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NAVIGATING THROUGH LATAM TAX COMPLEXITIES

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“Increasing awareness of the complexity of the tax regimes in LATAM”

Abstract:

This article aims to raise awareness of the complexity of different tax regimes within Latin American countries. It explains the evolution of tax policies in different countries and how advanced some countries are, compared to other Latin American countries. The article covers the digital transformation initiatives taken by the various tax authorities and how they influence the ERP landscape for multinational companies operating in LATAM and the rest of the world. The author provided an in-depth analysis of the technological requirements for electronic invoicing and digital compliance requirements for different countries.

Finally, this article describes how Helixr’s Global Tax Technology team can work like a trusted partner for multinational companies to navigate through tax complexities and provide support to deploy relevant tax solutions as part of ERP solutions and Business restructuring initiatives.

Overview of LATAM tax systems:

History on South American tax systems:

Latin American countries were once a part of the Spanish and Portuguese colonies. During that time, the tax policies gave preferences to the wealthy and elite people rather than the majority of the population. Gradually many reforms were made to their tax systems to improve efficiency.

The first round of tax reforms and changes in tax policies came in around 1970, whereby the tax systems moved away from progressive taxes and concentrated more on public spending to tackle the inequality in society. At the same time, Value Added Tax (VAT) was first introduced into the region. Brazil and Ecuador were among the first to introduce VAT, and the rest of the countries in the region followed very closely.

In the early 2000s, taxation has been the central focus in all South American governments’ fiscal policy. They increased the tax rates and introduced new taxes to increase spending on the public and bring equality among them.

These reforms led to the South American region being one of the most complex tax systems in the world. Tax systems are different from one country to another as many tax instruments, regimes, and agencies are involved in their regulation. The management of the tax systems varies based on the country’s political and administrative organisations.

Tax systems:

The tax system was changed over a period of time through various fiscal policy changes and tax reforms. Some countries like Argentina and Brazil have concentrated more on indirect taxes, and they have managed to increase the tax revenue by 50%. The ratio between Tax revenue vs. GDP has grown considerably for these two big countries. On the other hand, countries like Mexico and Columbia have adopted ,more straightforward tax regimes, especially in Indirect taxes.

The complexity of the indirect taxes is considerably much more than that of the direct taxes. A particular transaction between buyer and seller could attract multiple federal level taxes and also at the same time state or provincial level taxes in Brazil and Argentina. For example, when a product is sold to a customer in Brazil and Argentina, the invoice (e-invoice / /nota fiscal) usually contains federal and state-level taxes. Additional complexities in the case of Brazil is the social contribution taxes based on the revenue of the seller. At the same time, it is VAT percepciones and retenciones at state and city level in the case of Argentina. In other Latin American countries, the same sales invoice will have simplified indirect taxes similar to the European countries Value Added Taxes. This is the case for Mexico and other Central American countries.

These differences add complexity to the ERP systems’ landscape for the big companies who want to expand their operations into the Latin American countries. The other important aspect that influences the ERP landscape for the Global companies is the tax determination rules.

Dynamics of Tax rules:

Argentina:

VAT is applied at all stages of the production and sales processes. The taxes that are recognised in the immediately preceding stage are deductible from the output tax payable. The following are the different types of taxes in

- Federal Taxes – Income tax, Tax on Minimum Presumed Income (TMPI), VAT, Financial taxes on Bank transactions and Personal asset transactions.
- Provincial Taxes – Turn over tax and stamp duty are the ones collected by the provincial governments.
- City tax – One city acts like a province and collects taxes i.e. in Buenos Aires.
- Municipal taxes – There are more than 2000 municipalities in Argentina and they collect taxes on rates and assessments.

Retenciones: It becomes even more complex for the ERP system to determine who will be responsible for collecting taxes and making payments to the relevant tax authorities. The collection mechanism was defined for both VAT and Turnover Tax as a form of “Withholdings” (Retenciones). Withholdings are performed by buyers appointed as Withholding Tax Agents (WTH) in the respective federal (VAT) and provincial (Turnover Tax) regulations. In general terms, the WTH agent performs Withholdings upon payment to suppliers (remitting a lower payment and issuing the Withholding tax certificate).

