

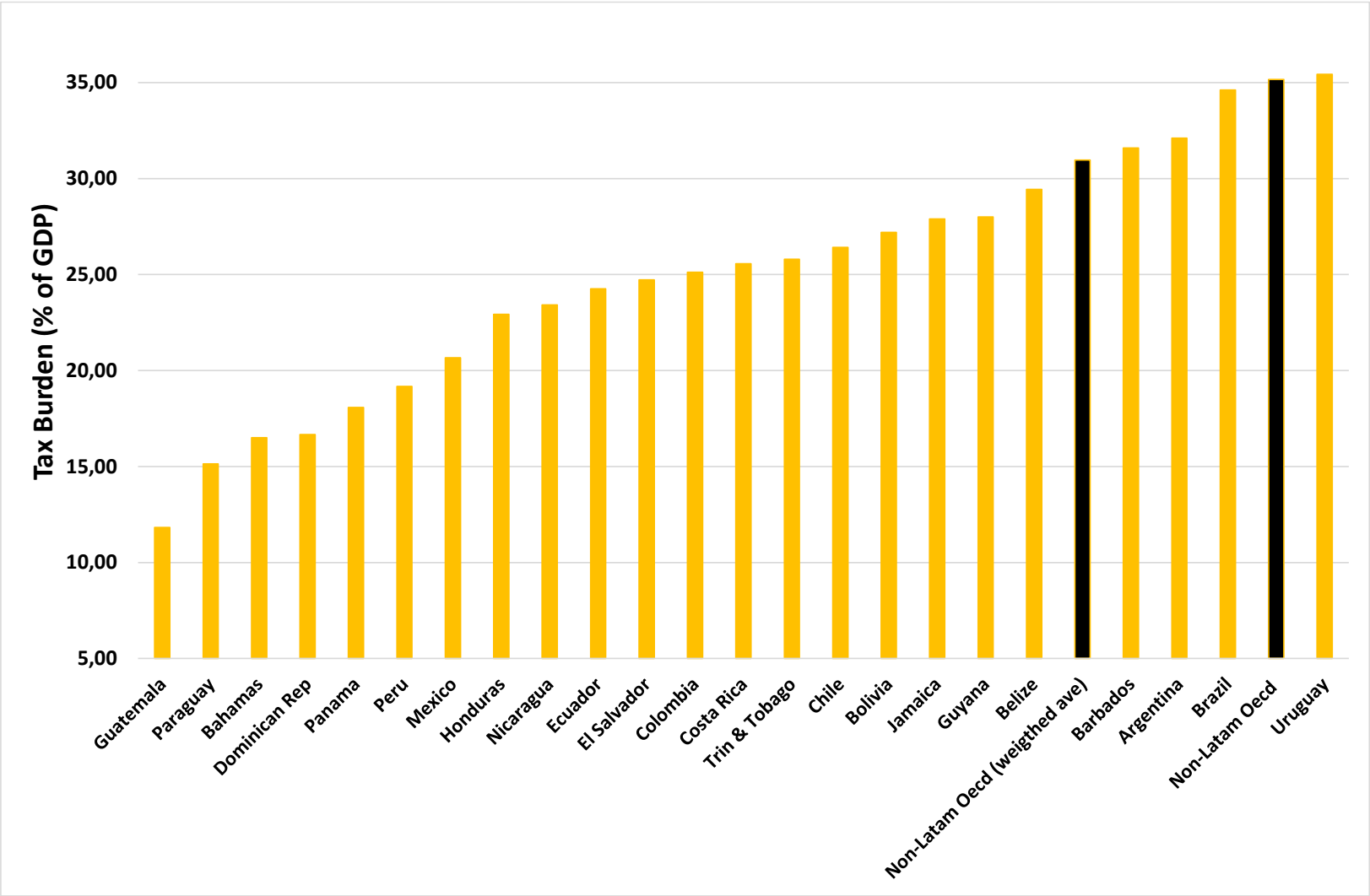
Are tax systems in Latin America a failure?

