to access the facilities in order to allow the transfer of the vehicle. **IV. DURATION AND FINANCIAL CONDITIONS** This contract will enter into force on the same day it is signed. The duration of this will be ………. months except termination of the contract for any of the causes established by law or in this contract, or by the reliable and written request of any of the parties with.… days in advance. 5 the price to be paid by the lessee as payment for the provision of the service provided is equivalent to ………….. Q (……………………… quetzals) per month, which must be paid on the first day of the calendar month. The subscription price does not include VAT. Said amount will be paid by bank deposit in the account ………………………………… of the entity ………………………………………….. **V. CONFIDENTIALITY AND DATA PROTECTIO**N All documents, information, agreements, contracts and pre-contracts, including e-mails and all types of communications to carry out this contract, as well as any knowledge or information that may be had about either of the two parties or their activities are completely confidential information, so it must be treated with the most absolute of secrets, even when the contractual relationship has expired. In compliance with the provisions of Decree 57-2008 Law on Access to Public Information, which establishes the Protection of Personal Data, we inform you that your personal data will be incorporated and will be processed in the files of both parties, in order to be able to maintain this contractual relationship. We inform of the possibility of exercising rights of access, rectification, cancellation and opposition to your personal data by requesting it in writing along with a photocopy of his PID (Personal Identification Document) at the following address indicated in the header of this contract. **VI. OWNERSHIP OF THE ASSETS** In recognition of the ownership that the lessor party is entitled to over the assets that are the subject of this contract, the lessee undertakes to proclaim that these assets are the property of the Leasing Company to whom it may proceed, in all kinds of cases., mainly in the seizure by a third party or inclusion of these in the mass on the occasion of a universal trial or any other of identical nature. In the same way, the lessee agrees to notify the Leasing Company of any event that may put at risk the property that corresponds to him on the goods that are the object of this document. **VII. RESPONSIBILITY** The lessee has chosen the goods to be leased, having determined their technical characteristics, as well as the supplier. Such assets have been acquired by the Leasing Company with the sole purpose of assigning their use to the lessee, who agrees with all the procedures carried out. The lessee is not responsible for the delay in the delivery of the property for reasons not attributable to it, and especially those due to delays attributable to the lessor. The lessor is the legitimate owner of the property that is the object of this contract, being able to guarantee that there is no charge or encumbrance of any kind on it, and that it works correctly at the time of delivery. The lessor cannot be liable for direct or indirect damages, for consequential damage or loss of earnings, work interruption, breakdown, failure or losses, or that are due to a major cause, this being understood as that which is a consequence of facts or circumstances that are beyond its control, including, but not limited to, governmental action, fire, flood, insurrection, earthquake, technical failure, riot, explosion, embargo, legal or illegal strike, shortage of personnel or material, interruption of transport of any type, delay in work, or any other circumstance beyond the control, that affects the services in any way. The lessee undertakes to insure the property that is the object of this contract throughout the term of this contract, paying the corresponding premium to his account. In the policy that he subscribes, the condition of user by the lessee and the condition of beneficiary of the lessor will be mentioned. **VIII. COMMUNICATIONS** The parties are obliged to communicate all the information that may be necessary for the proper development of the service, any change of address or contact address must be communicated to the other party in writing at least …… business days in advance. All communication between the parties regarding this contract will be made in writing or by telephone. For the purposes of communications and / or notifications, the parties designate the contact persons in the Annex. **IX. ASSIGNMENT OF RIGHTS** The parties may not assign, alienate or subrogate in any way their contractual position in favor of any third party without the express written authorization of the other party. Said authorization will not be needed if the contractual assignment occurs as a result of a merger, reorganization or other operation of the transmission to another legal entity of all the assets of the opposing party. **X. TERMINATION OF THE CONTRACT** Failure by any of the parties to comply with any of the obligations that this contract imposes will empower the opposing party to immediately terminate this contract or demand its fulfillment, without prejudice to the compensation for damages that proceed in both cases. However, this contract will be terminated, in addition to the general causes of Law, for the following: For the breach of any of the clauses of this contract. In this case, it will not be necessary to give prior notice, and in no case pay any compensation amount by the party that terminated the contract. For the duration of this. For being declared in a situation of suspension of payments, bankruptcy or bankruptcy any of the parties. For the non-payment of any of the monthly installments. Once the contract is terminated for cause b) of this clause and if the lessee is up to date with his obligations, he may choose to: Grant a new financial lease contract, in which the amount of the residual value will serve as the basis for calculating the installments. Acquire ownership of the asset for the amount of the agreed residual value. 8 the option must be made reliably within 30 days prior to the expiration of the contract. Once said period has elapsed without having exercised this right, it will be understood that the lessee chooses to return, at the end of the contract term, the goods that are the object of this to the lessor in the place that he designates for that purpose, the lessee being responsible for the restitution expenses. and without more wear than normal as a result of use. **XI. INTEGRITY AND SAFEGUARD CLAUSE** All the clauses or ends of this contract must be interpreted independently and autonomously, the rest of the stipulations not being affected in the event that one of them has been declared void by a final judicial sentence. The contracting parties agree to replace the clause or clauses affected by another or others that have the corresponding effects for the purposes pursued by the parties in this contract. **XII. COMMERCIAL RELATIONSHIP BETWEEN THE PARTIES** In no case will the signing of this document and its annexes or the provision of the services detailed be presumed the existence of any labor relationship between the personnel of both parties, with only a framework collaboration agreement between both entities. All the lessor's staff is subject exclusively to the lessor's organizational address and will have the means provided by it. **XIII. ENTRY INTO FORCE** This contract enters into force, with all the force to bind the parties, as of the date it is signed. Both parties agree that this contract has all its legal effects from the signing of this contract. **XIV. JURISDICTION** This contract will be governed by the law in force in Guatemala and for any controversy that may arise between the parties regarding its validity, execution, compliance or resolution, in whole or in part, the parties expressly submit to the Jurisdiction of the Courts and Courts of …………………………, expressly waiving any other jurisdiction that may correspond to them. And in proof of conformity, both parties read this document, which is issued in duplicate, and finding it as they sign it in the place and on the date indicated in the heading.

Annex 2
PROPOSED MEMORIAL REQUEST FOR CHANGE OF DEPRECIATION METHOD

Mr.
Inspector General, National Tax Administration.
Superintendency of Tax Administration
Office:

Subject: Request to change the depreciation method for property, plant and equipment assets owned by the entity Assets en Leasing, Inc. Society.

Sincerely, I __________________________________, of legal age, married, Guatemalan, of this address, acting as legal representative of the entity Goods in Leasing, Inc., with tax identification number_______________, indicating a place to receive notifications in ____, Guatemala City , I appear before this institution, and;

In accordance with article 28 of the Political Constitution of the Republic, articles 21 "A" numerals 4 and 5, and 102 of Decree 6-91 of the Congress of the Republic of Guatemala, articles 22, 25, 26 and 27 of Book I of the Decree 10-2012 of the Congress of the Republic of Guatemala, Tax Law Update, Income Tax.

Due to the right to assist my client as a taxpayer and based on the articles cited in the previous paragraph, I proceed to expose the reasons for this memorial and request authorization for the application of a different depreciation method established by the Income Tax, for which I express the following:

EXPOSE:

Article 25 of the Tax Update Law establishes that the depreciations and amortizations whose deduction this book admits, *are those that correspond to be carried out on fixed and intangible assets, property of the taxpayer* and that are used in lucrative activities that generate taxed income.

For its part, Article 27 of the aforementioned legal authority establishes that, at the request of taxpayers, when they demonstrate documentary evidence that the straight-line method is not adequate, due to the characteristics, intensity of use and other special conditions of the depreciable assets used. In the activity, the Tax Administration may authorize other methods and that once a depreciation method has been adopted or authorized for a certain category or group of assets, it applies for the future and cannot be changed without prior authorization from the Tax Administration.

Likewise, article 21 numeral 14, in the case of leased goods, requires that certain costs be deducted during the term of the lease, in successive and equal installments, establishing as an exception, in the case of construction on leased land, when it has been agreed in the contract that the lessees will be the owners of the construction, *who must record them as fixed assets, for depreciation purposes for the term of the contract*.

In relation to the above, it is important to mention that, under the premise of the independence of the will, there has been a need to create a large number of special or atypical contracts such as Leasing, which manifest the needs adjusted to the commercial activity, it is through all these contracts that economic needs are met for each of the activities carried out by companies for the improvement of production and trade.

It is important to note that financial leasing has emerged as an expeditious financing alternative, which adapts to the needs of capital goods lessees, it changes the role of ownership of productive assets, to give relevance to their economic use, exempts the lessee from the risks inherent to the property, that is, deterioration, loss, theft or obsolescence, although it does not free him from all the risks associated with the assets he uses.

Likewise, the contract analyzed here allows the delivery of an asset to the lessee, who leases it with the purpose of using it in their income-generating activity, and if they deem it convenient, to acquire it at the end of the agreement.

As already indicated, when the lease contract expires and the lessee exercises the purchase option, the ownership of the property and the total risks that the property entails are transferred, in which case the property is derecognized in the records of the lessor and registered as the property, plant and equipment of the lessee.

In this regard and giving an example of such a situation with its corresponding effect, if the case were that a lease contract for a property, plant and equipment, whose depreciation percentage according to article 28 of Book I of the Tax Update Law, Income Tax, would be of 33.33%, which implies a 3-year depreciation period, despite the fact that *the asset, or the mass of leased assets has been leased for a period of 18 months, the assets that have been leased, they would transfer ownership at the end of that period, leaving 18 months pending, in which it would not be possible to record any depreciation, since the premise established in article 25 of the same legal body would cease to be fulfilled, which as already aforementioned, regulates that the depreciations and amortizations whose deduction this book admits, are those that correspond to carry out on fixed and intangible assets,* ***property of the taxpayer*** and that s are used in lucrative activities that generate taxed income in addition to the fact that such assets would not generate taxed income, also ceasing to comply with what is established in article 22 of the same law, by indicating that the deductions made by the taxpayer of their income are appropriate Gross deductible costs and expenses that are useful, necessary, pertinent or indispensable to produce or generate taxed income or that are necessary to conserve their source of production and for those required to keep complete accounts, which are duly accounted for.

Due to the aforementioned, if an asset by virtue of the terms of the leasing contract concluded ceases to be the property of the taxpayer, to generate taxed income and to be accounted for in the records, from such, it is no longer appropriate to deduct any depreciation amount, reason for which the depreciation that corresponds to register and the most appropriate thing would be to do it for the term of the contract, not during the time and percentages established by law.

In addition to the aforementioned, it should be mentioned that many of the companies engaged in the leasing business, being their main activity, have a significant amount of insurance expenses, which are paid by virtue of owning the risks inherent to the ownership of the assets shown in the Statement of Financial Position, insurance that is contracted for the term agreed in the contract for each leased asset owned by the entity.

It is necessary to mention article 25 of Decree 10-2012, which establishes that as a general rule *when for any circumstance the depreciation or amortization fee of an asset is not deducted in an annual settlement period or is made for a value lower than the corresponding one, the taxpayer does not have the right to deduct such quota in subsequent tax periods*.

By virtue of what has been indicated, I ________________________, appear as legal representative of the entity Bienes en Leasing, Sociedad Anónima, with TIN: ___________ which I certify with my appointment of legal representative duly registered with the Commercial Registry on (date) ..., which is attached to this memorial, to request the following:

1. That the present memorandum of request to change the depreciation method established in the article is admitted and processed.

2. That the place to receive notifications is ____________________, Guatemala City of the Department of Guatemala.

3. That the quality with which I act is considered accredited.

4. That the evidence offered and provided in this memorial be considered presented[1].

5. That the corresponding resolution of merit be issued in a timely manner, authorizing the change in the depreciation method that must be applied by virtue of the operations of the entity Tecno Leasing, S. A.

1 An annex must be attached with the documents that support the arguments made in the memorial.

THE TAX INCORPORATION REGIME

and its tax context in Mexico

José Manuel **Osorio Atondo**
Víctor Manuel **Ramírez Leyva**

SYNOPSIS

This study presents the tax context of the tax incorporation regime in Mexico, a taxation modality established in the 2014 tax reform in correlation to the behavior of the taxpayer registry as of the fiscal year 2020, as well as the collection and exemption in the three most important taxes of the Mexican tax system, represented by the Income Tax, the Value Added Tax and the Special Tax on Products and Services, supporting the analysis with data issued by the Tax Administration Service from 2014 to 2019.

Keywords: Tax Incorporation Regime, Collection, Exemption, Fiscal Incentive.