Percepciones: Similar to Retenciones, but in this case the seller acts as WTH by applying the reverse Withholding taxes. VAT and Turnover Tax regulations provide provisions for this type of collection mechanism. Reverse Withholding taxes are included in the invoice as an additional amount to be paid by the buyer. The amount of the reverse Withholding will be deemed as a tax amount paid for the buyer and it should be included in the VAT/Turnover tax return in the same period when the reverse Withholding tax was applied.

Buenos Aires –The city regulations have provision for Retenciones and Percepciones. The percentage rate of the Withholding or reverse Withholding taxes are determined by the tax group that is assigned to each organisation, based in Buenos Aires by the City tax authorities.

Impact on ERP Deployments:

- Managing the different types of taxes that should apply to a transaction along with deriving the tax rates requires special tools or functionalities within the ERP systems. Country specific solutions are needed to determine the correct taxes and to perform the tax calculations. The companies who use SAP as their ERP system usually activates or configures their system with the Argentina Localisation content.
- Determination of the collection agents for VAT and Turnover Tax at all three levels like Federal, Provincial and City taxes is complex, and relevant information needs to be kept in the system to derive

the right tax.

- The process of issuing and receiving Withholding taxes under Retenciones and Percepciones is different and considered a new process for Argentina. This requires changes in the procure to pay end to end process. Also, at the same time it impacts the order to cash process in terms of recognising short pay or accepting the Withholding tax certificates.

Brazil Tax System:

Brazil has a complex system of corporate taxation in which the federal government levies:

- Corporate income tax (IRPJ);
- Social contribution tax on profit (CSLL);
- Federal value-added or excise tax on manufactured goods (IPI);
- Financial transactions tax (IOF);
- Excise tax on cross border royalties and services (CIDE);
- Social security financing tax on revenue (COFINS);
- Social Integration Program tax on revenue (PIS/PASEP);
- Employer social security contributions (INSS);
- Rural property tax (ITR).

The Brazilian states and the Federal District of Brasília, 27 in total, impose a value added tax (VAT) on the circulation of goods and telecommunication and transportation services (ICMS), and taxes on inheritances, donations (ITCMD), and motor vehicles (IPVA).

Municipalities and the Federal District charge taxes on services (ISS), urban property (IPTU), and transfers of urban real estate (ITBI).

Brazilian requirements around the calculation of taxes and the information required to support the calculation basis in the electronic invoice (Nota Fiscal) are complex.. For example, turnover, geographical location, and the tax status of the vendor/customer determines whether to apply reduced social contribution tax rates or not. Similarly, the type of products and to whom they are sold, determines the tax rates and the applicability of the State and Federal level taxes.

The tax payer who is issuing the Nota Fiscal is responsible for specifying the references to the tax legislation whenever a reduced or special rate is applied on the transaction.

Impact on ERP systems:

- The determination of different taxes and rates to be applied is based on several attributes of the buyer, seller and the goods and services that are involved in the business transaction. This means the master data standards that are defined as part of the global template process or solution for large corporates, requires amendments and new local processes needs to be defined.
- In the case of SAP systems, Brazil Localisation content has delivered approximately 15 new fields to capture the information about suppliers and customers in their master data.
- Similarly, Material master information has additional fields to determine the parameters that are required for tax calculations.
- There are several other attributes that are required to prepare the Nota Fiscal and they are determined as part of the tax calculations. For example, the CFOP code represents the type of business activity – sale, purchase, transfer, etc. Similarly, the tax situation codes determine whether the standard tax rate is applied or if it is reduced/exempt.

Electronic Invoicing:

Usually, big corporates exchange big volumes of data electronically with their counterparts. This is considered to be best practice. Large pharmaceutical and process companies issue purchase orders electronically to fulfil their contract manufacturing requirements; similarly, sales invoices are issued to the big wholesale distributors and pharmacy chains.