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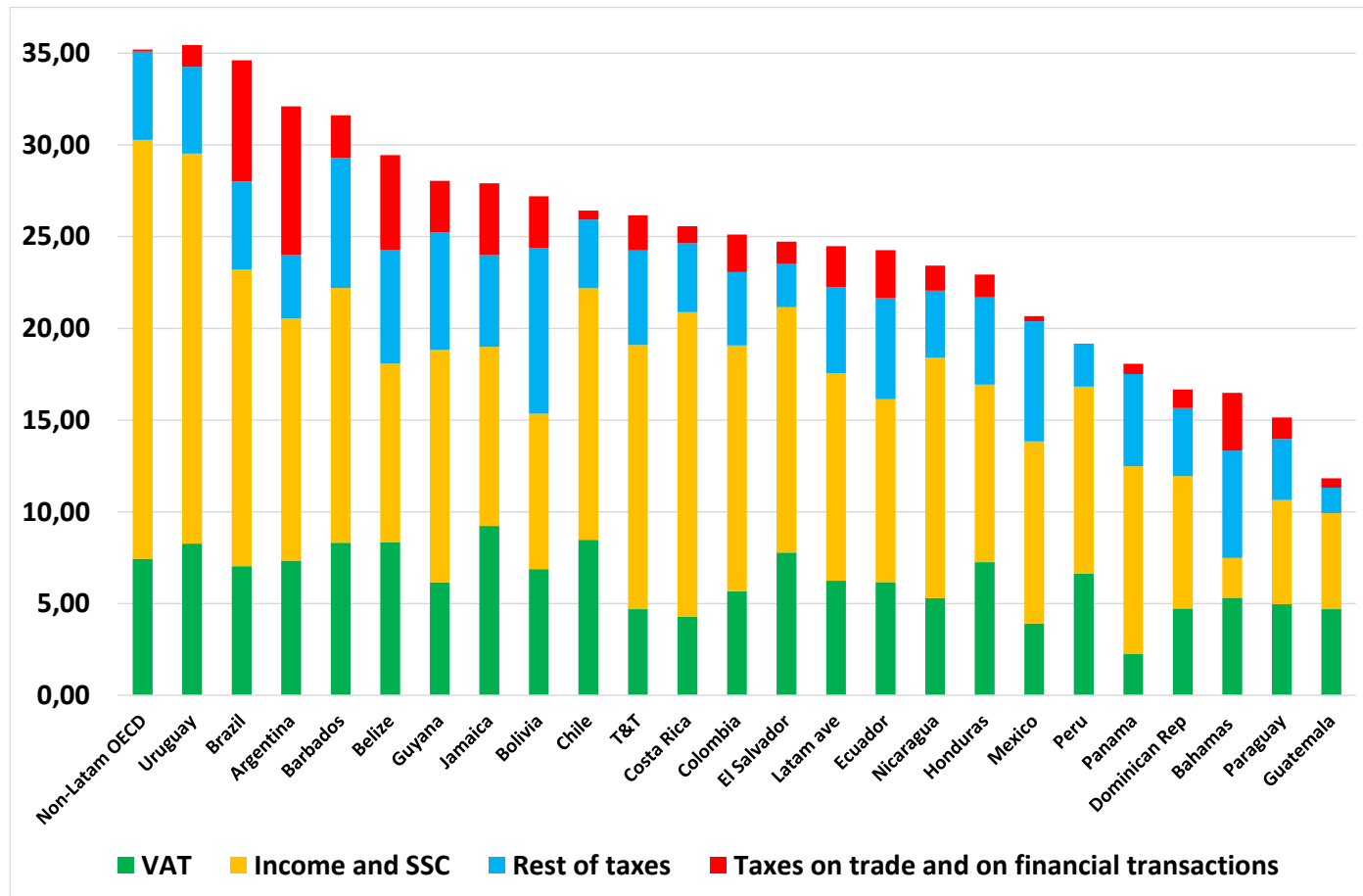
Global Tax Symposium

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Are tax revenues low in Latinamerica?