CONTENT

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INTRODUCTION

The informal economy, low tax collection, tax evasion and fraud have been central themes in different analyses of economies worldwide; a scenario where States with the support of their fiscal policy have implemented in recent years a series of tax legal reforms with the inclusion of technological strategies for the expansion of the taxpayer base, as well as for the detection of possible illicit acts that affect the low revenue collection in public finances.

For the case that concerns us, according to the data issued by the National Institute of Statistics and Geography (INEGI), informality constitutes approximately a quarter of the national economy in Mexico, since from 2003 to 2019 it has symbolized over 22% of the Gross Domestic Product (GDP), a scenario that affects the low tax collection in Mexico compared to other countries.

Precisely in this regard, the Organization for Economic Cooperation and Development (OECD), shows that Mexico is the fifth country that collects the least in Latin America (LA), only above Guatemala, Dominican Republic, Paraguay, and Panama; receiving only 16.1 percent in proportion to GDP in taxes, being below the average of LA and economies that make up the OECD to obtain 23.1 and 33.1% respectively.

For this reason and among other factors, in recent years there have been structural changes in tax laws in Mexico, such as the implementation of electronic means for tax purposes (Osorio, 2017), the expansion of the powers of the tax authorities and the creation of taxation modalities among other legal reforms.

In this order and direction, this study presents the tax context of one of the tax modalities established in the tax reform that came into force from January 2014 and entitled “Tax Incorporation Regime” (In Spanish: RIF, *Régimen de incorporación fiscal*), in correlation to the most important contributions of the Mexican tax system.

1. ANTECEDENTS

The genesis of the RIF is expressed in the Official Journal of the Federation on December 11, 2013, decree in which some provisions of the Law of Value Added Tax (VAT Law), the Law on the Special Tax on Production and Services (LIEPS) are modified and the issuance of the new Law on Income Tax (LISR), as well as the repeal of the income Tax Act Business Single Rate (LIETU) and the Law on the Tax on Cash Deposits (LIDE). These reforms entered into force of on the 1st of January 2014 (DOF, 2013).

In the explanatory memorandum, it was stated that one of the main reasons for such modifications to the aforementioned tax laws was the search to increase the productivity of all sectors of the population, improve welfare, reduce poverty in an accelerated manner and reduce the phenomenon of informality; facilitating compliance with the payment of taxes by small businesses in order to incorporate them into the formal tax sphere (Presidency of the Republic, 2013: LXV).

With such a modification, the Intermediate Regime(IR) and the Regime of Small Taxpayers (REPECOS) was abolished in 2014, the new optional mode of IT taxation becoming instituted in the LIT for the individuals who perform business activities, sale of goods and provision of services that do not require a professional title, and whose income would not have exceeded two million in the fiscal year immediately preceding, this according to what is established in article 111 of this normative (Carrasco, 2017:504).

One of the main characteristics of the RIF aimed at the expansion or incorporation into the taxpayer base of small and medium-sized enterprises has been since its creation what is based on the same numeral mentioned above of the LIT and which literally indicates: “*The tax determined may be reduced according to the percentages and according to the number of years they have been taxed under the regime provided for in this Section, as follows:*”

Table 1: Percentages of reduction of SRI in the RIF

PERCENTAGES OF REDUCTION OF SRI IN THE RIF										
Year	1	2	3	4	5	6	7	8	9	10
For the presentation of income information, expenditures, and suppliers:	100%	90%	80%	70%	60%	50%	40%	30%	20%	10%

Source: Article 111 of the Income Tax Act.

Based on the above stated in the LISR, taxpayers who choose to pay tax in the RIF are granted a gradual exemption of ten fiscal years, so that during the first year of their preponderant activity they have 100% exemption, gradually decreasing until they meet the indicated time and pay 100% of the Income Tax (ISR) that results once they reach fiscal maturity and stability to transition to another mode of taxation according to the tax law under study.

It should be noted that in the state of the art, there are theoretical studies that have addressed this form of taxation, for example, examinations of its importance as a measure of economic development in Mexico and its possible impacts (Gómez, 2015), positions on the effects that the implementation of the RIF has had on the taxpayers involved (Espinoza and Vera, 2015); as well as empirical analyses that correlate its implementation in micro, small and medium-sized enterprises (López, González and Rivera, 2014), in analogy to its effectiveness in the collection of informality (Tejero and Nic, s. f.), on their incidence on IT (Osorio, Huesca and Terán, 2017) and quantitative illustration regarding their collection and fiscal incentive in the main taxes of the Mexican tax system (Osorio, Huesca and Terán, 2017b), as well as works that explain practical tax cases on the determination of the contributions payable by RIF taxpayers, manuals and procedures for filing their bimonthly returns in accordance with the current law (Victorio, 2014; Avila et al, 2016; Sanchez, 2020; and Luna, 2020), among others.

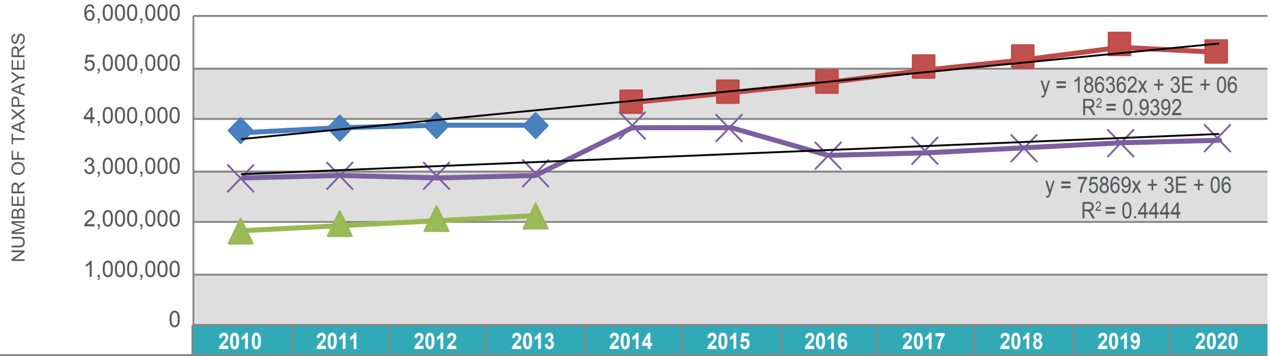
2. CONTEXT OF THE TAXPAYER REGISTRY, COLLECTION AND TAX INCENTIVE

Once the RIF entered into force, from the first of January 2014, taxpayers registered as REPECOS and IR according to the legislation in force until December 31, 2013, had the option of migrating to the RIF, as long as their annual income for such fiscal year were not superior to 2 million pesos; in the opposite case, they had to become taxed in the Regime of Business and Professional (RAEP) according to the same LISR.

According to the data issued by the Tax Administration Service (SAT) in its register of taxpayers, it was detected that in correspondence to the sum of individuals registered in the three forms of taxation at the end of 2013, a decrease of 8.8% of taxable persons compared to the fiscal year 2014 that contemplates the two regimes in force in that period.

Likewise, the data presented show that from 2014 to 2020 the same number of registered taxpayers has not been obtained compared to 2013, a period in which the three types of taxation (REPECOS, RI, and RAEP) existed, approaching the 2019 fiscal year with a single difference of 203 fewer taxpayers (RIF and RAEP). Similarly, by applying a simple linear regression to the data obtained from the RIF and RAEP, an approximately rectilinear behavior of the RIF until the year 2019 is shown, as the number of taxpayers in this modality increases in each fiscal year, with a decrease in the year 2020, which suggests the closure of small businesses due to the economic situation caused by COVID-19 in Mexico.

Graph 1. Registry of the Tax Incorporation Regime in Mexico. 2014-2020



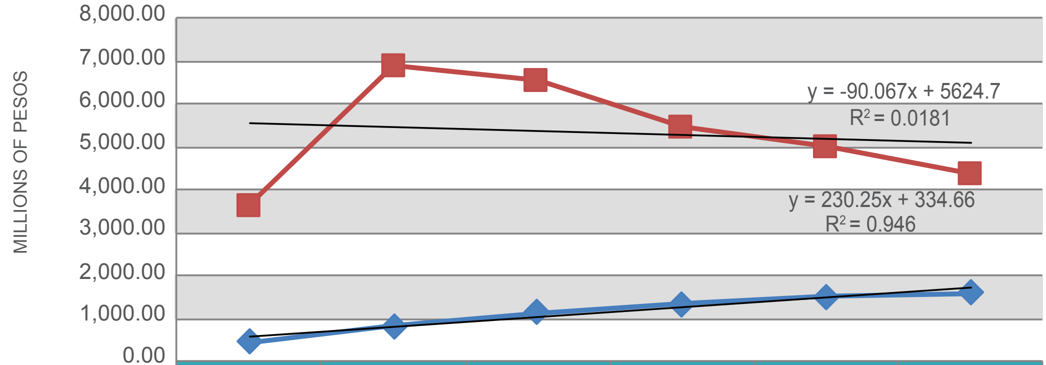
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
REPECOS	3,756,266	3,821,241	3,869,684	3,886,294							
RIF					4,309,106	4,507,015	4,708,228	4,975,385	5,177,393	5,411,974	5,288,789
INTERMEDIATE	1,839,742	1,949,097	5,047,593	2,132,940							
COMP. AND PROF.	2,857,123	2,898,544	2,889,678	2,928,604	3,850,198	3,829,058	3,301,503	3,364,147	3,439,796	3,535,661	3,622,087

Source: Authors' own creation with data issued by the SAT.

Based on the characteristics of the predominant economic activity carried out by the taxpayer in the RIF, in addition to being subject to the payment of ISR, the taxpayer may be obliged to pay Value Added Tax (VAT) and the Special Tax on Production and Services (IEPS), obtaining exemptions for the latter two taxes, as stipulated in the corresponding legal tax regulations, which are also reduced temporarily over a period of 10 years, as the case may be.

According to the data issued by the SAT in relation to the collection and tax incentive of taxpayers in the RIF, in the sum of IT, VAT and IEPS, through simple linear regression, there is a gradual increase in the collection and a downward behavior of the exemption granted to such taxpayers in the fiscal years from 2014 to 2019 for such contributions, being the fiscal year 2019 the most representative in proportional terms by reflecting about 27% of the sum of the collection and incentive generated.

Graph 2. **IT, VAT, IEPS Collection and Tax incentive in the RIF from 2014 to 2019**



	2014	2015	2016	2017	2018	2019
RIF total collection	433.27	831.34	1,130.77	1,339.03	1,516.65	1,592.17
RIF Total stimulus	3,631.63	6,891.04	6,538.64	5,446.35	4,987.09	4,361.99

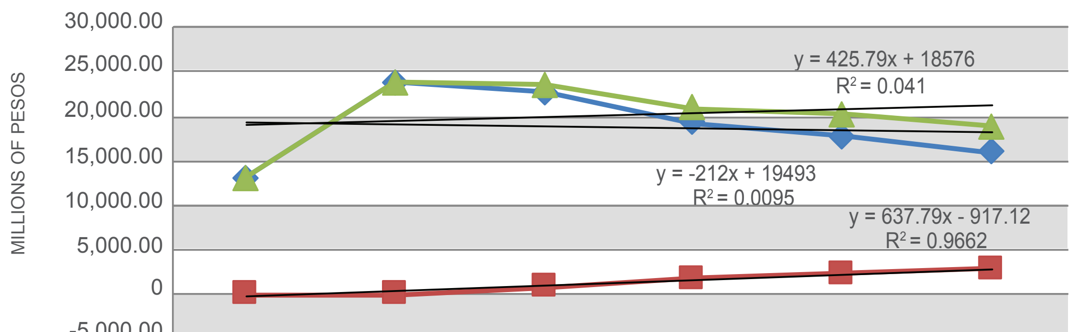
Source: Authors' own creation with data issued by the SAT.

3. INCOME TAX CONTEXT

The IT is the longest-lived tax of the Mexican tax system, named in its genesis as the centennial tax and implemented in 1921; direct tax that has gone through a process of modifications over time (Flores, n. f.), being also the most important source of financing for the solvency of public spending as it symbolizes more than 50% in correlation to the other taxes projected in the Income Law of the Federation (LIF) from 2012 to 2019 (Osorio and Osorio, 2019).

Based on the data issued by the SAT with respect to the collection and tax incentive granted to taxpayers taxed under the RIF, a linear regression shows the progressive increase in income tax collection and the behavior of the decrease in the exemption granted to these taxpayers from 2014 to 2019, with the fiscal year 2019 being the most representative in proportional terms, as it represents more than 15% of the total tax levied by these taxpayers.