There are several ways the companies exchange their sales invoices electronically. The most common method is to have an electronic data interchange (EDI) which is a direct connection between the seller's and buyer's systems.

In some cases, companies use a third party service to exchange invoices.

This initiative from private sector companies has been recognized by several governments and is seen as an opportunity to reduce tax gaps. Especially, in the LATAM countries, there are several areas where the VAT gap is causing an approximate 20% dent in public revenue. For example, some of these gaps are:

- Cash payments for exchange of goods without receipts and tax returns – this leads to a loss of VAT and income tax for the revenue department.
- Invoicing using the wrong amounts in exchange of goods.
- Invoices issued but goods are not supplied.

These kind of tax evasion business activities have become the biggest problem for South American countries since 1970s. Revenue departments of the relevant governments started collecting vast amounts of data using Data lake/Big data concept and with the help of Artificial Intelligence, they have started identifying the VAT gaps.

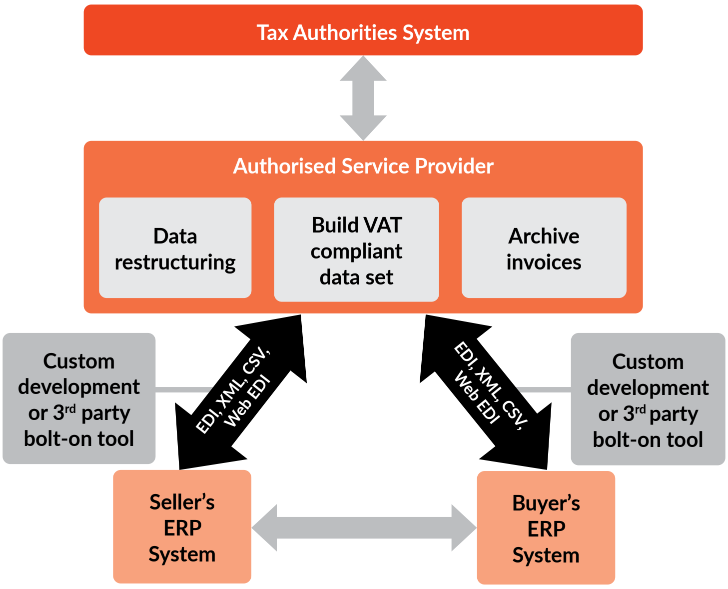
Considering all fiscal documents, it is the invoice which provides the most complete information for tax authorities. Hence, the governments started to mandate the companies/tax payers exchange invoices in electronic format only. The invoices data also needs to be shared with the tax authorities before or after shipment of the goods.

In Latin America, country-wide projects were launched by the tax authorities with the aim of reducing tax evasion. Chile was the first country in LATAM to introduce voluntary electronic invoicing in 2001. Brazil and Mexico are also one of the early adopters and made e-invoicing mandatory for all businesses with a very few exceptions.

From a technology point of view, the key challenges for any ERP deployment are:

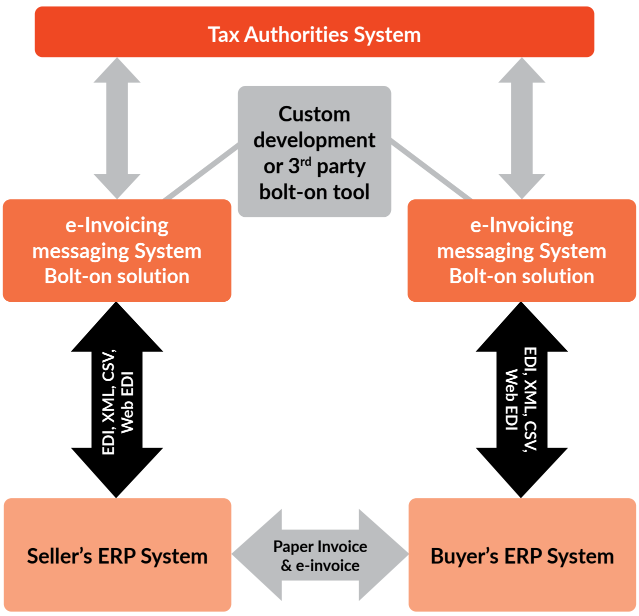
- Real time integration of electronic documents such as sales, purchase and transportation invoices into AR and AP processes within ERP systems.
- As explained in the previous sections, Latin American countries' tax systems are very complex with several taxes and taxes that are due at the time of the movement of the goods which do not add any value. Hence, tax determination in sales and purchase transactions seems to be one of the key challenges and the same needs to be reported correctly in all the electronic invoices.
- The e-invoicing structure is most comprehensive with more than 500 different XML segments in an invoice to report the business transaction in real time with the different tax authorities.
- Depending on the industry sector, extensive supply chain data needs to be provided in the electronic invoicing. For example, pharma and process industries are expected to report the regulatory information, batch traceability, serialization data, etc. This proves that the integration of finance and supply chain data is critical to generate an electronic invoice.

