Indirect tax challenges of the digital economy in Latin America

Governments in Latin America are choosing different ways to apply indirect taxes to digital services. This regional diversity and complexity requires a watchful eye on developments.

Introduction

As disruptive technologies and heightened connectivity continue to transform the way people around the world work, play and interact, the digital economy increasingly is becoming synonymous with the economy overall. According to a June 2016 study by Cisco (*Cisco Visual Networking Index Complete Forecast for 2015 to 2020*), 4.1 billion users—more than half the global population—will connect to the internet by 2020, using some 26.3 billion devices. The digital goods and services they consume are expected to top USD 4 trillion.

As consumer demands for social media, video streaming, gaming and music expand, digital services make up a growing portion of the overall market for electronically supplied items. This has caught the attention of tax authorities worldwide, which are identifying ways to capture tax revenue from the growing volume of digital purchases and to establish efficient ways to collect the revenue.

The OECD examined the issue of taxation in the digital economy as action 1 of its 15-point action plan to address base erosion and profit shifting (BEPS), and published its report, *Addressing the Tax Challenges of the Digital Economy*, in October 2015. The resulting recommendations, which include the imposition of a value-added tax (VAT), or an equivalent, on cross-border digital services provided by nonresident suppliers to individual consumers, are viewed as the leading standard for countries designing and implementing tax reform in this area, and largely follow the standards adopted from 1 January 2015 in the 28 EU member states.

This article takes a closer look at digital services taxation efforts in Latin America—a market ready for continued growth in digital services. Legislation addressing the tax treatment of digital services is likely to follow.

Companies selling digital services in this market must stay apprised of the (evolving) tax rules and compliance obligations, which is no easy task given the size, diversity and complexity of the region. This article examines the overall trends in the region and provides updates on the latest taxation issues and the progress in the largest countries.

Indirect tax landscape in Latin America

Latin America is a melting pot of regulations and requirements related to indirect tax laws. Only a handful of countries in the region are members of the OECD; while some, such as Colombia, seek to align themselves with the OECD, and Brazil recently has requested OECD membership, others such as Argentina show little indication of doing so.

The sheer diversity of the region, which has a distinct and complex mix of markets with varying complexities of indirect taxation, results in rules being implemented and enforced at different times and in different ways. Similar patterns can be seen in other regions, particularly Africa and Asia, and there are a number of comparisons that can be drawn between the experience of these regions and the state of play in Latin America. What is perhaps most interesting, as explored below, is that there are some fundamental challenges associated with implementing indirect taxation on digital services under the existing indirect tax legislation in Latin America.

Whilst local tax authorities appear to be recognizing this, they are doing so without finding any real solutions.

As a general rule, under local legislation in the Latin American region, nonresident businesses often are not able (or even permitted) to register only for VAT/indirect taxes. Instead, tax registration will cover all taxes and, before registration can be carried out, a business often will be required to set up some form of local establishment in the country, be it a branch or a legally incorporated entity. This runs counter to the OECD's recommendation that digital services should be taxed at the place of consumption and that the nonresident supplier should account for the taxes due.

In line with the difficulties experienced elsewhere, before any rules to tax digital services can be effectively implemented in Latin America, broader changes to most local indirect tax legislation will be needed, a step that seems to at least be under discussion in some countries. Not surprisingly, this is proving to be a complex process, and time-consuming to implement. As a result, the need to fundamentally rework legislation could mean that, one or two countries aside, introducing a requirement for nonresidents to register directly and specifically for indirect taxes may never really gain traction. The fact that countries such as Argentina and Brazil have multiple tiers of government, with varying levels of responsibility for taxation, compounds the complexities.

As an alternative to amending existing legislation, tax authorities in a number of Latin American countries have looked at other ways to collect indirect taxes on supplies of digital services. For example, new legislation that was introduced on 1 January 2017 in Colombia aims to bring digital services supplied by nonresidents within the scope of Colombian VAT. For business-to-business (B2B) sales—that is, when the service is provided to a business customer in Colombia—the VAT accounting responsibility will fall on the local business customer under the reverse-charge mechanism, which is in line with most countries worldwide other than South Africa, which requires suppliers of digital services to register and account for local VAT if they are supplying digital services to South Africa business customers. In contrast, business-to-consumer (B2C) sales—that is, when the service is provided to a private individual in Colombia—are, in theory, subject to VAT, but the mechanism for this VAT accounting is a withholding requirement imposed on credit card companies/payment processors that collect the payment for the services.

In principle, this approach eliminates the need for a nonresident digital services provider to register for VAT in Colombia. However, the approach is relatively untested and it raises a number of practical questions, not the least of which is how a bank or payment processor can be sure that what was purchased was in fact a digital service. Argentina wrestled with this issue after a withholding tax mechanism was introduced in 2014, under which credit card companies were required to withhold turnover tax from payments made by private consumers to nonresident service providers for digital services supplied in Buenos Aires. The government had to postpone implementation of the rules because the credit card companies lacked the systems needed to withhold the correct amount of tax.

Given the potential challenges associated with implementation, the new rules and the associated collection mechanism may not be in force in Colombia until as late as July 2018, so their possible effectiveness is uncertain for the time being. However, if the tax authorities can make the system work, it could serve as a model for other countries developing their own legislation, in the Latin American region and elsewhere.

Whether all countries would adopt this approach, or would seek to adopt any other model to tax nonresidents, is unclear. However, our experience in some of the Latin American countries tells us that not all tax authorities feel the need to change their existing rules.