Graph 3. **IT Tax collection and incentive in the RIF from 2014 to 2019**

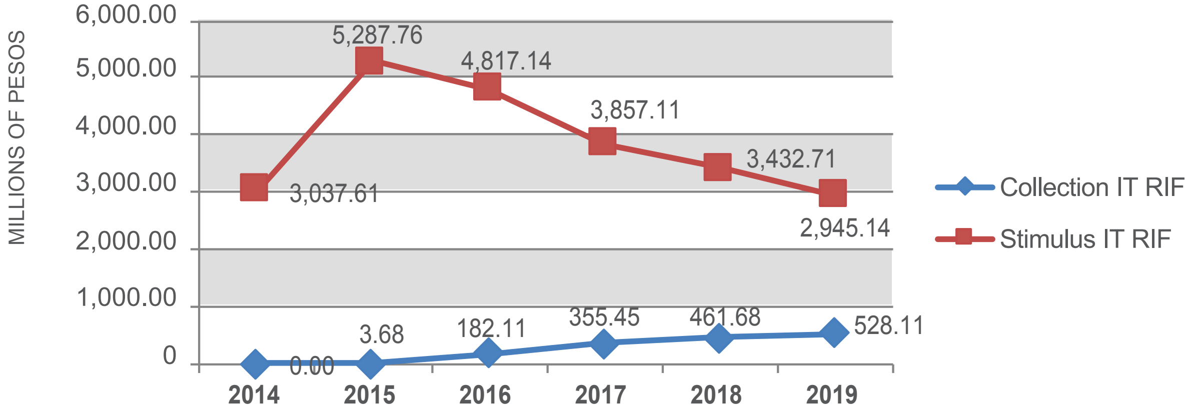


	2014	2015	2016	2017	2018	2019
Stimulus fiscal	13,069.40	23,832.00	22,680.20	19,190.60	17,772.50	15,939.00
Collection	0.00	16.60	857.40	1,768.50	2,390.30	2,858.10
Total IT	13,089.40	23,848.60	23,537.60	20,959.10	20,162.80	18,797.10

Source: Authors' own creation with data issued by the SAT.

Likewise, by correlating the number of taxpayers registered in the RIF with the tax collection and tax incentive in each of the periods, with the data provided by the SAT, it is possible to show the proportion of income tax obtained and exempted per taxpayer, thus showing the gap in the behavior of such figures, with tax collection increasing and exemption gradually decreasing.

Graph 4. Income Tax (IT) revenue collection and proportional tax incentive in the RIF from 2014 to 2019



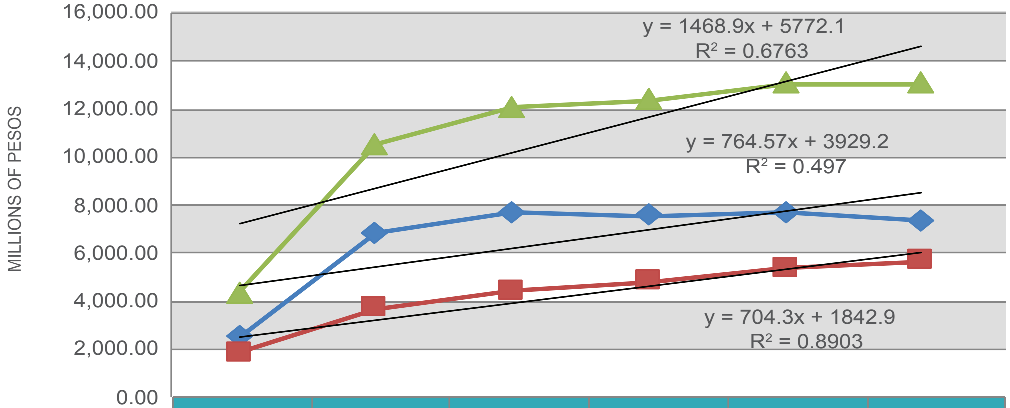
Source: Authors' own creation with data issued by the SAT.

4. VALUE ADDED TAX CONTEXT

VAT entered into force in 1980 in Mexico, an indirect tax that has had a series of modifications in the essential elements of the tax in its legal norm, primarily in the tax rate. Similarly, this tax represents the second most important contribution of the Mexican tax system in correlation to other taxes, symbolizing more than 29% and in some fiscal years close to 40% in the projection of the LIF from 2012 to 2019 (Osorio and Osorio, 2019).

In such a way that for the case in question, according to the figures issued by the SAT, the increase in the collection of said tax from 2014 to 2018 is shown through simple linear regression, with a small decrease in the year 2019 of taxpayers registered in the RIF. Likewise, this data shows the gradual decrease in the exemption granted to taxpayers in the taxation modality under study, and the corresponding graph shows the narrowing of the gap between the collection and exemption of this tax for the taxpayers under analysis, representing 43.52% and 56.48% respectively in the fiscal year 2019.

Graph 5. VAT Collection and tax incentive in the RIF from 2014 to 2019

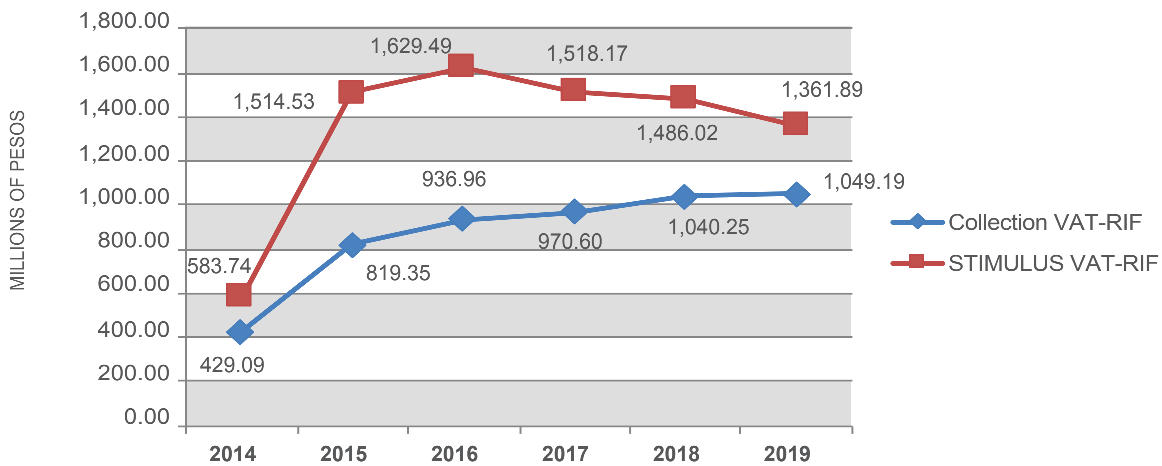


	2014	2015	2016	2017	2018	2019
Stimulus fiscal	2,515.40	6,826.00	7,672.00	7,553.50	7,693.70	7,370.50
Collection	1,849.00	3,692.81	4,411.40	4,829.10	5,385.80	5,679.80
Total VAT	4,634.40	10,518.81	12,083.40	12,382.60	13,079.50	13,050.30

Source: Authors' own creation with data issued by the SAT.

In the same way, by linking the number of taxpayers taxed in the RIF with the collection and the fiscal incentive granted, we obtain the proportional part of the VAT for those subject to the tax, where a smaller gap can be seen graphically as the collection and exemption from the tax gradually increase and decrease, respectively, from 2014 to 2019.

Graph 6. VAT Collection and proportional tax incentive in the RIF from 2014 to 2019



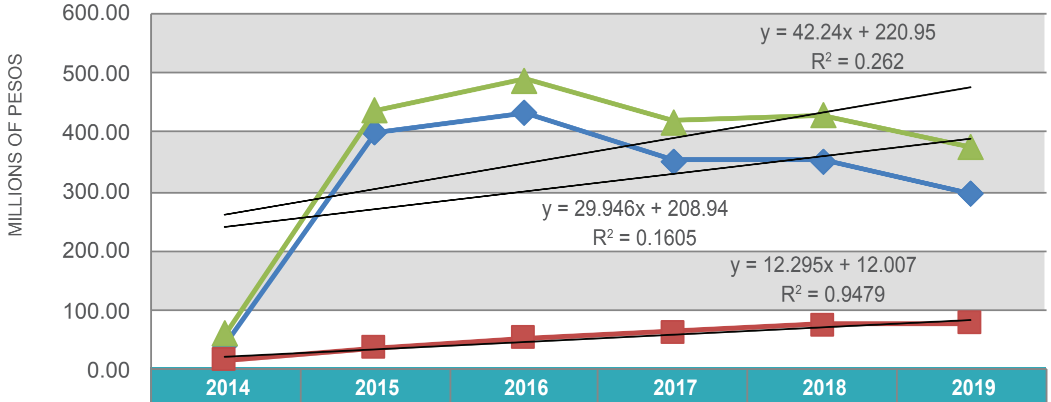
Source: Authors' own creation with data issued by the SAT.

5. TAX CONTEXT OF THE SPECIAL TAX ON PRODUCTS AND SERVICES (IEPS IN SPANISH)

The IEPS came into force in the application of its legal norm in Mexico on January 1, 1981, an indirect tax that likewise has had several modifications in its essential elements of the tax over time, representing the third most significant levy in the Mexican tax system, by symbolizing between 13 and 16% percent in correspondence to the other taxes budgeted in the LIF from 2016 to 2019 (Osorio and Osorio, 2019).

As you can see, the revenue from the taxpayer's RIF shows a behavior very linear and progressive, while its exemption granted to such taxable subjects exhibited a decrease in the analysis period, however, there is still a wide gap, in virtue of which the proceeds represent only about 21% in correspondence of the total IEPS generated in the tax year 2019.

Graph 7. IEPS Collection and tax incentive in the RIF from 2014 to 2019

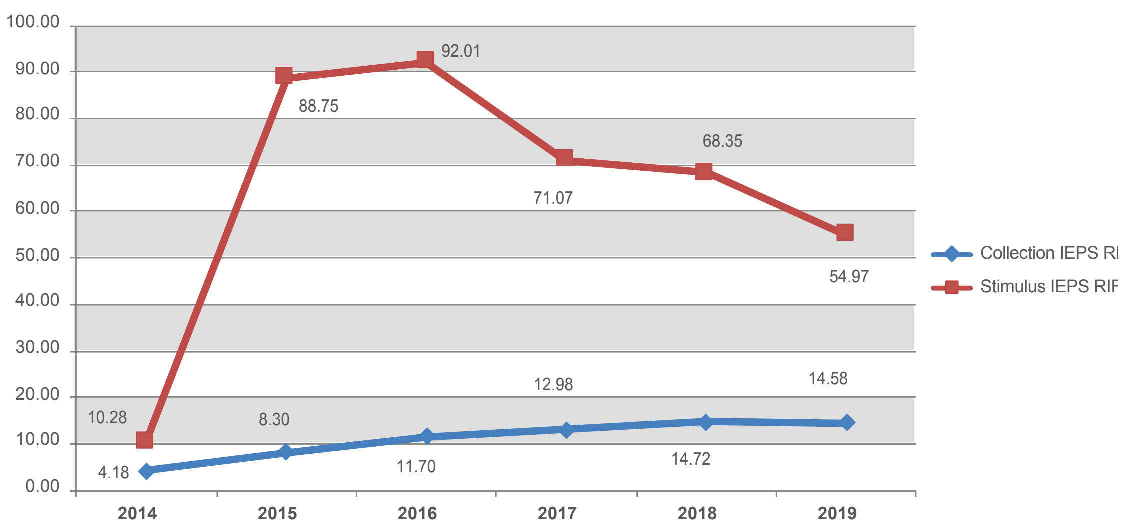


	2014	2015	2016	2017	2018	2019
Stimulus fiscal	44.30	400.00	433.20	353.60	353.90	297.50
Collection	18.00	37.43	55.10	64.60	76.20	78.90
Total IEPS	62.30	437.43	488.30	418.20	430.10	376.40

Source: Authors' own creation with data issued by the SAT.

Performing the same correlation of the tax in the analysis in correspondence to the number of taxpayers enrolled in the RIF, it is possible to further appreciate the extent of the gap between the amount collected and the exemption granted individually to RIF taxpayers, showing in such case a decrease in the proportion of the IEPS collected from 2018 to 2019.

Graph 8. IEPS Collection and proportional tax incentive in the RIF from 2014 to 2019



Source: Authors' own creation with data issued by the SAT.

6. METHODOLOGY

For the purposes of developing the study, it relied on a mixed methodology through the review of legal documents, applicable legislation and available writings on the subject. Likewise, localized data and figures provided by the SAT in their open data, as well as in the reports of tax and management 2014 to 2019, making the descriptive statistical treatment of data with the support tool in Excel by using the function of simple linear regression to understand the behavior of the collection and exemption of income TAX, VAT and IEPS, at the expense of taxpayers enrolled in the RIF to express their context.

