Taxing the Digital Economy in Latin America and the Caribbean: What can be done

By:

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Introduction

The aim of this contribution is to suggest some courses of action for Latin America and the Caribbean (hereinafter, LAC) in relation to the taxation of the digital economy. For this purpose, after a brief description of the international background on direct and indirect taxation, I refer to the state of play in the LAC region, making a few preliminary considerations and presenting some generalities on the measures that have been adopted. Finally, I will share some thoughts and recommendations.

International background

Due to the digitalization of the economy, it can be said that there is an international consensus around the need to update current standards, including

tax standards, to address this phenomenon. However, the way forward remains controversial, in particular, in relation to what the OECD, in its 2015 report on BEPS Action 1, referred to as “direct tax challenges”, i.e., income taxation. As the OECD itself has already expressed, the whole economy is being digitalized. However, it is also fair to recognize that digitalization affects differently each economic sector and there are some “highly digitalized businesses” to which current tax principles and rules are particularly difficult to apply. This causes great and, definitely, undesired uncertainty for both, taxpayers and tax authorities.

Digitalization poses challenges in both fields, direct and indirect taxation. Regarding this latter, there is international agreement around the imposition of VAT according to the destination principle, i.e., imports are taxed while exports are granted a 0% VAT rate and a credit for the VAT on inputs. Main challenges in this field, relate to the enforcement and collection of the tax on cross-border B2C transactions. Indeed, this type of transactions have expanded and with it, the tax expenditure arising from the non-collection of the tax, is increasing. In this regard, international organizations recommend a solution based on the registration of foreign suppliers and direct payment of the VAT in the jurisdiction of the final consumer. In the LAC region, there is a joint project carried by the OECD, the Inter-American Development Bank (IADB) and the *Centro Interamericano de Administraciones Tributarias* (CIAT) on the design of a “Toolkit” to precisely support the uniform implementation of these recommendations.

The story is very different in relation to direct taxation and lately the discussion around a two-pillar approach lead by the OECD within the Inclusive Framework on BEPS, has caught the attention of the international tax community. Pillar One, is supposed to address tax challenges posed by the digitalization of the economy beyond BEPS (i.e. nexus, data and income characterization) by “revisiting” the current allocation of taxing rights, while Pillar Two, is supposed to tackle remaining BEPS risks and tax competition by establishing a global minimum level of taxation for every operating international business. A deep analysis on these pillars exceed the scope of the present blog post… In any case, the future of these two pillars is really uncertain, though the so-called GloBE -Global anti-Base Erosion- proposal under Pillar Two may have the higher

chance to survive and be finally implemented.

The state of play in LAC

Preliminary considerations

To contextualize the measures adopted in the LAC region it is relevant to bear in mind some preliminary considerations. Firstly, the LAC region is heterogeneous (in relation to the volume of population and market size, the existence of natural resources, the level of economic development, the political ideology, etc.) and therefore different priorities may arise, conditioning public policies, including tax policy. Also, some LAC countries are G20 (Argentina, Brazil and Mexico) or OECD members (Mexico, Chile, Colombia and, as a candidate in accession, Costa Rica); Brazil is one of the so-called "BRICS" economies. The majority of countries in the region is a G20/OECD Inclusive Framework on BEPS (hereinafter, IF) member, under which the current "digital" debate is precisely taking place. However, as at January 2020, four LAC countries –Argentina, Brazil, Colombia and Jamaica- were members of the so called "Steering Group" of the IF, where, precisely, political decisions on Pillars One and Two are being taken.

Secondly, despite this diversity, it can be said that in general, LAC countries are net capital importing countries and are not the seat of the headquarters of the biggest multinational groups, which, from an international tax perspective, means LAC countries are mainly "source" jurisdictions.

Thirdly, the tax structure of these countries reveals a clear prevalence of consumption taxes in comparison of OECD countries: 51% vs. 32% (OECD 2020). Furthermore, in relation to income taxes, corporate income taxation in the LAC region has the highest relative weight, much more than in the OECD.

LAC measures to address the digital economy

- **Indirect tax challenges**

In general, LAC countries have addressed indirect tax challenges posed by the digitalization of the economy, introducing statutory changes to the VAT legislation in relation to cross-border “digital services”. New measures either complemented existing rules covering only B2B transactions or lacking an enforcement procedure, or created new ones. A detailed description of those changes exceeds the scope of this blog post, however, further information on some of these recent measures can be accessed in Arruda et. al. (2019), Suffiotti (2020), ECLAC (2019) and BID (2020).

As a result of the abovementioned changes, the treatment of services rendered by foreign suppliers varies amongst national solutions; legislation may refer to services in general (either only in B2B transactions or both, B2B and B2C ones), digital services or even to some types of digital services (and, depending on the case, excluding expressively others). In this regard, we should bear in mind that historically, and in general, in the LAC region, VAT on services has been based mostly on the origin principle (foreseeing, some countries, as an exemption to the general rule, a 0% VAT rate for specific services supplied to foreign consumers). In this regard, changes introduced to address the digitalization of the economy have intensified this LAC “hybrid” character of VAT systems, where the origin and destination principle coexist for cross-border services transactions.