Composition of tax revenues

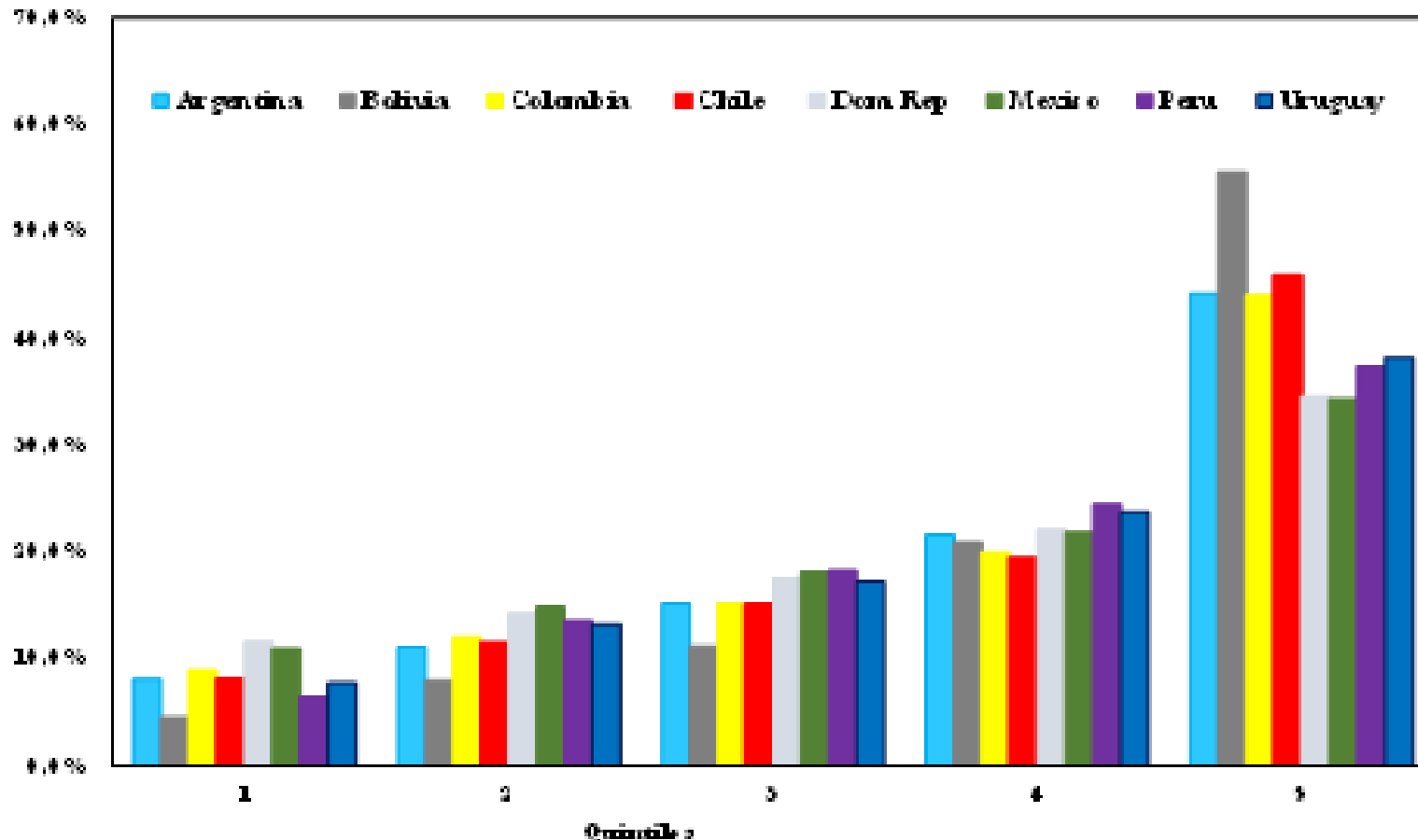


- Cascade and other inefficient taxes account for a large fraction of revenues of those Latam countries with relatively high tax burdens
- VAT revenues are similar to OECD
- With the exception of Uruguay, revenues from Income taxes and SSC are lower in Latam (about 50% of OECD)

Value Added Tax

- Most important problem is the proliferation of reduced rates and exemptions for sales to the domestic market
 - In a sample of ten countries, tax expenditures have a fiscal loss of 2.4% of GDP (35% of VAT collections with some countries like Colombia where it is similar to actual revenues)
- Are tax expenditures in the VAT progressive?