7. CONCLUSIONS

According to the registry of taxpayers registered in the RIF, there is undoubtedly a progressive behavior with the exception in the comparison of the year 2019 to 2020, speculating that such behavior of reduction of taxable persons is due to the problems caused by COVID-19 in Mexico. However, taking up again the statement of motives in the creation of the taxation modality under study, which reflected as one of its main objectives the expansion of the base of taxpayers who were in informality; while with the data exposed, the question still arises if such purpose has been fulfilled since there are fewer taxpayers at the end of 2020 compared to the fiscal year 2013. Similarly, such data shows the decrease in the RAEP, which suggests the migration of taxable persons who were in this mode of taxation to the RIF.

Also, with the data presented on the collection and exemption of ISR, VAT, and IEPS of taxpayers registered in the RIF, a progressive increase in the collection and a gradual decrease in the exemption of the three most important taxes of the Mexican tax system is shown; In this case, VAT is the tax that shows the smallest gap between the amount collected and the fiscal incentive granted to taxpayers, which reflects that if this type of taxation continues in the coming years, this tax will be the first to show the opposite behavior, i.e., higher collection obtained and lower exemption granted.

Having made the above considerations, the present study serves for future theoretical or experimental analysis in correspondence to the implementation of the RIF in Mexico and its fiscal, tax and economic scenario

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SIMPLE TAX REGIME IN COLOMBIA:

Relevant issues and analysis for the promotion of small business formalization in Colombia

Juan Pablo **Pinzón Contreras**

SYNOPSIS

One of the main causes of non-compliance with tax obligations is ignorance regarding the procedures that taxpayers must carry out and their complexity, beyond low collection figures in certain economic sectors and low formalization, this has resulted in mistrust on the part of the citizenship. Faced with this situation, the tax administration has directed its efforts to implement low complexity taxation schemes to reduce transaction costs and promote formalization among taxpayers. This article aims to expose the main characteristics of the Simple Tax Regime and propose it as an instrument that could increase the number of formalized enterprises in Colombia.

Keywords: Taxation, Formalization, Taxes, Tax reform, Simple Taxation Regime.

CONTENT

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INTRODUCTION

Informality data in Colombia are devastating, whatever the think tank, university, or entity that dedicates hours of research to issue figures on the subject, it drafts a report that is always discouraging. The most optimistic reports mark 40% and the pessimists up to 60% of informal occupation in the country[1]. This phenomenon is not new, since the large migrations to the cities, the search for informal jobs have become a normal part of economic development; in fact, to contemplate a Colombia without informality for some would be to strip it of aspects inherent to its culture and folklore.

In recent years, recent governments have tried through international cooperation models (especially North-South) to implement strategies and programs to improve this area. Some models have remained half-way and others have become public policy, however, in their execution they had serious drawbacks due to the difficulties of coordination between the entities involved.

With the issuance of Law 1943 of 2018 and Law 2010 of 2019, the Simple Taxation Regime comes into operation, which is an optional Regime for the simplification of different taxes and has the purpose of promoting formalization in Colombia, while improving the management of the tax administration and tax collection.

The present article has the purpose of exposing the operation of this new regime that already has more than 33,100 registered[2] and has raised half a billion pesos[3], analyze its components, highlight its virtues and point out aspects where it is possible to improve it at an operational and functional level. For this, aspects of the regulations frequently asked questions, and the relationship with cases that have been presented in the two years that it has been in full operation will be pointed out.

The pertinence of the comments and recommendations of the Commission of experts on Tax Benefits will also be pointed out and they will be compared or ratified with the opinion of the author. For this, it is suggested to review the CBT document and in general the working party materials (for this topic specifically 2) and analyze if the STR should disappear, should remain the same or can be improved.

Finally, it is essential that, if this article constitutes a first approach to the Simple Taxation Regime, I recommend reviewing the materials and simulators of the National Tax and Customs Directorate to be able to do comparative exercises of the effective tax rates that would be paid in a case or another. This, from a factual analysis, can guide to find more advantages or faults in the STR and thus review the temporal relevance of this writing.

1. WHAT IS THE SIMPLE TAXATION REGIME?

The Simple Taxation regime is an alternative system of tax clearance, which replaces and integrates taxes of the national and territorial order and other obligations, whose main purpose is to facilitate taxpayers' compliance with the tax obligation. It is important to mention the difference between integration and replacement, which is determined in article 903 of the Tax Statute:

1 Portfolio. Informality in Colombia reached 48,7% https://www.portafolio.co/economia/informalidad-laboral-en-colombia-llego-a-48-7-548249

2 Régimen Simple de Tributación en Cifras. Dirección de Impuestos y Aduanas Nacionales. February 2021. Page 2

3 Ibidem. Page 3

Art. 903 *Creation of the unified tax under the simple taxation regime - SIMPLE.*

Create as of January 1, 2020, the unified tax that will be paid under the simple taxation regime - SIMPLE, in order to reduce formal and substantial charges, promote formality and, in general, simplify and facilitate compliance with the Tax obligation of taxpayers who voluntarily take advantage of the regime provided for in this Book.

The unified tax under the simple taxation regime - SIMPLE- is an optional tax model of comprehensive determination, annual declaration, and bimonthly advance payment, which replaces the income tax, and integrates the national consumption tax and the consolidated industry and commerce tax, in charge of taxpayers who voluntarily choose to take advantage of it. The consolidated industry and commerce tax includes the supplementary tax on notices and boards and the firefighters' surcharge that are authorized to the municipalities.

This system also integrates employer contributions to pensions, through the tax credit mechanism.

On this, it is clear that the STR replaces the income tax for individuals or legal entities that decide to be taxed under this system, in this way the obligations of presentation and payment in any of the forms prescribed by the National Directorate of Taxes and Customs would be substituted. Likewise, obligations such as the presentation of the tax conciliation would not be part of the responsibilities of STR taxpayers since in the substitution they do not comply with the responsibilities of the ordinary regime.

Along the same lines, it is important to clarify that the responsibility for the electronic media reporting or exogenous information remains for the STR, also with the assets tax, because despite the fact that Law 1943 of 2018 indicated individuals as taxpayers of the assets tax, Individual income tax, and complementary tax. In Law 2010 of 2019, individual taxpayers of income and complementary tax or substitute income tax regimes, as in this case of the Simple Taxation Regime, were established as subjects.

On the other hand, when we talk about integration, we refer to the consumption tax, industry and trade tax (with supplementary notices and boards and firemen's surcharge), and payments to social security. In this context, it should be clarified that in the first two years of implementation and while not all the agreements of the municipalities in the country were signed, the taxpayers continued to discount what was presented in each municipality from what was anticipated in the TSR. As well as what corresponding to labor payments is discounted, which will be explained later.

At the same time, the TSR is optional, therefore, it is not a mandatory system and despite the provisions of Article 911 of the Tax Statute where the administration is empowered to register ex officio taxpayers who have not complied with the obligation of any of taxes substituted or integrated, until March 31, 2021, the DIAN informs that it has not included individuals or legal entities in this way.

The structure of the regime is progressive, adjusted to a rating system that increases according to the increase in income and with few discounts, for which it is defined by some sectors as a *flat tax*[4]. With this idea in mind, it is worth clarifying that said rate is fully determined by applying it to the base that arises from subtracting the expenses from the total gross income received by the taxpayer during the year.

4 Revista Contamos. Lo que nadie te dijo del Régimen Simple de Tributación https://contamos.com.co/lo-que-nadie-te-dijo-del-regimen-simple/

Do STR and the Monotax coexist?

No. The Monotax is a tax that was created by article 165 of Law 1819 of 2020, whose objective was similar to that of the TSR as it intended to promote formalization and simplification for tax compliance. However, it was aimed at individuals of a very narrow spectrum who had only one commercial establishment, between 1,400 UVT and 3,500 UVT of gross income in the immediately preceding year, and a strictly defined group of activities that included retail trade and hairdressers.

Despite having an interesting component at the rate level and a novel interaction with the Periodic Economic Benefits program of Colpensiones and the Ministry of Labor, the implicit characteristics of the scheme hindered its expansion, which translated into a tax collection close to the 8,000,000 Colombian pesos and a registered number of fewer than 100 taxpayers during its two years of existence[5].

With the promulgation of Law 1943 of 2018-Financing Law, the Monotax is repealed and in the eighth Book of the Tax Statute, what remains corresponds to the Simple Taxation Regime remains, from articles 903 to 916.

Are Simplified Regime and Simple Tax Regime the same?

The Simplified Sales Tax Regime was a regime that operated for almost 30 years in Colombia, specifically from the issuance of Decree 624 of 1989[6] and until the enactment of Law 1943 of 2018. This contemplated scope of obligations applied to those taxpayers who carried out activities or who had income, which, from the point of view of the legislator, were special or insufficient to include formal and substantial charges in tax matters.

Since its appearance, this provision turned into a tax management strategy had substantial transformations, due to a significant number of reforms that the country went through, however, it is since the issuance of Law 863 of 2003[7] that it takes the basic form, maintained until 2018, with tiny adjustments. Said text was as follows:

Article 499 *Individuals, merchants, and artisans, retailers, farmers, and ranchers, who carry out taxed operations, as well as those who provide taxed services, belong to the Simplified Regime of Sales Tax, as long as they meet all of the following conditions:*

1. *That in the previous year they had obtained total gross income from the activity, less than three thousand five hundred (3,500) UVT.*

2. *That they have a maximum of one commercial establishment, office, headquarters, premises, or business where they carry out their activity.*

3. *The business establishment, office, home, business premises where their activities take place are not under franchise, concession, royalties, licensing or any other system that involves the exploitation of intangibles.*

4. *That they are not customs users.*

5. *That they have not entered into contracts for the sale of goods and/or provision of services taxed*

5 Régimen Simple de Tributación en Cifras. Dirección de Impuestos y Aduanas Nacionales. February 2021. Page 2

6 Since Law 49 of 1990, which regulated the repatriation of capital and issued tax and customs regulations, the first changes have been made in the following areas

7 Ley 863 de 2003, 29 de diciembre de 2003. Por la cual se establecen normas tributarias, aduaneras, fiscales y de control para estimular el crecimiento económico y el saneamiento de las finanzas públicas. Diario oficial 45415.

for individual value, equal to or greater than three thousand five hundred (3,500) UVT, in the immediately preceding year or in the current year.

6. *That the amount of their bank appropriations, deposits or financial investments during the previous year or during the respective year does not exceed the sum of three thousand five hundred (3,500) UVT.*

PARAGRAPH. For the conclusion of contracts for the sale of goods and/or provision of services taxed for an individual amount and greater than three thousand five hundred (3,500) UVT, the person in charge of the Simplified Regime must previously register in the Common Regime[8]*.*

With the issuance of the Financing Law, the concept of a simplified regime disappears, since both article 499 (where it was normatively located) and the same concept are repealed. However, since it is of vital importance for the economic and commercial dynamics of our country to keep the taxpayers that made up this special group classified, the same provisions of 499 were maintained within the third paragraph of Article 437 of the Statute but naming those who by nature of their operations and minimum income belonged to the other Simplified Regime as “regime of non-VAT liable persons” with responsibility 49 in the Single Tax Registry.

Considering the above, it is clear that the Simplified Regime disappeared as of January 1, 2019, and that, in addition, it has nothing to do with the Simple Tax Regime, beyond the similarity in terminology. It is important to clarify that all taxpayers who do not comply with the provisions of the third paragraph of article 437 of the Tax Statute are Responsible for Sales Tax before the tax administration.

2. WHO CAN JOIN AND WHO ARE EXCLUDED FROM THE SIMPLE TAXATION REGIME?

The subjects that may belong to the STR are exhaustively listed in article 905 of the Tax Statute, which reads:

Art. 905 Liable subjects: *Individuals or legal entities who answer to all of the following conditions may be taxable persons of the unified tax under the simple taxation regime - SIMPLE:*

1. *That it is an Individual who develops a company or a legal entity in which its partners, participants, or shareholders are individuals, nationals or foreigners, are resident in Colombia.*

2. *That in the previous taxable year they had obtained a gross income, ordinary or extraordinary, of less than 80,000 UVT. In the case of new companies or legal entities, registration in the unified tax under the simple taxation regime - SIMPLE will be conditioned to the fact that the income for the year does not exceed these limits.*

3. *If one of the individual partners has one or several companies or participates in one or more companies, registered in the unified tax under the simple taxation regime - SIMPLE, the maximum limits of gross income will be reviewed on a consolidated basis and in the proportion to their participation in said companies or companies.*

4. *If one of the individuals’ partners has a stake greater than 10% in one or more companies not registered in the unified tax under the simple taxation regime - SIMPLE, the maximum limits of gross income will be reviewed on a consolidated basis and in the proportion to their participation in such companies.*

8 Ley 1819 de 2016, 29 de diciembre de 2016. Por medio de la cual se adopta una reforma tributaria estructural, se fortalecen los mecanismos para la lucha contra la evasión y la elusión fiscal, y se dictan otras disposiciones. Diario oficial 50101.