The complexity of legal requirements and the size of the organisation drives the requirements for technology. In the case of Brazil, to issue Nota Fiscal electronically, usually companies rely on bolt-on tools to the ERP systems. For example, SAP has a built-in integration with SAP's own bolt-on solutions like SAP Nota Fiscal Electronica and SAP Tax Declaration Framework. In other countries, like Colombia, Argentina and Mexico, most of the companies have either bolt-on tools or custom developments in their ERP systems to integrate the data with the authorised service provider's systems, for reporting the electronic invoices and also for getting the necessary approvals.



Picture 1: Tax Realtime reporting via Service provider

This model is applied in Mexico, Colombia, Argentina, Peru and other Latin American countries.



Picture 2: Tax Realtime reporting – Directly connected with Tax Authorities systems

The tax authority in the country mandates the organisations on the model through which the electronic invoices needs to be reported and validated. Refer to the below pictures for the different models:

Impact on ERP deployments:

Technical infrastructure:

Based on the tax authority mandate, companies need to source new technological tools to communicate with the tax authority systems. For example, in Brazil if a large organisation is using SAP as their ERP system, they might have to purchase another SAP server to install SAP Nota Fiscal Electronica and additional functionality or features in SAP Process Orchestration system. The other alternative option is to procure a third party bolt-on tool, for example, MasterSAF DFE can be integrated with any ERP system and acts as a messaging system with the tax authorities system (SEFAZ).

In other countries like, Colombia and Mexico, big corporates use third party bolt-on tools from authorised service providers. For example, EDICOM e-invoicing solution is one of the popular tools in the market along with Invoiceware and Sovos.

Complex Business models:

In order to simplify their selling process, some organisations use an agency model to sell their products. This is very common in pharma companies, whereby an agency sells the products on behalf of the pharma company to the distributors, wholesale shops, government agencies, hospitals and big pharmacy chains. This type of business model adds more complexity for issuing the electronic invoicing to the tax authorities and to the buyer. One of the key objectives of electronic invoicing is to match the financial movements with the physical movements of the goods, so that there will not be any leakage in terms of VAT and income tax reporting.

Disruptions to the Global template solutions:

Some of the Latin American countries tax authorities have implemented very strict regulations whereby companies cannot move their goods without the prior approval of electronic invoice, but in other countries the approval can be obtained either within 24 or 48 hours after the invoice has been issued. From the buyer's perspective, in some countries there is an obligation to confirm the receipt of the goods and acceptance of the seller's invoice in their accounting books. These additional process steps disrupt the global procure to pay or order to cash processes defined in the large companies' global template solutions.

In most cases, companies had to implement additional functionality or custom logic to integrate the LATAM Localisation components with the global template solution. As a result, whenever there is a legislation change in the electronic invoicing, companies have to assess the impact on their global template solution, requiring additional regression testing efforts.

Impacts on master data:

The three main master data objects which are core to any business, require additional information in each Latin American country to issue or receive electronic invoices.

To provide the required details in an e-invoice, information about suppliers and customers needs to be up to date in ERP systems. For example, as part of Brazil Localisation, SAP has introduced around 15 additional fields to support the e-invoicing solution for Nota Fiscal. Similarly, for Argentina additional fields have been introduced to support the tax decisions. The management of the additional fields requires changes to the Global template solutions and master data standards.