Distributional impact of tax expenditures in the VAT

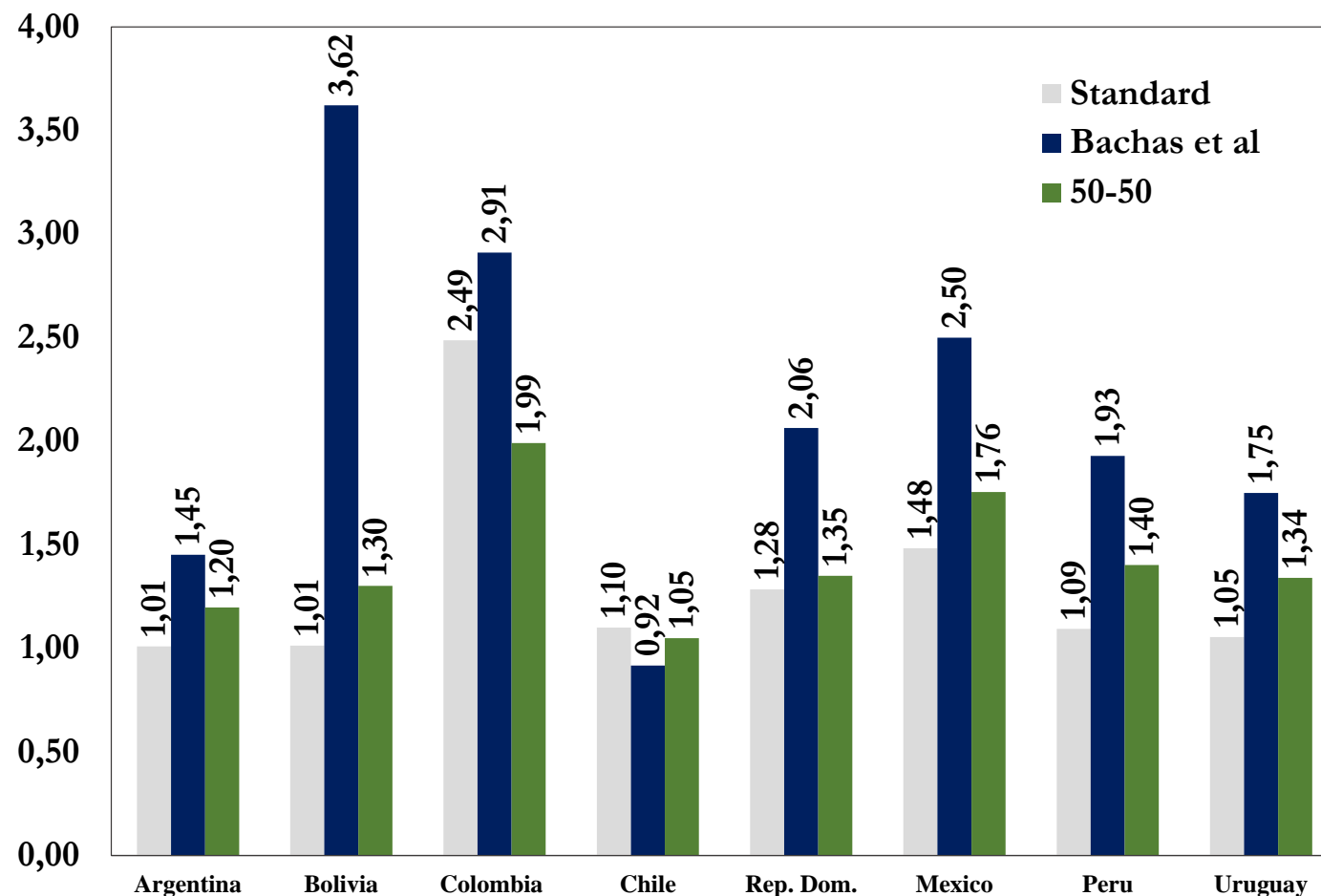


- They are progressive
 - If individuals are ordered according to their pc income the VAT is regressive in the eight countries
- But tax expenditures are pro-rich. About 40 of the tax loss benefits the highest quintile.