5. *If one of the individual partners is a manager or administrator of other companies or societies, the maximum limits of gross income will be reviewed in a consolidated way with those of the companies or societies that he manages.*

6. *The individual or legal entity must be up to date with their national, departmental and municipal tax obligations, and with their obligations to pay contributions to the Comprehensive Social Security System. They must also have the respective registration in the Single Tax Registry - RUT and all the electronic compliance mechanisms, electronic signature, and electronic invoice.*

Par. *For purposes of the consolidation of the maximum income limits that are dealt with in numerals 3, 4, and 5 of the art. 905, only income will be considered* for tax purposes.

Given the above, it is important to clarify that the income limit established by its ceiling at 80,000 UVT is estimated by some sectors of the academy as very high. It is worth mentioning the comment made by the 2021 Tax Benefit commission, which considers that this threshold could constitute a problem as it would generate an important avoidance window for taxpayers who are close to the income limit. The recommendation read:

While globally praising SIMPLE, CBT considers the gross income cap to access and remain in the regime unusually high. Currently, businesses can opt for the SIMPLE regime whose revenues are less than 80,000 UVT (approximately 771,000 dollars or 2,849 million pesos), a relatively high limit even for medium-sized companies in Colombia - most businesses with that level volume should have the ability to pay a CIT in the Ordinary Regime. However, since SIMPLE has already been introduced into the national system, reducing the gross income cap at this stage could deter informal businesses from applying to the regime. Therefore, the Commission considers that the gross income limit of the SIMPLE could be maintained in the medium term, however, the DIAN should guarantee that the regime is not abused and that the businesses that opt for the SIMPLE provide enough information to verify that their income is below the cap[9].

In view of the above, it is important to clarify that Article 906 of the Statute includes measures to prevent the use of the threshold by taxpayers who may develop complex strategies. These measures include the following:

Article 906 Subjects who cannot opt for the unified tax under the simple taxation regime - SIMPLE*. They will not be able to opt for the unified tax under the simple taxation regime - SIMPLE:*

4. Companies whose partners or administrators have in substance an employment relationship with the contracting party, as they are personal services, provided with regularity and subordination.

10. The companies that are the result of the segregation, division, or spin-off of a business, which has occurred in the five (5) years prior to the time of application for registration.

With respect to section 4, it is important to clarify that it is a measure that intends to control, but that under no circumstances does intend to enclose the participation of the partners as employees of their own company, in light of this the DIAN decided to issue a concept to clarify its interpretation regarding the normative.

Two different subjects are deduced from the transcribed rule: i) companies that cannot opt for the tax regime and ii) the contractor.

9 Report of the Committee of Experts on Tax Benefits. Page 25 Colombia 2021.

Thus, the rule refers to the fact that companies cannot opt for the SIMPLE Regime:

1. Whose partners or administrators have a subordinate employment relationship with a third party.

2. Labor relationship consisting of the provision of personal services on a regular basis.

This norm refers to the contracting concept, as a third subject, since it would be illogical for it to be the same company as an employer, because generally, the administrators maintain a subordinate labor relationship with the company for which they work, being their employer. Thus, what follows logically from the legal precept is that companies whose partners or administrators provide their personal services with regularity and subordination, maintaining an employment relationship with a third party, called a contractor, are excluded from the possibility of opting for SIMPLE.

The foregoing makes visible the existence of a dependency link of the partners or administrators with that third party, to whom they provide their personal services (DIAN, 2019).

In this way, taxpayers would be prevented from hiring themselves from third parties, with the aim of reducing the tax base through elusive practices.

Subsequently in the proposed analysis, on numeral 10 of article 906 of the Statute, the legislator contemplated requiring that these transactions or processes have a fixed prior time since it is intended to prevent taxpayers from fragmenting the companies into several different economic units that allows them to separately register companies in the STR and thus massively reduce taxation, exemplifying what was stated by the commission.

On the other hand, the provisions of article 906 where taxpayers who could not subscribe to the regime are specified, expose two situations that I believe could be analyzed in a reform context, where adjustments could be included:

***Article 906** Subjects that cannot opt for the unified tax under the simple taxation regime – SIMPLE. They will not be able to opt for the unified tax under the simple taxation regime - SIMPLE:*

3. The individuals residing in the country who, in the exercise of their activities, make up the elements of a real-life contract or legal and regulatory relationship in accordance with current regulations. The Directorate of National Taxes and Customs - DIAN will not require a pronouncement from another judicial or administrative authority for this purpose.

8. Individuals or entities engaged in any of the following activities:

b. Asset management activities, intermediation in the sale of assets, asset leasing, and/or activities that generate a passive income that represents 20% or more of the total gross income of the person or entity.

Faced with what is stated in paragraph 3, I believe that limiting the inclusion of service provision contractors would promote practices where persons with this type of employment relationship do not include all the activities they provide, also breaching formal duties in order to hide all the income they have from various professional activities. In this sense, the articles must foresee situations where contractors can register and thus find it attractive to comply with the electronic invoicing requirements, in this way the formalization of sectors with activities that currently present high levels of non-compliance would be promoted.

Regarding asset leasing activities such as those provided in paragraph b of numeral 8 of article 906 of the National Tax Statute, it is possible that a significant bulk of taxpayers who would see an opportunity to formalize in the STR are being excluded since the Real estate leasing is one of the typical activities to generate income in Colombia[10]. By setting the cap at 20%, an important sector with mixed income from activities with low formalization would be excluded.

3. WHAT IS THE RATE SYSTEM LIKE IN THE SIMPLE TAXATION REGIME?

The rates are defined in article 908 of the Tax Statute, they are rates that are defined according to the volume of gross annual income and the business activity carried out by the persons or companies who decide to enroll in the regime.

The article establishes 4 groups, namely:

1. Small shops, mini-markets, micro-markets and hairdressers.

2. Wholesale and retail commercial activities; technical and mechanical services in which the material factor predominates over the intellectual, electricians, masons, construction services and mechanical workshops for vehicles and electrical appliances; industrial activities, including agro-industry, mini-industry, and micro-industry; telecommunications activities and other activities not included in the following paragraphs.

3. Professional, consulting, and scientific services in which the intellectual factor predominates over the material, including the services of the liberal professions.

4. Food and beverage vending activities, and transportation activities:

As general rules, it is contemplated that group number 2 is residual, therefore, any activity that is not specified in the other groups will have the rates established there. Likewise, if a taxpayer carries out activities different from the nature of its corporate purpose, it must pay the tax at the highest rate of the groups where it carries out operations[11].

From my personal and non-institutional perspective, the proposal may have the first aspect to improve in the rating system that clearly can seem high when analyzed regarding the possible profit that a business may have, especially in circumstances such as the current ones. At the time of declaring, the taxpayer must apply the rates with respect to the total gross income after subtracting the income not constituting income and occasional profit, even so, it should subtract the corresponding to the discounts that the established regime has, which it would be fine in a scenario where many workers are formally hired or there is a bulk of major electronic transactions.

However, the reality could show that the profit generated by the Colombian business fabric would be at levels that would not allow the implementation of said strategies to reduce the tax burden, in other words, the low profits would close the decision margin to link the labor force that allows assuming the fiscal impact of the STR.

The figures on profit in Colombia vary too much, specifically for the discussion regarding the Simple Taxation regime, they should be close to micro, small, and medium-sized companies for whose profitability values they set 12.27% on their operations, after assuming all costs, expenses, and taxes incurred in the period[12].

10 IDB. Study on the housing leasing market in Colombia. Final report. Page 26.

11 Decreto extraordinario 624 de 1989, marzo 30 de 1989. Por medio del cual se expide el Estatuto Tributario de los impuestos administrador por la Dirección General de Impuestos. Artículo 908. Diario Oficial 38756.

12 Wilder Quintero, Jose G Arévalo y Genny Navarro. Perfiles de rentabilidad financiera de las pequeñas y medianas empresas (PyMEs) en Colombia: Un análisis discriminante multivariado (AMD) y de conglomerados. Revistas espacios Vol. 41. Page 4. 2020

This is why it would be convenient to verify rates to allow a more powerful use of the STR, contrary to the decision made by the legislator who made an increase in rates for group 3 in the process of Law 2020 of 2019, which increased substantially the value of the obligation for these service activities.

Group	UVT Income	Rate Law 1943/18	Rate Law 2020/19
1	0-6,000	2%	2%
1	6,000-15,000	2.8%	2.8%
1	15,000-3,0000	8.1%	8.1%
1	30,000-80,000	11.6%	11.6%
2	0-6,000	1.8%	1.8%
2	6,000-15,.000	2.2%	2.2%
2	15,000-30,000	3.9%	3.9%
2	30,000-80,000	5.4%	5.4%
3	0-6,000	4.9%	5.9%
3	6,000-15,000	5.3%	7.3%
3	15,000-30,000	7%	12%
3	30,000-80,000	8.5%	14.5%
4	0-6,000	3.4%	3.4%
4	6,000-15,000	3.8%	3.8%
4	15,000-30,000	5.5%	5.5%
4	30,000-80,000	7%	7%

Source: Own comparison of STR rates, Law 1943 of 2018 and Law 2010 of 2019.

As can be seen, there are some groups that present attractive rates that clearly would cause a decrease in the effective tax rate or that could at least translate into maintaining a similar level of payment with reduced compliance with formal obligations. In other words, due to the nature of the system, the taxpayer would have a similar tax burden but the transaction costs to comply with said obligation would be substantially lower.

Group one is a particular case because it presents rates that range between 2% and 11.6% that would also include the Sales Tax as specified in the regulations. This makes the regime an alternative to be evaluated for those taxpayers who engage in activities such as mini markets, small shops, and hairdressers.

In conclusion, although the rate review specifically for group three is necessary, the rate ranges, in general, look attractive and invite us to do a comparative exercise between the payment levels in the general regime and the eventual STR levels. Another point to be analyzed is the income levels of the cities and, in general, the volume of income that businesses have in different territories of the country, as this rate includes the ICA rate, notices and boards, and firefighters' surcharge.

4. WHAT ARE THE BENEFITS FOR A TAXPAYER TO ENROLL IN THE SIMPLE TAXATION REGIME?

To talk about benefits, first I have formed three categories in which a decrease in the tax burden could be reported at a substantial level and at a formal level, these points would be tax discounts, cash flow, and reduction of transactional costs.

Tax discounts: Tax benefits in the STR are given in the form of discounts and are described in paragraph 4 of article 903 and in article 912 of the Tax Statute. We proceed to analyze the first provision that contemplates the discount of pensions, whose article reads:

Art. 903 *Creation of the unified tax under the simple taxation regime - SIMPLE.*

PAR. 4. The value of the contribution to the General Pension System in charge of the employer who is a taxpayer of the unified tax under the simple taxation regime - SIMPLE, may be taken as a tax discount in the electronic payment receipts of the SIMPLE bimonthly advance referred to in the article 910 of this Statute. The discount may not exceed the value of the bimonthly advance paid by the taxpayer belonging to this regime. The part that corresponds to the consolidated trade and industry tax may not be covered with said discount.

Considering the above, the contributions made by the employer to pensions by their employees would be discounted in the clearance of the Simple Regime, not their own contributions to pensions that are considered non-taxable. The proposed exercise is interesting, as it motivates the employer to formally hire more workers in order to reduce tax burdens.

Art. 912 Credit or tax discount for income from credit cards, debit cards, and other electronic payment mechanisms.

Payments or credits into account that may constitute taxable income for taxpayers of the unified tax under the simple taxation regime-SIMPLE, for the concept of sales of goods or services made through the credit and/ or debit card systems and others. Electronic payment mechanisms will generate credit or discount of the tax payable equivalent to 0.5% of the income received by this means, in accordance with the certification issued by the acquiring financial entity. This discount may not exceed the tax payable by the taxpayer belonging to the simple taxation regime - SIMPLE and, the part that corresponds to the consolidated industry and commerce tax, may not be covered with said discount.

The introduction of this provision has as its obvious purpose the banking of businesses, at the same time it can generate an interesting reduction in the final payment made by taxpayers. However, to improve its impact, the percentage could be rethought, especially considering that Colombia had an index of 8.4 in access to electronic commerce until before 2019, which is two points below the Latin American average (10.7%) and more than 50 points below the OECD average (61%)[13].

Although it is understood that the objective is to promote electronic commerce, not all sectors are likely to increase their presence in transactions in this way, even despite the global pandemic and the rebound in *e-commerce* during 2020[14], the sectors hardest hit by the pandemic They would not have in principle how to develop strategies to join, so a more attractive discount could lead to rethink the way the business is developed and implement virtual commerce strategies.