Depending on the type of industry and type of materials, different information needs to be provided in the electronic invoices. In the case of controlled drugs or medicinal products, companies are required to provide the regulatory information along with the batch information. Similarly, for petroleum products, there is a requirement to provide the oil & gas regulatory information in the electronic invoice.

Compliance process:

All the Latin American tax authorities are building up the massive databases via electronic invoicing from different businesses, and have initiated other key projects across different administrative departments to make sure the tax payer is correctly reporting their accounting records from an indirect and direct taxes point of view.

In order to validate the vast amounts of data, most of the revenue departments of the countries mandate the organisation to fulfil the compliance process electronically, either by providing the data extract or preparing the data in specified file formats like XML.

For example, companies in Brazil must comply with SPED, Sistema Público de Escrituração Digital, which translates into Public System of Digital Bookkeeping. This system was created in 2008 to replace the paper copies of the invoices and tax records of every tax payer. This system keeps the record of every electronic Nota Fiscal and accounting system, making it easier for the tax authorities to uncovertax evasion or criminal activities by companies or individuals. As a result of implementing the SPED system for invoicing and reporting, Brazil has seen a remarkable increase in tax revenues by $58 billion dollars and managed to close the VAT/Tax gap.

The tax compliance process is one of the most complex processes and the number of legislative changes are considerably high in almost every Latin American country. A study indicates that on an average 46 new legislations are issued every business day. This ensures the tax departments of every organisation put in every effort to satisfy the compliance reporting requirements. The below picture demonstrates the number of hours spent on direct, indirect and employment tax obligations.

The types of tax filings are different from one country to other within LATAM and the number of submissions and tax payments are different. This is mainly driven by the tax system within each country and it varies based on the number of tax authorities and the granularity of the business information required for each tax authority.

For example, in Argentina, on a monthly basis all tax payers are expected to submit Daily VAT, Electronic duplicate, CITI ventas and Compras to federal, provincial and city authorities.

The other complexity in the case of Argentina's compliance process is to make sure the Withholding tax certificates have been issued and received correctly. In the case of Retenciones, the seller computes the Withholding tax on their own returns with reference to the Withholding tax certificates received from the buyer. In certain cases, the seller could get an exemption from the Withholding tax deductions upon formal request to the relevant tax authorities.

Similarly, in Percepciones the buyer could get an exemption from Reverse Withholding tax from the seller upon formal request to the relevant tax authorities.