What happens when there is informality

- Bachas et al (2020): If the poor make a larger fraction of their purchases in informal shops...
- ..And if informal shops transfer the tax savings to the consumer..
- ...Then the VAT may be progressive and tax expenditures have no justification to improve income distribution
- What happens if the informal shops do not transfer the full amount of the tax to the consumer because they need to keep a fraction of it to compensate for their lower efficiency?
 - Many papers provide information that suggests that informal shops are less efficient than formal ones

Ratio of the average VAT rate of the highest decile to the average VAT rate of the lowest decile



Like in Bachas individuals are ordered according to their pc consumption

A ratio of 1 means that the VAT is proportional

VAT reform options

- If we generalize the VAT and compensate the poor for the additional VAT they have to pay, tax revenues would increase in the 7 countries we analyzed and income distribution would be the same or would improve
- If we generalize the VAT and compensate the poor for all the tax they pay, income distribution would improve in the 7 countries, but tax collections would decline in 3 of them
- Latinamerican countries have programs that distribute money to the poor.
- Resistance to a reform like this: either because the non-poor have an influence on policy design or because society does not trust the government to distribute compensations efficiently

Income tax

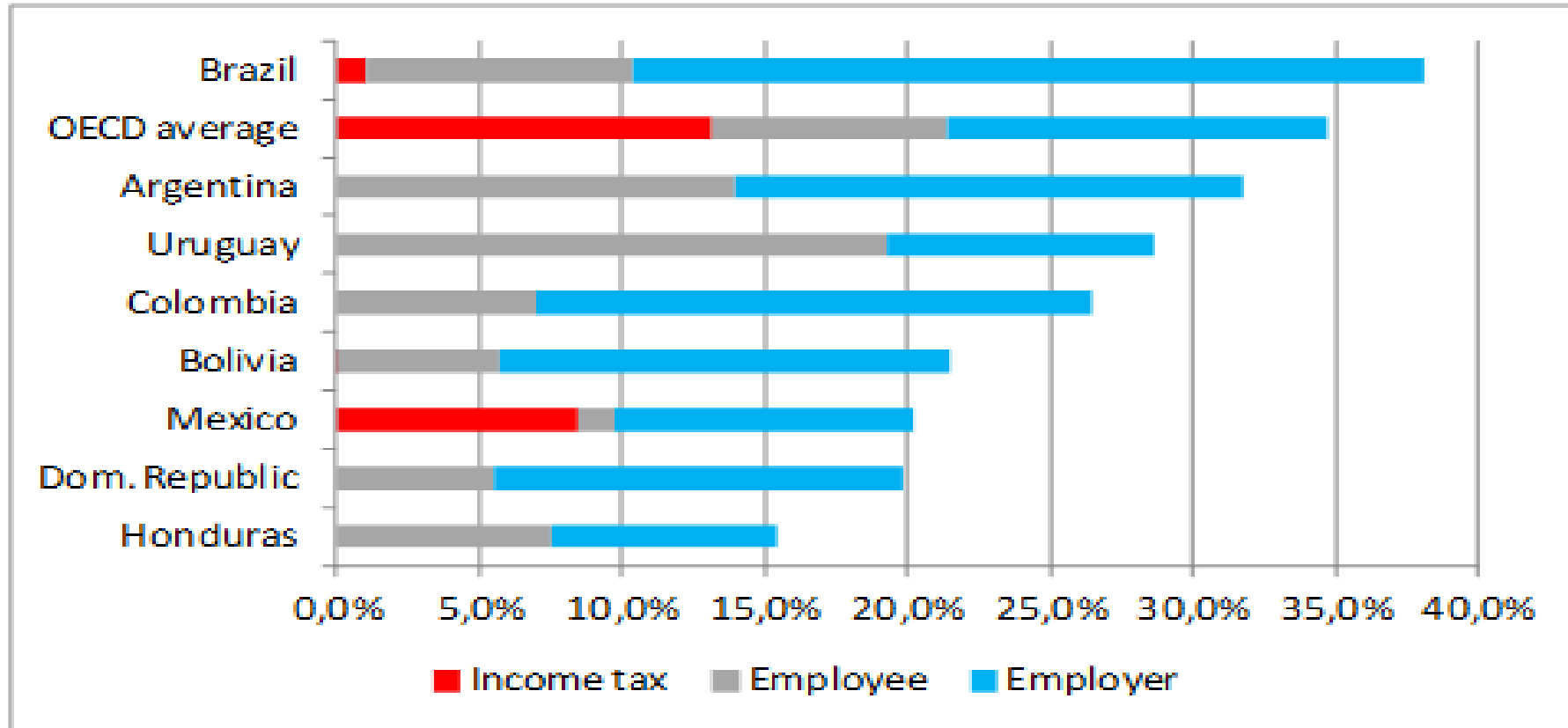
- Why revenues are lower in Latam?
 - Higher informality (about double)
 - Higher minimum exempt levels (at most 15% of the population pays income tax compared to more than 40% in OECD)
 - Lower marginal rates for Personal Income Tax
 - Tax expenditures are high
- Taxes on labor income have to include social security contributions that are high in some Latinamerican countries