Connecting factors, i.e. the criteria to locate the consumer of the service, though not exactly the same for each country, they present some convergence. Furthermore, in general, and when defined, digital services not only are characterized similarly within the LAC region, but also, bearing great resemblance to the definition of “automated digital services” proposed for income tax purposes under Pillar One as we refer to *infra*.

Finally, and in relation to the collection of the VAT, solutions either require the foreign supplier to register and pay directly the tax in the jurisdiction of consumption or resort to a withholding mechanism by intermediaries such as, financial or telephone institutions. In the particular case of Argentina, the responsible to pay the tax may even be the individual consumer itself.

Direct tax challenges

- ***Corporate income tax***

As for income taxation, except for the case of Uruguay and more recently and as part of last year tax reform, Paraguay, in general the LAC region, including "biggest players in the LATAM region" (Teijeiro 2020), has not adopted any measure, probably waiting for the OECD recommendations. In both, the Uruguayan and the Paraguayan cases, specific provisions were introduced within the income tax system itself. Nevertheless, the Paraguayan provisions are not yet in force. Though the reason claimed for suspending the enforcement was the COVID-19, the decision may be related to the fact that intermediaries have expressed some dissatisfaction in withholding the tax.

The Uruguayan solution (Riccardi 2019; 2020), though partial (i.e. just some types of digital businesses are covered), is the outcome of a collaborative dialogue between digital providers, tax authorities and other interested parties, and mainly relies on digital providers registering themselves in Uruguay and paying directly the corresponding tax (6% or 12% on the "gross" income).

Peru can be said to be a real visionary, as its income tax legislation concerning digital services corresponds to pre-BEPS times. Indeed, as for a statutory change by the end of 2003, in force as of 1 January 2004, income arising from digital services economically used in Peru is considered to be of Peruvian source. However, this provision is limited to digital services supplied to businesses (i.e., B2B transactions) and the amount of the tax is set at 30% of the (gross) income paid to the digital service provider.

Peruvian legislation defined digital services as those services provided to users via Internet or similar means, accessible on line, essentially automated and not conceivable without information technology. As you may note this definition and the definition of "automated digital services" proposed under Pillar One converge; furthermore, the Peruvian legislation foresees a non-exhaustive "positive list".

- ***Positive externalities***

Registration of foreign suppliers, in particular, of digital intermediation platforms, has spillover effects as may help on taxing those offering their services or goods via said platforms. Indeed, formalization of underlying activities has been possible, and at the same time, tax compliance obligations for smaller taxpayers have been facilitated. This has been the case in Uruguay for land passenger transport and, with a broader scope, in Mexico, where digital platforms are responsible for withholding the tax corresponding to those underlying suppliers. Besides they provide information to the tax authority on a regular basis.

Recommendations for LAC

Digital transformation is here, not only to stay but to keep growing. The search for a solution should not be delayed. However, at this point I believe we should not look for the “perfect” one, but one that, with time, could be improved (“making the path by walking”). However, the solution (though, “incomplete”) must be principled-based, otherwise we risk the coherence of the tax system itself.

In relation to VAT, there is space for improvement. In this regard, I recommend LAC countries to follow the international trend on taxing cross-border services transactions –not just digital ones- based on the destination principle. This would imply taxing “imports” but also the application of a 0% VAT rate on exports, representing this, a competitive advantage for the region. While the reverse charge is the ideal collection mechanism for B2B transactions, the registration and direct payment by the supplier seems to be a better option for services delivered to individuals. For this purpose, not only digitalization of Tax Administrations is key, but also cooperation and the exchange of best practices. In this regard, joint regional standardized mechanisms can be explored.

MNEs as business they are, should be taxed, but, as I always say, fairly, i.e. not imposing excessive tax and administrative burdens. Cooperation and collaboration between taxpayers and Tax Administrations is also of upmost importance; the creation of transparency and the involvement of all interested parties should be the pillars of such cooperation. Also, it should be born in mind that corporate social responsibility is nowadays of upmost importance for MNEs

and reputational risks conditions their actions. This, definitely may enhance their compliance. Furthermore, digital businesses have an advantage: technology, which is their expertise, and may serve to ease compliance burdens.

Having said this, in a globalized world with global taxpayers, solutions should ideally converge. However, such convergence demands first the recognition of the existence of an unbalanced international allocation of taxing rights. Only after this is recognized, a “real” global solution could be conceived.

Regarding corporate income taxation, what I recommend to LAC countries is to make an effort to keep the coherence in their tax system. LAC countries are known as defenders of taxation at “source”. In this sense, traditionally the concept of source has been that of “source of production”, i.e. the source of an item of income is linked to the place where activities are carried out and factors of production are applied. However, an increasing tendency to introduce provisions based on the “source of payment” criterion (i.e. the source of an item of income is linked to the place of residence of the payer), particularly in relation to services of a technical nature, and now digital services, has resulted in the coexistence of both criteria. Yet, it should be recognized that this takes place in a context where LAC countries have been compelled to sign tax treaties based on the OECD and UN models, which, it is no news to mention, both, favours residence taxation.

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