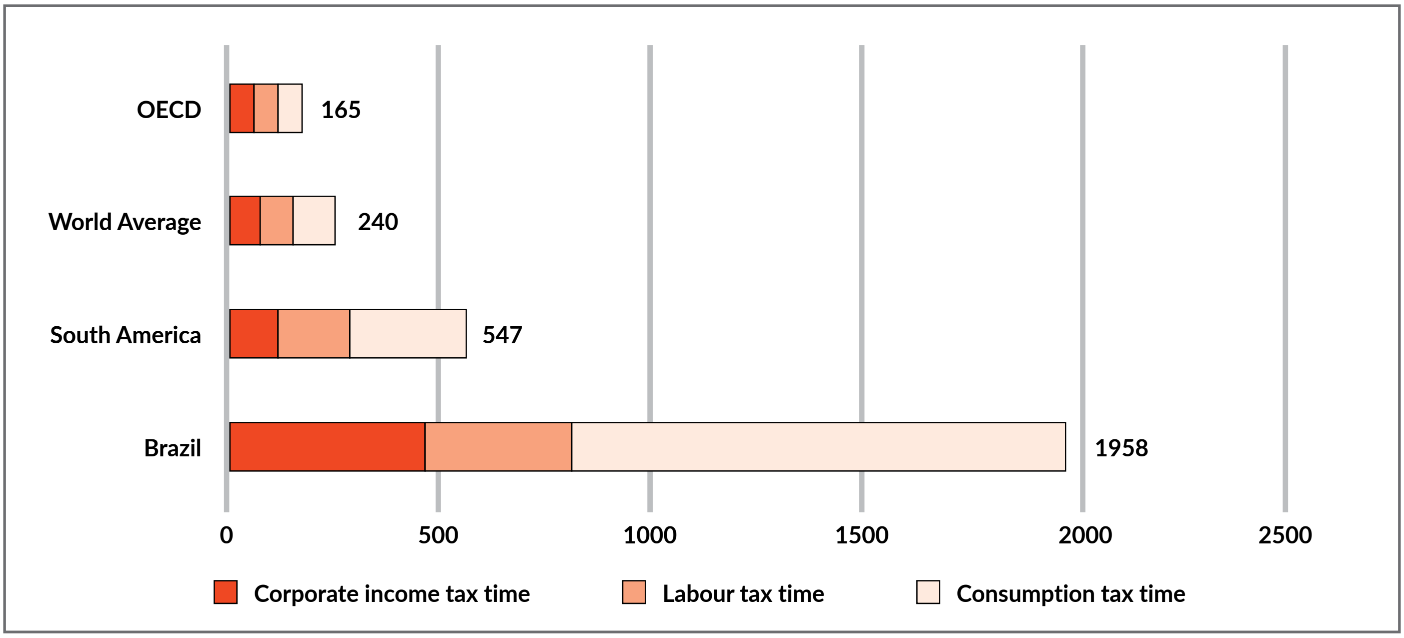
The most complex tax system in LATAM is in Brazil, who also has the most number of tax filings and tax payments via the SPED program. As an example, for an organisation who has one manufacturing facility and two distribution centres to sell the goods across Brazil, potentially the company needs to file at least 110 tax filings and about 130 tax payments.

In Brazil, the SPED program is defined to include the measures to foster technological development and the implementation of the electronic accounting and SPED tax bookkeeping system. SPED represents an integrated initiative by the federal, state and municipal tax authorities to promote a transparent relationship between tax authorities and taxpayers. Adapting to this new model of reporting, however, requires significant commitment from legal entities, including investment in process standardisation, training and technology. SPED affects how tax and accounting records are issued and kept, as well as how legal entities relate to the tax authorities.