Tax expenditures in the income tax

	Argentina	Bolivia	Chile	Colombia	Mexico	Peru	Dom. Republic	Uruguay	Honduras	Brazil
Personal Income tax	0,14%	0,00%	0,90%	0,67%	0,96%	0,30%	0,11%	0,44%	0,62%	0,83%
Company Income Tax	0,42%	0,10%	1,04%	0,94%	0,52%	0,23%	0,68%	0,96%	2,08%	0,66%
Regions & sectors	0,30%	0,03%	0,00%	0,84%	0,06%	0,10%	0,53%	0,82%	1,32%	0,24%
Cooperatives & non-profit	0,11%	0,06%	0,00%	0,00%	0,00%	0,08%	0,09%	0,08%	0,03%	0,05%
General & not classified	0,01%	0,00%	1,04%	0,10%	0,46%	0,04%	0,06%	0,06%	0,73%	0,37%
Income Tax expenditure / Tax Revenue	11%	3%	26%	25%	21%	8%	18%	19%	43%	21%
Personal Income tax	7%	0%	33%	50%	28%	19%	9%	9%	29%	29%
Company Income Tax	14%	3%	22%	18%	14%	5%	22%	36%	50%	15%

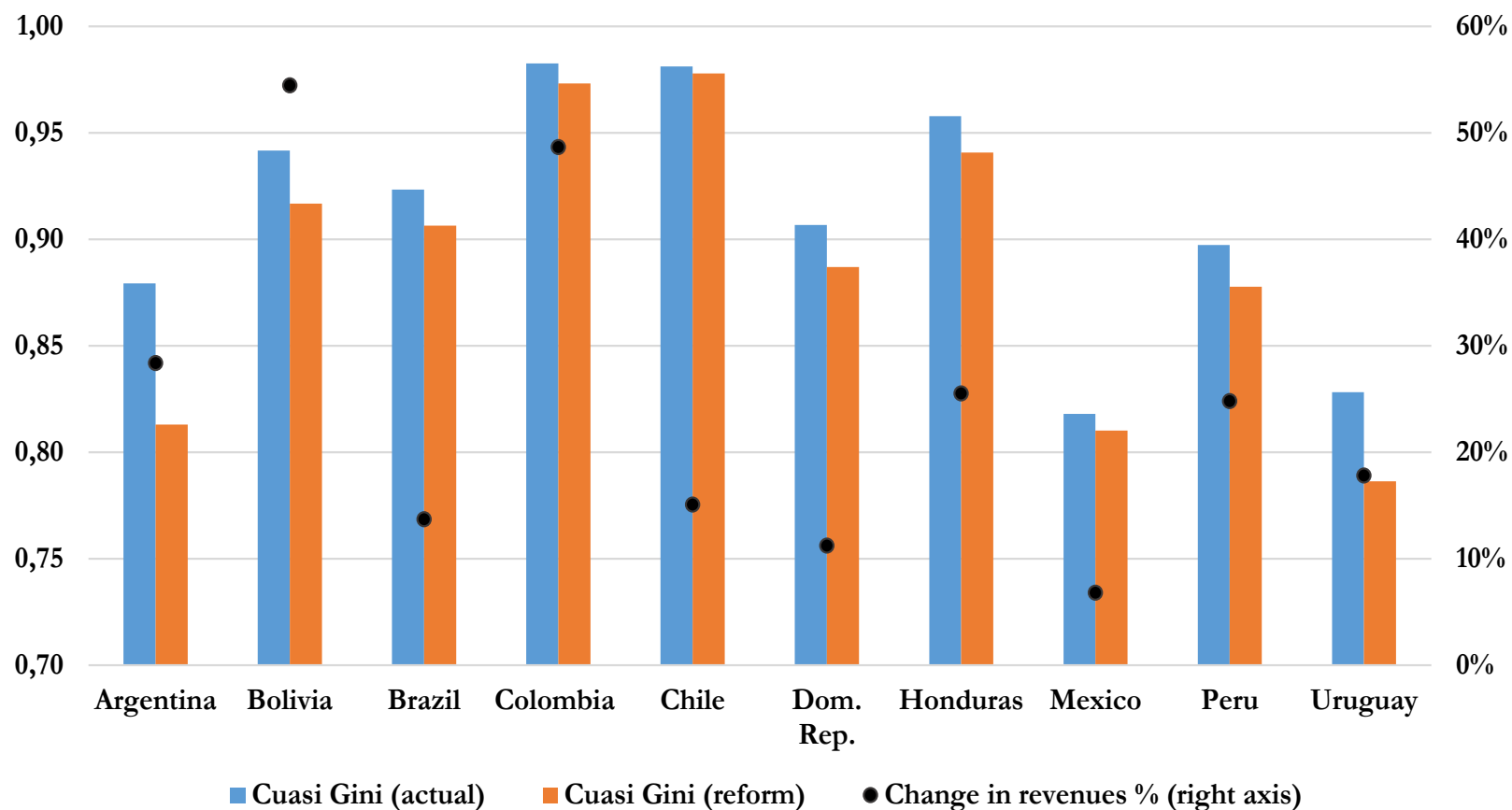
They have a fiscal loss equivalent to 3% to 26% of income tax revenues

Tax wedge for the average single worker at one average wage. Percentage of the Labor Cost