The Chilean authorities, for example, seem to be of the view that existing domestic withholding tax legislation should result in collection of the appropriate tax. Whether tax actually is collected in this manner is less clear, but it raises the question as to whether all countries in the region may eventually follow Colombia’s approach, or whether they will instead to choose to remain reliant upon their existing taxation framework.

Summary of practices in various countries

The taxation environment in the Latin American region clearly will continue to evolve. As illustrated by the table below, changes are taking place and legislation is being considered in a number of countries. However, the efforts are slow and diverse, and it seems unlikely that any type of uniformity—even that all countries in the region will tax digital services—will exist in the near future.

Country	Status of indirect tax legislation related to digital services
Argentina 	In 2014, the city of Buenos Aires sought to apply a withholding tax on digital services. However, the tax was suspended the next year to allow the withholding agents—credit card companies—time to adequately modify their systems to collect the tax. At a federal level, the taxation of digital services is on the tax reform agenda targeted for the end of 2017, but Argentina currently taxes only digital goods (i.e. goods sold into Argentina via web sales), not services. Some provinces, such as Cordoba, have introduced a turnover withholding tax for certain services (including digital services) provided by foreign parties, but the rules are not yet in force.
Brazil 	While there currently are no rules in Brazil that require nonresident suppliers to register and account for indirect taxes, legislation has been introduced that would require Brazilian resident business customers to account for local indirect taxes on the purchase of digital services from nonresident suppliers. This arguably could be the first move to tax nonresidents on B2C transactions, and the taxation of these services at the municipal level remains a possibility. However, there are still debates in Brazil on the concept of "digital services" and, to date, there is no legislation that would require a foreign supplier, i.e. a supplier without any physical/legal entity presence in Brazil, to charge and collect indirect taxes.
Chile 	Chile operates a territorial-based VAT system, and services provided from outside of Chile typically are not within the scope of Chilean VAT. Chile also operates a direct tax withholding mechanism that should apply to most payments made to nonresidents. As such, the provision of services by nonresidents to Chilean customers should be subject to such withholding, which theoretically ensures that such services are taxed in Chile.
Colombia 	Legislation that applies as from 1 January 2017 taxes both B2B and B2C supplies of intangibles by nonresidents. From a B2C perspective, the intention is to collect the tax through banking institutions and payment processors, although limited guidance has been issued to date and an 18-month timeline for implementation is in place. As such, affected banks/payment processors still are in the process of determining the exact impact this has on them.
Mexico 	There is no mechanism in Mexico to collect tax on digital services purchased by residents from a nonresident supplier. Despite Mexico being a member of the OECD, the Mexican tax authorities are not understood to be considering the introduction of such rules, given that they would require significant changes to the tax code. Given the recent changes in the Mexican VAT law, there is no expectation that the authorities will prioritize the taxation of digital services any time soon.
Uruguay 	Recently drafted regulations aim to tax two or three specific nonresident companies operating in the transportation and leisure industries in Uruguay. These regulations would appear to illustrate a desire to tax such services, but there is little clarity on how this might be accomplished or when actual changes may be introduced.

Staying ahead of cross-border indirect taxation in Latin America

The fast pace of digital technology disruption and the introduction of new digital services is creating considerable complexity, and it is difficult for both the tax authorities and taxpayers to keep up with technological advancements and how such services should be taxed. This is unlikely to change; if anything, the complexity in this area from an indirect tax perspective is likely only to increase. Although it is unknown which countries will be the first to implement indirect tax changes and new collection mechanisms, one thing is clear—from both a legislative and a business standpoint, indirect tax developments in Latin America as they relate to digital services should be monitored closely, and getting in front of the developments is key.

Whether it's keeping up with the local legislative position in countries in which a company does business, managing customer interactions to ensure that sufficient customer data is collected, considering whether pricing models (and, hence, margins) are affected or giving thought to how (and whether) business operations should be restructured, companies should be taking some sort of action. At the very least, keeping a watchful eye on developments and working with affected functions within the company (e.g. finance and information technology) should put businesses in a position to navigate the inevitable change that will arise in the coming months and years.

Ronnie Dassen
Principal
Deloitte US
+1 718 508 6846
ronniedassen@deloitte.com

Jon Tilson
Senior Manager
Deloitte US
+1 212 436 2006
jotilson@deloitte.com

Steve Butler
Manager
Deloitte US
+1 213 996 4351
stebutler@deloitte.com

Additional contacts

Country / Deloitte office	Contact		
Deloitte Argentina	**Gaston Quignon** Partner +54 11 4320 2700 x3010 gquignon@deloitte.com	**Pablo Minniti** Manager +54 11 4320 2700 x8435 pminniti@deloitte.com	
Deloitte Brazil	**Carolina Verginelli** Partner +55 11 5186 1074 cverginelli@deloitte.com	**Douglas Lopes** Partner +55 11 5186 1002 dolopes@deloitte.com	**Guilherme Giglio** Senior Manager +55 11 5186 1921 ggiglio@deloitte.com
Deloitte Chile	**Paula Osorio** Partner +56 2 2729 8311 posorio@deloitte.com	**Regina Scherzer** Director +56 2 2729 8390 rscherzer@deloitte.com	
Deloitte Colombia	**Diego Franco** Partner +57 1 426 2282 dfranco@deloitte.com	**Carolina Bueno** Manager +57 1 426 2214 cbueno@deloitte.com	
Deloitte Mexico	**Erik Magos** Partner +52 55 5080 7033 emagos@deloittemx.com	**Cecilia Montano Hernandez** Partner +52 55 5080 6419 cmontanohernandez@deloittemx.com	
Deloitte Uruguay	**Enrique Ermoglio** Partner +598 2916 0756 x6153 eermoglio@deloitte.com		