Cash flow: The cash flow for STR taxpayers can improve substantially since they are not subject to withholdings, this is specified in article 911 of the Tax Statute, which specifies:

Art. 911 *Withholdings and self-withholdings at source in the unified tax under the simple taxation regime - SIMPLE.*

Taxpayers of the unified tax under the simple taxation regime - SIMPLE will not be subject to withholding at the source and they will not be obliged to make withholdings and self-withholdings at the source, with the exception of those corresponding to labor payments. In payments for purchases of goods or services made by taxpayers of the unified tax under the simple tax regime - SIMPLE, the third-party recipient of the payment, taxpayer of the ordinary regime and income tax withholding agent, must act as self-withholding agent of the tax. The foregoing

13 Colombian Chamber of Electronic commerce. E-commerce in 2020 and prospects for 2021. Bogotá, March 2021.Page 44

14 Ibid., 45

without prejudice to the withholding at source under the sales tax -VAT, regulated in numeral 9 of article 437-2 of the Tax Statute.

In accordance with the provisions of the regulation, STR taxpayers are not subject to, nor should they practice Withholdings at Source as Income or as Industry and Commerce Tax. The exceptions would be on labor payments and the withholding practiced by the VAT manager when buying a product or acquiring a service from a STR taxpayer[15]. With this measure, taxpayers will have more money as cash flow to meet the needs of their business, a measure that I consider is one of the strengths of the proposal in general and that should be sustained over time.

Reduction of transactional costs: Through an annual declaration the taxpayer may declare various taxes of the national and territorial order, including income tax, sales tax in the case of carrying out group 1 activities, consumption tax, taxes of industry and commerce, notices and boards and firefighters' surcharge, which reduces the number of declarations and procedures that the taxpayer has to file.

This applies especially with the particularities of the Industry and Commerce Tax (ICT), when the taxpayer carries out operations in different municipalities and must comply with the transactional burden of reporting in each of the municipalities, which is onerous and complex. Along the same lines, the system of advances through receipts 2593 will allow compliance to be expeditious, since it facilitates by means of electronic payments the possibility of complying in an agile manner.

Given this, it is important to conclude that any measure focused on reducing compliance costs will directly impact formalization, it is estimated that at least in Bogotá these costs usually cover between 2% and 3% of total annual gross income[16] . The compliance cost study in Bogotá carried out in Bogotá during 2015 and 2016 would reveal that taxpayers have a totally outsourced relationship with national and local tax administrations, since they delegate this aspect to their accounting and tax advisers[17].

Finally, in the face of formalization costs, it is important to mention that STR taxpayers should not make bets for prosecutors referred to in 114-1 of the Tax Statute, operating the general rules provided for legal persons (from the first worker) and for natural persons (from two workers), considering that it applies to those who earn less than 10 SMLMV.

5. IS THE SIMPLE TAX REGIME A DEFINITIVE TOOL FOR THE FIGHT AGAINST INFORMALITY?

The criticisms and exaggerations made in the article are based on the idea that there is still much to improve, however, with respect to what has been achieved by the single tax and other strategies implemented in the past, it is a huge leap in quality. The most important advance is the number of new taxpayers that the regime has, that is, individual and businesses who had never registered states before the DIAN or the territorial administrations and who constitute approximately 42% of the total registered, being 71% individuals and 29% legal entities[18].

On the other hand, it is common for large cities in the country to have a significant number of registrants, however, currently there are more than 750 municipalities with registered in STR, that is, approximately 70% of the

15 Decreto extraordinario 624 de 1989 por medio del cual se expide el Estatuto Tributario de los impuestos administrador por la Dirección General de Impuestos. Articulo 437-2. Diario oficial 38756

16 World Bank. Compliance costs in Bogota businesses. Bogota -2016 page 36

17 Ibid. Page 8

18 Régimen Simple de Tributación en Cifras. Dirección de Impuestos y Aduanas Nacionales. February 2021. Page 3

country's municipalities, which could be an important indicator that the implementation of public policy is having an important permeability, taking advantage of the multi-territorial commercial dynamics that still prevail in certain areas of the country.

This dynamic could be exploited together with the economic activities currently represented by the most representative groups, such as human health care, construction, information and communications, transportation and storage, and accommodation and food services[19].

6. REGULATORY FRAMEWORK TO TAKE INTO ACCOUNT

Law 1943 of 2018

It is the main rule, through this the single tax is repealed and the Simple Taxation Regime is included in Book VIII of the National Tax Statute, between article 903 to 916. However, through ruling C.381 of 2019 it is declared unenforceable and therefore I operate until December 31, 2019.

Law 2010 of 2019

Currently in force, the provisions of Law 1943 are almost complete with the exception of some drafting is and of course the rates for taxpayers who carry out group 3 activities.

Decree 1468 of 2019

It was the Decree by means of which the STR was regulated in the provisions of Law 1943 of 2018, therefore, its content applies to what happened in the first year of operation.

Decree 1091 of 2020

By means of which Law 2010 of 2019 was regulated, it has all the provisions to purify the tax, resolve specificities about who may or may not belong to the regime, the way to declare, the presentation of advances 2593, withdrawal of the Simple and other essential formalities for taxpayers.

Faced with the regulatory framework, it should be clarified that the Simple Taxation Regime can change its content according to what is defined by both the government and the legislator for an upcoming tax reform. So far, the proposed articles that the government sent to congress on this matter only contains estimates regarding the interaction with electronic invoicing[20] but none of the recommendations made by the experts of the tax benefits commission.

This final part of the article will describe four important contributions that from the author's point of view could be highlighted from the discussions between academics, members of the government and experts in general.

7. WHAT DOES THE COMMISSION OF EXPERTS ON TAX BENEFITS RECOMMEND, REGARDING THE SIMPLE TAX REGIME?

We note what was mentioned by the Tax Benefits commission in terms of the system, in terms of fighting for its integrity and preventing it from functioning as an avoidance mechanism, they establish the following:

The standard corporate tax regime can be complemented by a presumptive tax regime, such as SIMPLE, which is focused on small businesses. The objective of this system is to encourage businesses to enter the formal economy and guarantee that their workers have access

19 Ibid. page 6

20 Preliminary version of the Sustainable Solidarity Law 2021 (April version)

to pension and health benefits; the TBC welcomes this approach. Indeed, if an extension of SIMPLE were accompanied by a more service-oriented approach by DIAN - with officials supporting microenterprises with access to government benefits and financial programs - the incentives for businesses to enter the formal sector should be further strengthened. /25 OECD - DIAN - MINISTRY OF FINANCE, However, the SIMPLE's design can still be improved. After businesses choose the system, they should be required to remain in the regime for a specified period of time. Likewise, SIMPLE should include all small businesses in all sectors of the economy. The foregoing would allow this model to play an important role in the integration of small businesses from all sectors within the formal economy and the registration of employees in the General Social Security System[21].

Faced with this, the CBT promotes that the time that the registrants must stay should be longer to avoid being used as a vehicle to avoid obligations of the General Regime. Regarding the usefulness of the system to promote employment and formalization, the commission has stated:

"Entrepreneurs must be encouraged to organize their activities in such a way that their workers enter the formal economy, make contributions and benefit from the health and pension systems. For this, the companies belonging to the agricultural sector could register to the Simple Taxation Regime".

Likewise, the commission highlights that the STR has points to attend to, among them there must be a tendency towards its maximum simplification in view of this, it provided:

SIMPLE is less simple than it seems at first glance and, therefore, the Government may consider strategies that synthesize SIMPLE. Entries not considered as income in Colombia is not included in the SIMPLE base, and SIMPLE taxpayers must evaluate occasional earnings using the general regime. The SIMPLE is more favorable for sectors with a high level of labor, since the value of the discount for mandatory pension contributions increases with the salaries paid. This is likely to have a positive impact on employment, and encourage the formalization of workers by employers, in order to benefit from the tax discount. However, the system also encourages the establishment of companies by independent workers since the owners of unincorporated companies cannot deduct their own pension contributions from the tax liability.

This clearly coincides with what was stated above, although different taxes are enunciated in an integrated way, the truth is that the taxpayer still needs to carry out different formal procedures such as declaring VAT in another form, evaluating the occasional profits from the general regime, require registration in the tax identification records of the districts and municipalities, which continues to generate difficulties to fully comply with the obligations.

21 Report of the Committee of Experts on Tax Benefits. Page 112 Colombia 2021

Finally, the conclusion of the commission contradicts some opinions that argued that an additional regime should be included to the STR and the general regime, against this they state:

The Tax Benefits Commission maintains that it would not be advisable to introduce an additional special tax system between SIMPLE and the standard tax regime. The current tax system is already too complex and introducing a new one would be taking a step in the wrong direction[22]*.*

Various voices had stated that a regime should be included for taxpayers with income below 3,500 UVT per year, similar to the one that operates in Brazil with SIMPLES. These types of regimes are aimed at a delimited group of taxpayers very similar to those who belonged to the defunct simplified regime, however, the commission did not say anything about this and apparently emphasizes its concern about the threshold of 80,000 UVT as a quite high amount, directing its recommendation to the inconvenience of a regime that is located above 60,000 UVT and up to the threshold that the STR currently has.

22 Ibid. Page 136

8. CONCLUSIONS

The approach of this text to the operation of the Simple Taxation Regime provides a practical experience of how it has been implemented since January 2019, presenting strong collection figures and an interesting number of registrants. However, it is possible to take advantage of the conjunctural moment that the country is going through to implement a tax scheme that would be based on the STR but that could be improved in favor of including small taxpayers or companies in sectors that usually remain in shadow economies and that are very difficult to formalize.

The recommendations that are made analyzing point by point, describe needs that the small entrepreneur may meet when he decides to develop typical operations of his business, obviously if there is adequate planning the economic agent could take full advantage of the STR as it is. However, as described, it is complex to implement the provisions in some cases due to the operational and legal reality faced by businesses in Colombia, such as the percentages of net profit, compliance costs and understanding of the legal framework.

Another essential point to consider is the general tax ecosystem, since the recommendations made by the CBT are also aimed at eliminating territorial taxes that affect invoicing, such as the Industry and Commerce Tax, in this case the STR would no longer be so attractive for taxpayers because it would not have the integrating effect of territorial rates. Although it is unlikely that the ICT will disappear in the short term, the specific simplification of this tax could work against the massification of the Simple Regime as it is.

The work of the DIAN is essential for these purposes, highlighted by the current commission on tax benefits and highlighted by the commission of equity experts that was established by Law 1739 of 2014 and which derived from the recommendations that fed into Law 1819 of 2016. DIAN has implemented technological tools to improve management through analytical and tax operation programs, however, the existence of a legal framework that provides the security allowing the tax administration to implement permanent and long-running programs is necessary.

Finally, the interaction between the most economically relevant entities in the State sets the course for a correct public policy that promotes formalization, since there may be a convenient tax system, but without constant support from the Ministry of Commerce, Industry and Tourism, the secretaries of finance and the chambers of commerce, it would result in failure. The proposal is to build governance networks that seek synergies from common points between the objectives of each of the entities, even linking academia[23].

What happened with the single tax should be a warning to the authorities, where the lesson is that even interesting normative constructions can be totally lost in the execution and turn out to be a manual of what not to do for the future.

23 Juan Pablo Pinzón. Gobernanza e Impuesto Plano. UNA. 2016 page 33

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TRANSACTION TRACING STRATEGIES

for addresing tax evasion in the shadow economy: International success stories and lessons for Kenya

Miriam **Wangui**

SYNOPSIS

In Kenya, data for the shadow economy spanning 24 years reveals an average of 33.18 percent in terms of percent of GDP, pointing to a significant shadow economy and hitherto staggering revenue collections should the shadow economy and the resultant tax evasion be addressed. Against this backdrop, this study set out to assess in a desktop review, international best practices in respect to transaction tracing strategies for tax compliance in the shadow economy and draw lessons for Kenya. The analysis reveals that the most effective strategies include data matching, risk modelling and advanced analytics, ID fraud detection technologies and pre-filling.

Keywords: Data Matching, Risk Modelling, Shadow Economy, Pre-filling.

CONTENT

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INTRODUCTION

Accrued experience from tax administrations across the globe reveals a number of strategies that have realized measured success in driving up tax compliance in the shadow economy. A majority of these have been focused either on encouraging businesses into the formal economy or penalizing non-compliance. These strategies have however over the years proven to fall short, highlighted by continued tax evasion and non-compliance particularly among a growing and evolving underground economy, estimated to constitute a staggering third of the global economy (Amoh & Adafula, 2019). A review of tax administration strategies for addressing the shadow economy globally reveals that transaction tracing comes top, with recorded success stories from various jurisdictions, which may be tailored to address tax evasion in the Kenyan context.