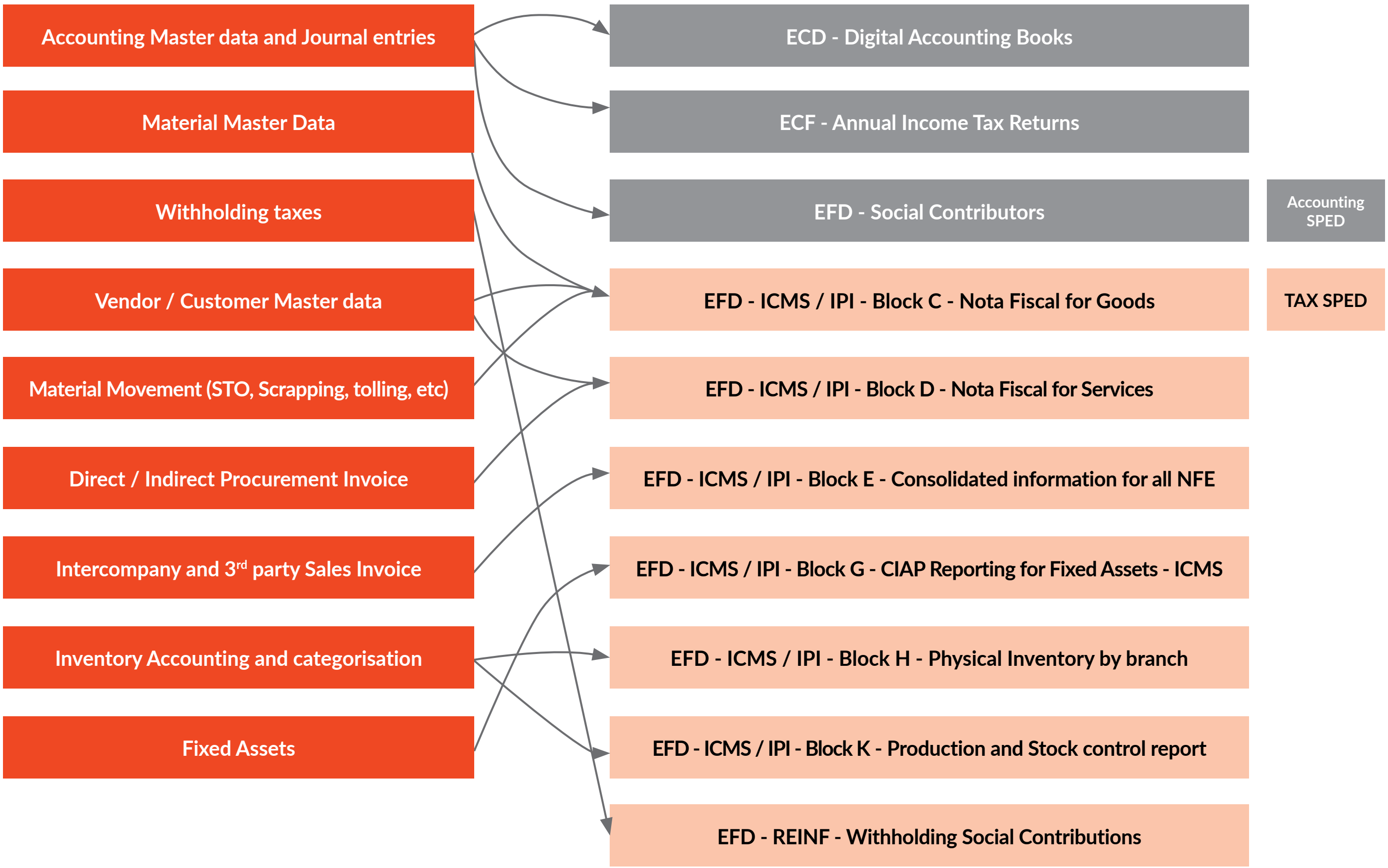
The below picture describes how the Brazil compliance process relies on upstream processes across the organisation:

In Mexico, E-Accounts are required from every company that is registered as a tax payer and have to be be filed on a monthly basis to the tax authorities. Companies are legally obliged to keep electronic accounting records and convert this information into an XML format for periodic submission (e.g., on a monthly basis) via the tax authority (SAT) web portal.

Figure 1: Time to comply with taxes



Source: Paying Taxes (2018).



All companies are required to submit three different files:

- Chart of accounts (standardised to accounts defined by SAT)
- Trial balance based on chart of accounts
- Journal entries based on the same chart of accounts for SAT reporting purposes. Some journal entries will require e-invoicing data (UUID, date, RFC emitter/receiver, amount before tax, taxes, total amount, payment method, etc.)
- Companies must have an internal chart of accounts for and a mapping (translation) to the standard version provided by the Tax Authority. Only the first two files must be submitted every month but all three must be generated at the same time. All three must be in XML format.

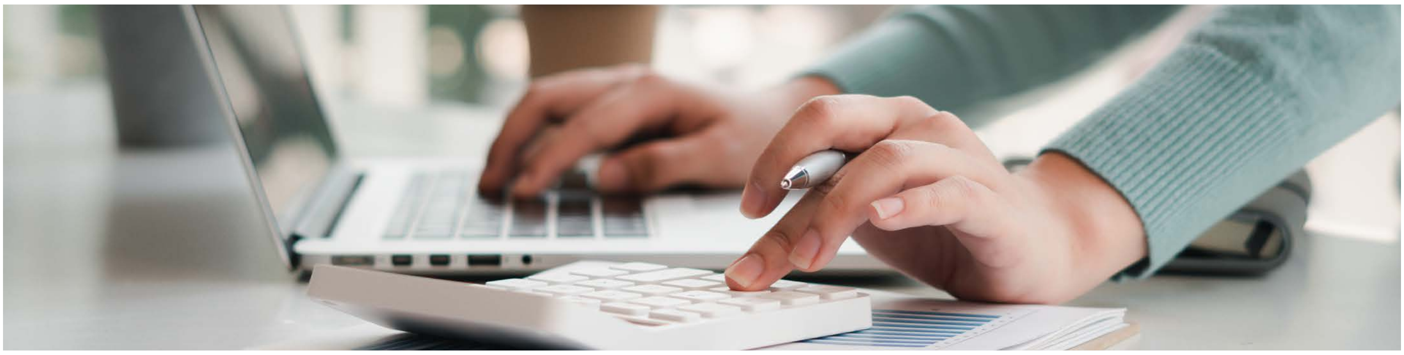
According to the Mexican Miscellaneous Rules, rule 2.8.1.6 fraction II, electronic accounting must be filled no later than the third working day of the second month after the month that the information corresponds to, for every month of the fiscal year (e.g. January transactions are reported and submitted by 3rd March).

