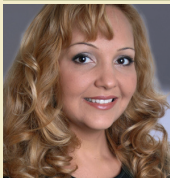


# VAT focus

## Indirect tax in South America

**SPEED READ** The unification of consumption taxes in Brazil, as well as tax standardisation (at least among the MERCOSUL members) is an important factor for attracting new investment and, ultimately, increasing South America's share in the world economy. While MERCOSUL members Argentina, Paraguay and Uruguay have moved toward harmonisation of taxes over consumption, the adoption of a single federal VAT in Brazil is pending tax reform. Brazil's indirect tax structure is unique within MERCOSUL and its Associated members, where taxation over consumption is primarily through a VAT and falls under federal administration. In Argentina, Chile and Colombia there is a tax on consumption (IVA) similar to the EU's VAT.



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This article provides an overview of indirect tax and VAT administration in South America and, in particular, Argentina, Brazil, Chile and Colombia.

### Steps toward economic integration

In 1991 Brazil, Argentina, Paraguay and Uruguay took steps toward economic integration through the Treaty of Asunción (updated in 1994 by the Treaty of Ouro Preto). The goal was to develop a common market among South American nations, similar to the European Union and NAFTA, and resulted in MERCOSUL/MERCOSUR (Mercado Común del Sur in Spanish, Mercado Comum do Sul in Portuguese, or the Common Market of the South in English).

About 95% of intra-MERCOSUL trades are carried out free of tariff barriers. Member nations have defined a single tariff table with legal compatibility with other commercial blocs such as 'Associação Latino-Americana de Integração' (ALADI) and GATT.

Besides the original members of MERCOSUL, Bolivia, Chile, Colombia, Ecuador and Peru are considered Associated Members, and are entitled to be part of certain agreements. Venezuela is in the process of integration.

Since its formation, MERCOSUL expanded its commercial relationships with other economic blocs, and the EU recently presented to MERCOSUL a proposed trade pact that would create a new world economic bloc. Progressive tax cuts are being analysed by the EU and South American nations, although concerns have been raised on both sides.

### MERCOSUL and taxes

Despite efforts toward commercial unification, the regulation of internal tax systems in South America presents a significant challenge for

companies operating in the continent. As a result, the standardisation of taxes over consumption among the MERCOSUL and its Associated States has become increasingly important to these companies in order to alleviate the tax administration and compliance pressure. While three MERCOSUL members have moved toward harmonisation of taxes over consumption, the adoption of a single federal VAT in Brazil is pending tax reform.

### Brazil: indirect taxes

Brazil's indirect tax structure is unique among MERCOSUL and its Associated States, where taxation over consumption is primarily through a VAT and falls under federal administration.

Brazil has one of the most complex tax systems and highest tax burdens in the world. The complexity originates from:

- the density of tax legislation, the large number of taxes (that fall under different levels of administration);
- multiple types of tax authorities;
- numerous possible rates and ever-changing rules;
- recent changes in compliance procedures (ie, Electronic Invoice and Public Digital Bookkeeping System or Sistema Publico de Escrituração Digital (SPED) – an e-bookkeeping system used by Brazilian companies; differentiated taxation for interstate acquisition of goods through internet and call centres).

Legislation related to state and municipal taxes is issued by each jurisdiction (more than 5,500 cities and 27 states), which results in challenges for companies in the form of interpretation of updated legislation and the associated compliance requirements.

There are five indirect taxes in force in Brazil, distributed among the federal, state and municipal administrations, applicable to the domestic transactions:

- **PIS – Contribution for Social Integration Program** (Federal Administration): Levied monthly over the gross income of corporate entities. Liable 2 main types of regimes – Cumulative and Non-Cumulative.
- **COFINS – Contribution for Financing of Social Security** (Federal Administration): Levied monthly over the companies' gross income. Liable 2 main types of regimes – Cumulative and Non-Cumulative.
- **IPI – Federal Excise Tax** (Federal Administration): Imposed on businesses with imported products or goods manufactured in Brazil. IPI is non-cumulative; and thus tax due may be offset by credits arising from the acquisition of raw materials, intermediary products, and packaging materials. The IPI rates vary in accordance with the nature of the goods.
- **ICMS – State VAT** (State Administration): The main state tax, and levies on movement of goods, communication services and transportation (interstate and inter-municipal), ICMS is non-cumulative tax, so input credits are allowed to

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taxpayers. Its taxable basis is the cost of goods and services, added to all the expenses charged to the purchaser plus the ICMS itself ('gross up' effect) and IPI (on sales to final consumers).