Shadow economy is defined by Schneider, Buehn, and Montenegro (2001) as “including all market-based legal production of goods and services that are deliberately concealed from public authorities to avoid payment of taxes or social security contributions or having to meet certain legal labor market standards.” Recent developments however indicate that the shadow economy goes beyond the deliberately concealed market-based legal production of goods and services from public authorities, but includes among others, identity fraud, use of fictitious invoices/receipts, sales suppression through off-book receipts, sales suppression software and devices, non-reporting of offshore income and/or moving un-taxed income offshore, Value Added Tax (VAT) carousel fraud and Illegal employment (Organisation for Economic Co-operation and Development (OECD), 2017).

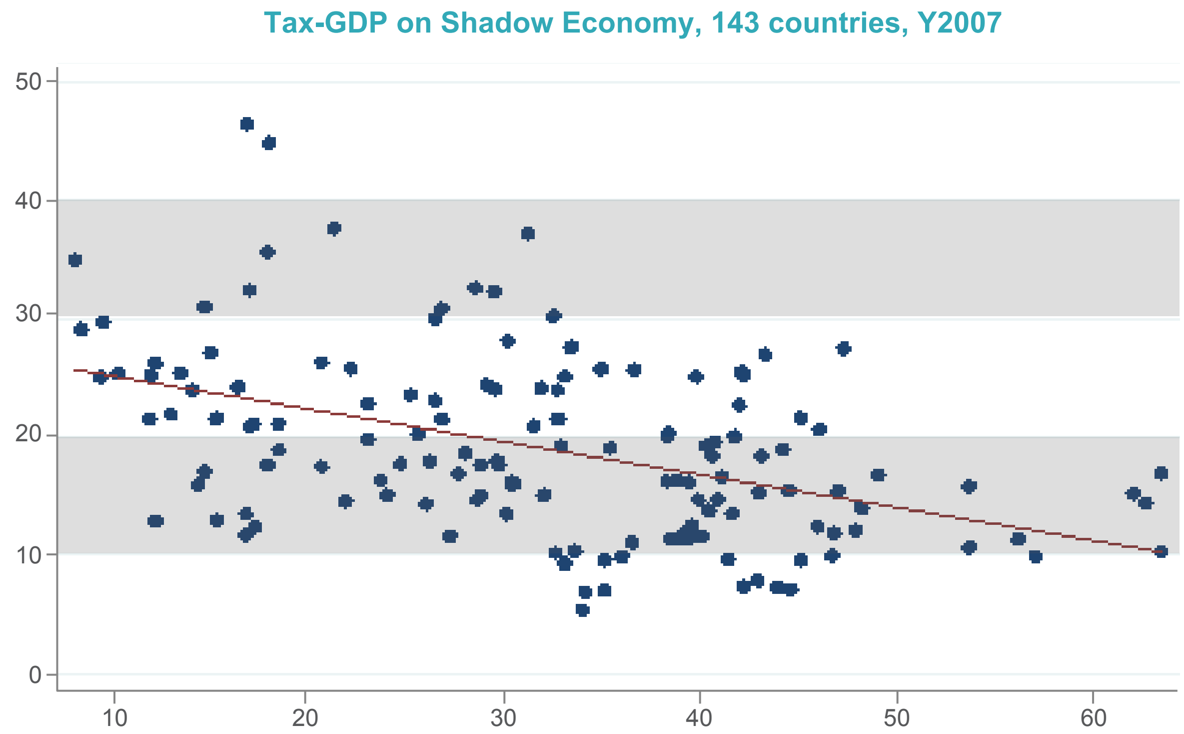
1. SHADOW ECONOMY AND TAX EVASION

Particularly in developing economies, tax administrations are increasingly concerned about the tenacious challenges of tax revenue losses to the underground economy. This is primarily occasioned by tax base erosion which curtails economies from achieving targeted revenue collections to deliver such essential services as education, infrastructure, and healthcare. Whereas the shadow economy has a significant presence in the transition countries of Europe and Central Asia region accounting for 36.4 percent of the ‘official’ GDP, it is particularly predominant in Sub-Saharan Africa, whose activities account for 37.6 percent. Comparatively, in high income OECD countries, the shadow economy accounts for only 13.4 percent of the GDP.

In Kenya, data for the shadow economy from 1991 to 2015 reveals an average of 33.18 percent in terms of percent of GDP, with a maximum of 36.24 percent in 1998 and a minimum of 28.68 percent in 2014, pointing to a significant shadow economy (TheGlobalEconomy.com, 2015). This is attested to, by Akello (2019) who reports that against an approximate working-age population of over 31 million Kenyans, only 4 million are registered taxpayers in the country. This, according to Vikiru (2021) is indicative of the significance of Kenya’s shadow economy which places the burden of tax on a small working percentage of the population. This eventually leads to massive annual revenue collection shortages which results in increased rates of taxation to address fiscal deficits and consequently non-compliance in the formal sector and an increase in the shadow economy.

As illustrated in Graph 1, a simple linear regression using data from 143 countries reveals a statistically significant and negative relationship between tax-GDP ratios and shadow-GDP ratios, indicating the staggering hitherto revenue collections should tax evasion addressed from the shadow economy.

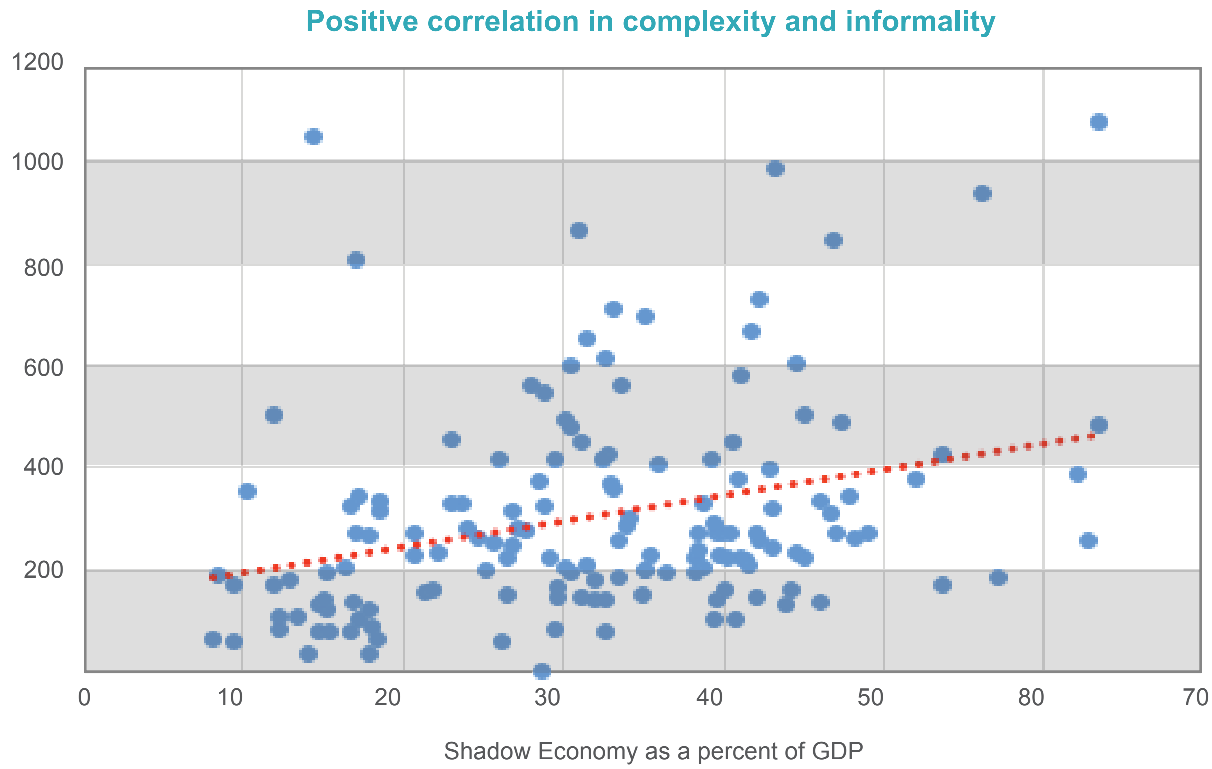
Graph 1. **Linear Regression of Tax-GDP Ratios against Shadow-GDP Ratios**



Source: Schneider, Buehn and Montenegro (2010); IMF tax-GDP data (2007)

As part of efforts to treat informality of businesses which is the over-arching descriptor of the shadow economy, tax administrations have sought to find out what drives informality in an effort to address the same. Statistics to this end show that informality of business is positively and highly correlated with high levels of tax complexity. Accordingly, when the law and tax regime are complex, the duration of time it takes to comply with taxes is greater. As illustrated in Graph 2, Schneider, Buehn and Montenegro (2010) employ World Bank's (2009) doing business report's sub-indicator against time to comply in relation to the shadow economy and uncovered a positive and significant correlation.

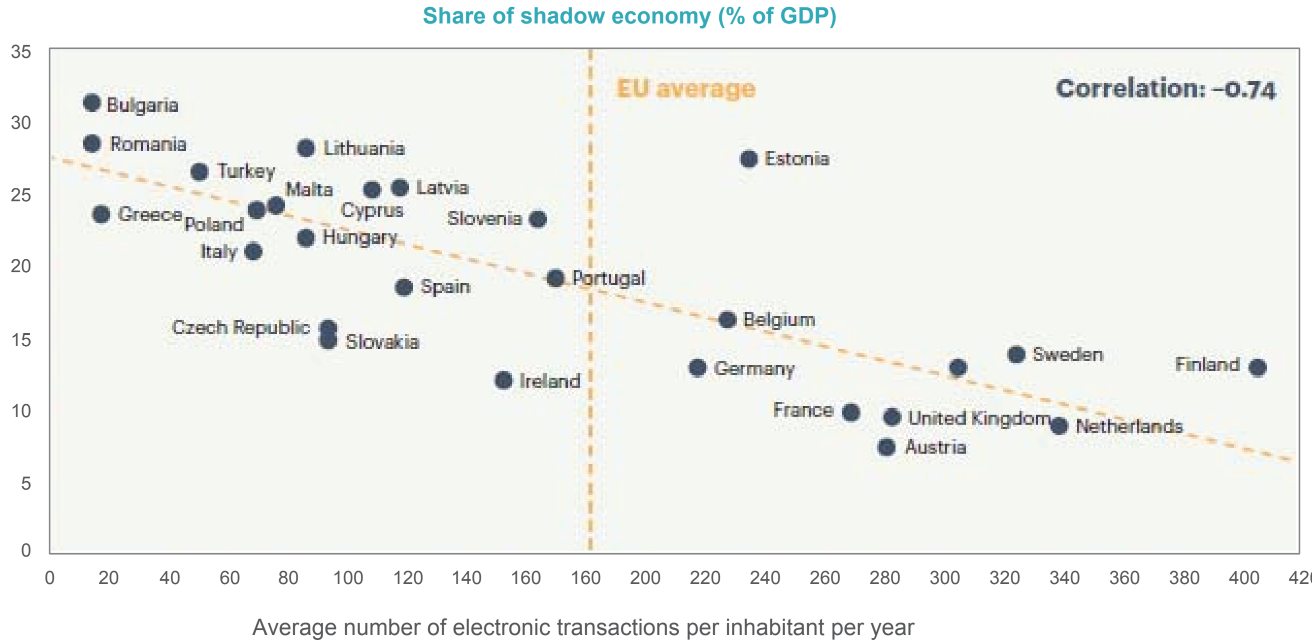
Graph 2. Correlation between Complexity and Informality



Source: Schneider, Buehn y Montenegro (2010); World Bank (2009)

Experience from developed economies indicates that incentives, both negative and positive, to conduct business transactions and diversify options for making payments including through formal banking channels, result in a notable decrease in the level of business informality, which eventually results in tax compliance. Among the avenues through which these incentives can be availed, include tax policies and the various measures taken by the tax administration.

Graph 3. **Correlation between Electronic Payments and size of Shadow Economy**



Note: Data is for the EU-27 (except Luxemburg, due to data availability) plus Turkey. The 2011 data for electronic payment is based on latest available publication by ECB.

Source: European Central Bank; Interbank Card Center; Dr. Friedrich Schneider, Johannes Kepler University of Linz, Austria; Kearney analysis

The analysis in Graph 3 implies that adopting policy and administrative tax measures, reducing complexity of the tax system, and incentivizing formal payments for business transactions through among other means, electronic payments, banking channels, and use of "plastic money" can be effective in reducing informality and the shadow economy resulting in improved tax performance. The analysis further shows that additionally, employing Information and Communication Technology (ICT) solutions to enhance tax enforcement against shadow economy transactions, principally measures to track transactions in the shadow economy, would be most effective. Against this backdrop, this paper reviews the various transaction tracking strategies employed by economies across the globe, that have recorded success stories in addressing tax evasion with the aim of tailoring and domesticating the same in Kenya.