For the annual reports, the trial balance at the end of the fiscal year should be uploaded no later than the April of the following year. Companies must also submit the information related to payments, withholdings and crediting and charging of VAT with suppliers. This needs to be done on a monthly basis.

Similar to Brazil, the Mexican compliance process requires the information from the upstream processes like procure to pay, order to cash, warehousing and distribution and financial information from the record to report process. The solution is very intrusive to any ERP system. Even with SAP systems there are certain areas where the compliance requirements are not fully met. One particular area worth mentioning is the preparation of electronic accounts in an XML format that is acceptable to SAT (tax authority in Mexico).

Some companies in Mexico look for a third-party compliance tools in order to meet the requirements. But these tools have both positives and negatives; they may resolve the XML file presentation problem, but add complexity to ERP systems in order to provide the necessary details for third party tools. Licencing and integration costs would be an additional burden to the ERP teams.

In terms of VAT returns in Mexico, the DIOT's must be filed using the Tax Authorities software (downloaded from the Tax Authorities webpage), even if SAP is able to provide and create a report, the manual input of the data into the software is necessary. SAP reports have to be configured/built in order to have the necessary data to fill out the web form.



Conclusions:

Indirect taxation and the corresponding compliance requirements are quite different from one country to another within LATAM. The degree of complexity also varies depending on how advanced their tax digitalisation journey is. The ongoing tax digital transformation initiatives from tax authorities will drive new legislations or changes to the existing legislations.

This is creating a very dynamic tax environment that every multinational company is trying to accommodate within their current ERP systems. In most of the cases, the lead time to react to these new tax rulings or legislation changes is very limited and the tax departments end up defining a manual workaround to meet the legal requirements until their IT teams come up with an appropriate solution.

The dynamic environment makes it even more difficult for any new multinational company that wants to roll out their global ERP systems/template to Latin American countries. These new deployment initiatives require additional due diligence from tax technology experts with prior experience of LATAM taxes and a feel for the new technologies these companies will require as part of their ERP deployments. This includes additional hardware and software requirements, involvement of third-party service providers for certain countries and integration of the Global master data standards with the localisation master data requirements from Latin American countries. In addition, due diligence must include the impact assessment on the global process by including the localisation steps for generating the electronic invoice or processing the additional steps that may be required from a tax point of view.

The compliance reporting requirements vary from quite complicated detailed line by line submissions for Brazilian SPED or Mexican e-accounting systems, to simplified tax submissions for other Latin American countries; the number of compliance submissions will vary from country to country. The majority of ERP systems like SAP and NetSuite's have developed localised country version solutions to meet most of the compliance requirements. But in the case of complex regimes like Brazil, tax department need to look at third-party tools to integrate the data from their ERP systems to deliver the compliance submissions.

Helixr's Global Tax Technologies team has extensive experience in Latin American tax systems and have delivered tax solutions for a wide range of project types.. The team has experience of deploying a Global template solution to the LATAM region and performing technology due diligence on the back of business restructuring activities like Mergers and Acquisition, Joint Ventures and Divestitures. Our team can competently navigate through the tax complexities of LATAM and provide local expertise to implement relevant tax solutions as part of ERP deployments.

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