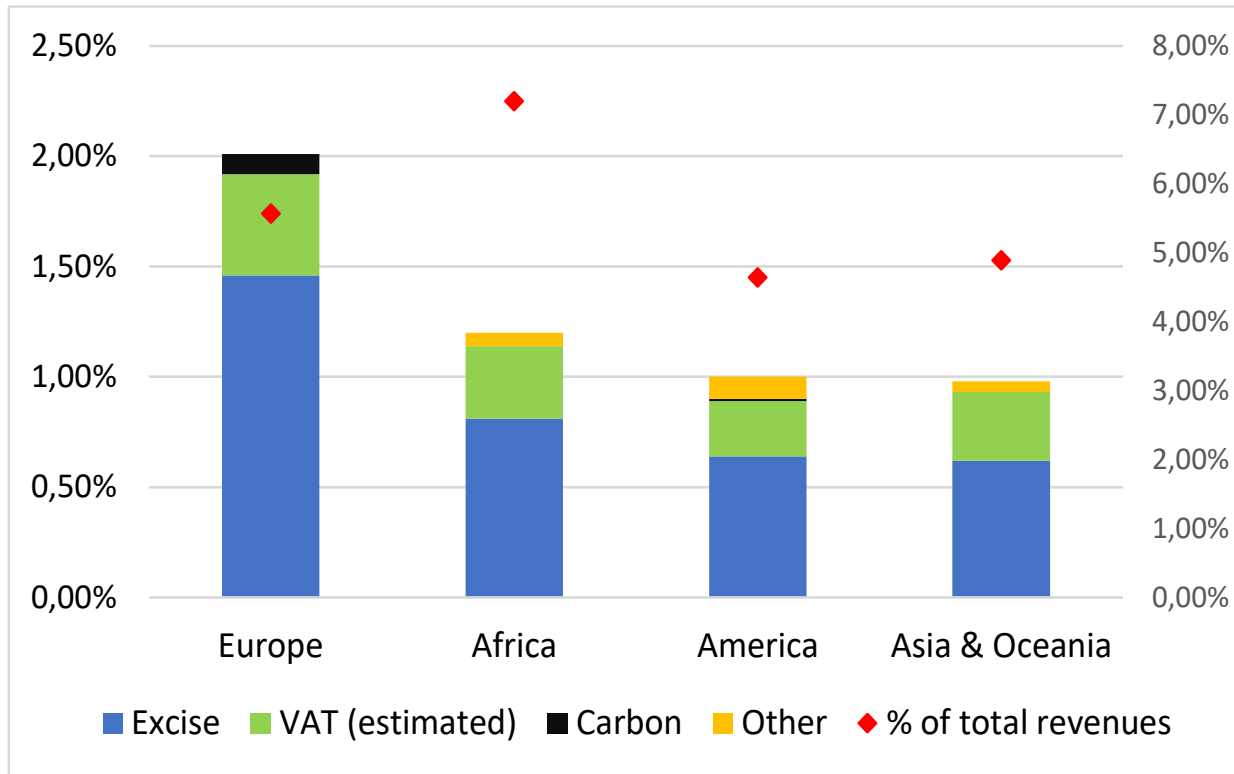
- Personal Income tax is relevant only in Mexico
- SSC are high in some countries of the region
- Lower productivity suggests the comparison may be better with workers earning less than the average wage in OECD

Simulation of a 20% reduction in the minimum exempt level in the personal income tax



PIT still very progressive and revenues would increase

Taxes on fuels



Moreover, if subsidies are deducted the net contribution is only 0.4% of GDP compared to 1.3% in Europe.

Other problems and some conclusions

- High cascade inefficient taxes in some countries
- Tax evasion is still high, especially in income taxes (an average of about 70% of tax collections)
- Tax systems in the region have many flaws but are not a failure
- Post Covid the region will need to reduce fiscal deficits. A reduction in inefficiencies in public expenditures could help but there is also a need to increase revenues at the same time that there is a need to foster growth and formal employment

Some policy options

- Improvements in the efficacy of tax administration should be a priority
- A reduction in tax expenditures may provide enough resources to address future fiscal challenges and in some countries may allow for a reduction in tax rates
- In some countries there is some room to increase “sin” taxes, that may provide enough revenues to abolish many excises on “goods” that have little economic meaning
- In the personal income tax, the minimum-exempt levels can be reduced if the income distribution of the country and payroll taxes do not make it prohibitive, providing more revenues and still maintaining the progressivity of the tax.
- The special regimes for small taxpayers are also in need of reform in some countries. It is necessary to reduce the abrupt jumps in the transition from the simplified regime to the general one and it is also advisable to reduce the relative high ceilings that allow some medium-size firms or middle-income individuals to reduce their tax burdens.
- Cascade and other inefficient taxes are better replaced by reducing exemptions in the VAT or personal income taxes, but the low visibility of these taxes make a reform like this difficult to pass.
- Increasing revenues from property taxes is possible, but this requires investments to keep cadasters up to date and strengthening the methodologies and tools for estimating the valuation of real state and other assets.