2. DATA MATCHING

Data matching strategy is increasingly being used by tax authorities to assess the main tax revenue risks and to identify cases for further examination. Data matching techniques can focus on tax evasion sectors, issues and tax streams. With regard to assessment of tax revenue risks to, data matching enables the tax administration to carry out a more methodical analysis of large taxpayer data volumes. External sources of information can be matched with tax records to identify cases of businesses/ people operating in the shadow economy.

In Russia, the Federal Tax Service (FTS) has implemented a system that allows it to monitor VAT compliance on a nationwide basis, drastically reducing opportunities for fraud. The approach is based on automatic cross-matching of all VAT paid with all VAT claimed across all transacting parties. All incoming data is processed and analysed mostly in real-time, with only an eight-hour delay across the country. The system allows the FTS to zoom-in on transactions or VAT taxpayers and automatically identify related tax risks. It can then initiate a VAT tax audit that is assigned to inspectors. The system also allows the FTS to monitor and measure performance of regional and local offices and of tax inspectors. Implementation of the system became viable following amendments to the tax code that introduced mandatory digital filing of all VAT tax returns, VAT invoices and digital grand ledgers, and the construction of new IT infrastructure concentrated around data processing centres. FTS Data Processing Centres are capable of collecting, storing, and analysing large amounts of data to provide a single platform for all tax administration business. The 2016 results show an increase in VAT collection over 2015 of 8.5%, while in 2015 and 2014 the increase amounted to 12.2% and 16.8% respectively.

In Sweden, the widespread use of the personal number (Social Security Number) allows data about people from different sources to be easily compared, such as information from banks. The “ROT” initiative allowed taxpayers to reduce their tax by submitting invoices where they employed someone for household services. The invoices submitted by taxpayers with their tax return enabled the tax authority to identify people working in the hidden economy.

In Canada, the Revenue Agency (CRA) reported in 1999 that over the previous five years it had obtained more than 70 databases from other federal departments, provincial and municipal governments and private sector sources and matched them against their own databases. The Ontario Workplace Safety and Insurance Board and the Revenue Agency recently agreed to exchange information to identify people and businesses registered with one government agency but not the other. The Agency also obtained private sector databases of payments made to city construction contractors. When a sample of payments was matched with contactors’ tax returns around 40 per cent had not reported all of their income (Revenue Canada, 1999).

In Australia, the Taxation Office during 2005-06 automatically matched the information on income tax returns with large volumes of external information from companies, financial institutions, government agencies for example, Australian Transaction Report and Analysis Centre (AUSTRAC), Australian Bureau of Statistics and various state and territory authorities, employers and private health funds. The Taxation Office is specifically targeting business-to-consumer transactions including matching businesses appointment and quote books to invoices; tracing owner-builder transactions using local council records; matching information from trade suppliers to domestic service businesses; and analysing local advertisements (Australian National Audit Office, 2006). The Taxation Office is developing industry benchmarks for some trades and industries where there is a high volume of cash transactions. Where the Taxation Office identifies taxpayers, who do not fit within the benchmarks that relate to them, it will take a closer look at their activities to see whether there is non-compliance. This approach will provide an opportunity for taxpayers who are outside benchmarks to adjust their behaviour, where necessary (Australian Taxation Office, 2007).

In the United States, the Internal Revenue Service (IRS) intends making greater use of data matching to detect those who may be under-reporting their taxes. It receives and handles a growing number of information returns from third parties; around 1.7 billion for tax year 2006. The IRS pursues millions of discrepancies between the individual taxpayers’ tax returns and the information returns, including both under-reporting of income and a failure to file tax (US Department of the Treasury, 2006). The National Taxpayer Advocate has suggested that the IRS should also explore creating a database combining all information sources into a single system that would allow the IRS to develop new techniques for identifying potential under-reporting. The Advocate has also suggested that the IRS could develop industry ratios on the average share of sales from cash and payment cards. It could use any unexplained deviations from these ratios in combination with other criteria to select returns for audit (National Taxpayer Advocate, 2007).

3. RISK MODELLING AND ADVANCED ANALYTICS

Tax administrations have used advanced analytics to inform the management of overdue tax returns and collection of tax arrears for more than a decade. In recent years, coinciding with the significant increase in data, administrations have begun to use a range of techniques to identify proactive and responsive actions to assist taxpayers to meet their obligations, or to determine the best intervention to support compliance. Advanced analytics is increasingly being used as a tool to help tackle the shadow economy.

In Ireland, the Revenue Authority has expanded its risk management scope by incorporating real-time risk analysis in VAT compliance and collection programmes. The VAT Real-Time Risk approach is an example of a hybrid rules and predictive analytics-based compliance model which is improving prevention and detection of non-compliance in both payable and repayable VAT returns. The design process is informed by expert business users at all stages. The resulting compliance process automatically applies a number of checks at the time a VAT Return is filed, which include primary controls as well as taxpayer-specific data such as VAT return and payment history, company and Director status, composite scoring from other risk systems, and return and payment compliance for other taxes.

Once the checks are completed, a risk score is assigned to each Return and is used to categorize Returns as either green (low risk) with any VAT repayment due being paid automatically; orange (medium risk); or red (high risk) which necessitates an intervention and full investigation by a staff member in order for a Return to be validated and for any repayment claim to be released. The success of this risk-based approach highlights the importance of evidence-based data analysis and risk management. In 2016, in excess of 57,000 red risk VAT cases were examined resulting in an indirect yield of EUR 75 million.

In Canada, the CRA has developed, and continues to refine several predictive models to assist in the delivery of its non-filer programmes. The models support improved workload selection and prioritization for the programmes, and also supply estimates for taxpayers that have not filed returns. In its first year in production, one non-filer model resulted in a total of CAD 127.6 million in additional positive assessments. The CRA is now moving away from a pure predicted value to a relative ranking indicator, dynamically scoring accounts on an ongoing basis. The CRA has also developed several other models to improve programme effectiveness and enhance taxpayer services by predicting self-resolution and responsiveness to a specific compliance action.

4. TECHNOLOGY TO REDUCE ID FRAUD

Supplying false information is at the heart of much shadow economy activity, whether to disguise identity or income. This is an area where tax administrations need to continuously monitor developments as new technologies and the growth in the illicit market supporting fraud are used to circumvent previous controls such as the earlier introduction of electronic tills.

In India, the government has built a nationwide biometric database based on fingerprints and iris scans from more than a billion residents. Those residents are issued with a 12-digit identity number (an “Aadhaar number”) which is used for security purposes in many governments and private sector applications, from pensions to wages, telecoms and the distribution of benefits. The use of the number is now being mandated for income tax returns and other applications.

In the United States, the IRS continues to identify ways to improve and strengthen strategies to combat identity theft as mechanisms used by cyber-criminals continue to evolve. Among the improved and expanded features are: new data elements transmitted by the tax industry with every tax return have been updated and expanded providing additional information to strengthen the authentication that a tax return is being filed by the real taxpayer; the tax industry will share with the IRS and state tax agencies several data elements from business tax returns which extend more identity theft protections to business filers as well as individuals; the Verification Code initiative started by the IRS in 2016 for the Wage Tax Statement (using a 16-digit verification code) will expand to 50 million forms.

Brazil is among a number of countries that have mandated e-invoicing: electronically sending, receiving, and storing invoices between suppliers and buyers (either business to business or business to government).

This has helped establish a national digital bookkeeping system, "SPED", which enables direct reporting of annual income taxes and other tax information. The Brazilian tax authority can now review, assess and act on some information almost instantly, including issuing penalties in near real-time. As a result, the number of audits, their assessed value and total tax collected has significantly increased.

5. PRE-FILLING

Partially pre-filled tax returns are used more commonly by tax administrations than fully pre-filled ones. A pre-filled tax return, where minimal input is required from the taxpayer, is available in countries such as Belgium, Denmark, Finland, Hungary, Iceland, Lithuania, Malaysia, Malta, Norway, Singapore and Slovenia. In these jurisdictions, if the taxpayer does not make any changes after a certain amount of time, they are 'deemed' to have accepted it. It is reported that Scandinavian countries experience 50–75% rates of returns not requiring changes by the taxpayer (OECD, 2006).

In Australia, the ATO provides the opportunity for clients to choose to pre-fill information directly into individual income tax returns, including salary, interest and private health insurance data sourced directly from employers, banks, and insurers. The information provided through this system helps the ATO improve services and makes it easier for those who want to comply to do so and harder for those that choose not to. In 2015-16, the ATO made close to 96 million transactions available for pre-filling, with taxpayers downloading more than 54 million of those transactions. It used over 636 million transactions reported by third parties to match individual income tax returns and other income statements. The ATO is using increasingly sophisticated data analytics and risk modelling to identify and review income tax returns that may omit information or contain incorrect statements. The ATO conducted around 450,000 reviews and audits resulting in revenue adjustments of over AUD 1.1 billion in income tax. Cases involved omitted income or over-claimed entitlements such as deductions or offsets, including those significantly different to claims made by taxpayers in similar circumstances.

6. TELEPHONE HOTLINE

Hotlines allow members of the public to provide information in confidence by telephone or by completing a form either paper-based or online on those they suspect of evading tax. There is little information available on the comparative effectiveness of hotlines and on the merits of particular ways of organizing them. Compared to other countries, HM Revenue & Customs in the United Kingdom is at the forefront in using a telephone hotline to obtain information from the public on those suspected of operating in the hidden economy. HM Revenue & Customs (HMRC) has used advertising to encourage the general public to provide information to the telephone hotline on those suspected of operating in the hidden economy. They can provide information on other types of suspected tax evasion cases as well (European Commission, 2007).

In Australia, the Taxation Office operates two telephone lines. The Tax Evasion hotline (or "dobbing line") is based at the Tax Evasion Referral Centre. In 2007 the Taxation Office also started the Tax Practitioner Integrity Service initiative where tax practitioners can telephone and report clients or former clients that they think may be worthy of closer investigation. The Tax Evasion Referral Centre received about 19,000 contacts about suspected tax evasion in 2004-05. Just over one quarter related to businesses suspected of operating in the cash economy and not declaring tax on their income. The main industries reported to the hotline were building and construction, retail trade and cafes and restaurants. The top 500 cases completed in 2004-05 resulted in additional revenue of approximately AU$29.7 million (£12.7 million).

In Belgium, the general public can use a general helpline number to alert the tax authority to cases that may be of interest. In Canada, there are several hotlines operated at the local level, but the Revenue Agency plans to set up a single number regionally. The United States has a large number of tax helplines aimed at improving compliance, but the Internal Revenue Service does not have a dedicated hotline. The general public can complete a form (Form 3494 A) to provide information on those they suspect of operating in the hidden economy which can be posted or faxed to the Internal Revenue Service.

7. CONCLUSIONS

In Kenya, the tax administration has already put in place a number of measures aimed at addressing the shadow economy and tax evasion. These include demonetization of the Kenyan currency; provision of tax amnesty on foreign assets and income; a common identifier (Huduma Number) synchronizing government services; as well as establishment of inclusive mechanisms to allocate government tenders to special interest groups particularly women and the youth (Akello, 2019). These have been notably adequate in addressing tax evasion in the shadow economy, driving up opportunities for transaction tracing and compliance to enhance revenue collection. These are however yet to significantly impact tax evasion by the shadow economy, as collections still perform below potential.

To realize improvement in efforts to address the shadow economy in Kenya, the paper recommends the adoption of the foregoing strategies as they have recorded success in tax administration particularly with regard to tax evasion in the shadow economy. These include data matching, risk modelling and advanced analytics, adoption of technologies to reduce ID fraud, including biometric database and digital verification, pre-filling as well as use of telephone hotlines.

In borrowing the foregoing strategies, it is to be noted that the countries reviewed differ socio-economically to Kenya and therefore one size does not fit all. As such, the strategies ought to be tailored to the country's specific circumstances. Also, addressing the shadow economy and improving tax evasion requires long-term reform efforts, beginning with strengthening the management and organization of the Kenya Revenue Authority, and building capacity in core tax administration functions including registration, debt collection, payment and filing enforcement, audit, processing of appeals and taxpayer services. Reform of the judiciary and legal framework may also be required to ensure that pertinent powers, dispute resolution processes and penalty regimes are in place.

It is also to be noted that reform priorities to improve tax evasion differ across regions and countries, reflecting differences in scope of tax abuse, administrative capacity, and stages of development. The relatively lower revenue productivity and wider tax gaps inherent in the country generally suggest possibilities of greater revenue yields from tax evasion addressing initiatives. For Kenya, getting the basics of revenue administration in place, particularly effective audit and enforcement and taxpayer service operations ought to be the first step.

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