- **ISS – Municipal Tax on Services** (Municipal Administration): Levied on the services supply (other than those subject to ICMS) listed in the federal legislation. The taxable base of ISS is the price of the service provided. It is a cumulative tax, so ISS tax credits on inputs are not available.

Recently, Brazilian tax authorities instituted the fiscal SPED, an electronic file comprising the register of all tax documents among other fiscal information of interest to the Brazilian tax authorities, as well as the statement of tax accruals related to transactions carried out by the taxpayers. This file is digitally signed and transmitted over the internet to the SPED environment.

With the World Cup and the Olympics Games to be held in Brazil in 2014 and 2016 respectively, the federal, state and local governments have recently launched the 'the goodness tax packages' in order to help free funds needed for activities deemed essential to organising and conducting such events. This tax relief package proposes the waiving of various federal taxes, such as the IPI, II, PIS, COFINS, CIDE, and import tariffs of products applied on organising and hosting of these events.

Some states and municipalities have also agreed to grant the ICMS and ISS proportional exemptions, for the transactions involving goods and services related to such events.

Interstate acquisitions of goods, by end consumers, made through internet, telemarketing or show room has been subjected to an additional ICMS taxation since 1 April 2011. Such additional ICMS must be calculated and collected by the seller to the destination state (further than the ICMS already paid by the seller to the origin state).

Current discussions toward the unification of the ICMS interstate rate to 4% (actually 7% for the North and Northeast and 12% for all others) by the Brazilian states. The rate unification will be gradually implemented from January 2012. Another recent tax development in Brazil involves a change made by the Brazilian government in March 2011 to the tax on financial operations (IOF) rate. The tax, levied on foreign loan transactions, was to increase the IOF tax rate on foreign currency transactions from zero to six percent, subject to certain conditions.

### Comparison table of VAT rates

VAT rate*	Argentina	Brazil	Chile	Colombia
<b>Standard</b>	21%	Federal: IPI (0% to 330%) PIS (0.65% or 1.65%) COFINS (3% or 7.6%) State: ICMS 17% or 18% Municipal: ISS: 0% to 10%	19%	16%
<b>Reduced</b>	10.5%	Interstate Transactions: No ICMS rates reduced to 12% or 7%	No	10%, 5%, 1.6%, 0%
<b>Increased</b>	27%	No	No	20%, 25%, 35%

\*The rate can be different for some specific products/services.

### Argentina, Chile and Colombia: taxation on consumption (IVA)

The taxation on consumption (IVA) in Argentina, Chile and Colombia is similar to the EU's VAT. Generally speaking, it consists of an output and input tax levied on the sale of goods located within the country, services provided, and also to other commercial transactions such as import of goods brought from other countries. The VAT calculation basis is net price of the goods or service.

In terms of compliance, the excess of the output tax over the input tax must be paid within a certain period, but there are exemptions for some products and services.

The most recent tax developments among the three nations have come from Chile, albeit in relation to corporate tax. The country announced in 2010 that it would raise its corporate tax rate from 17% to 20% in 2011 in order to supply revenue for the nation's reconstruction efforts stemming from the 2009 earthquake. Under the plan, the rate will decrease to 18.5% in 2012, and return to 17% by 2013.

Chile also recently established a reorganisation process regime under which the Chilean Tax Authority (IRS) is prohibited from having staff assess a transaction in case of a total or partial contribution of assets (including shares or quotas), carried out within the reorganisation of a group of enterprises due to a legitimate business reason and made at its tax book value or accounting book value, among other requirements. ■

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