

PROVISIONAL

CPF/SR.7

10 December 1962

ORIGINAL: ENGLISH/SPANISH

JOINT TAX PROGRAM OAS-IDB-ECLA

CONFERENCE ON FISCAL POLICY  
Santiago, Chile, 5-14 December 1962

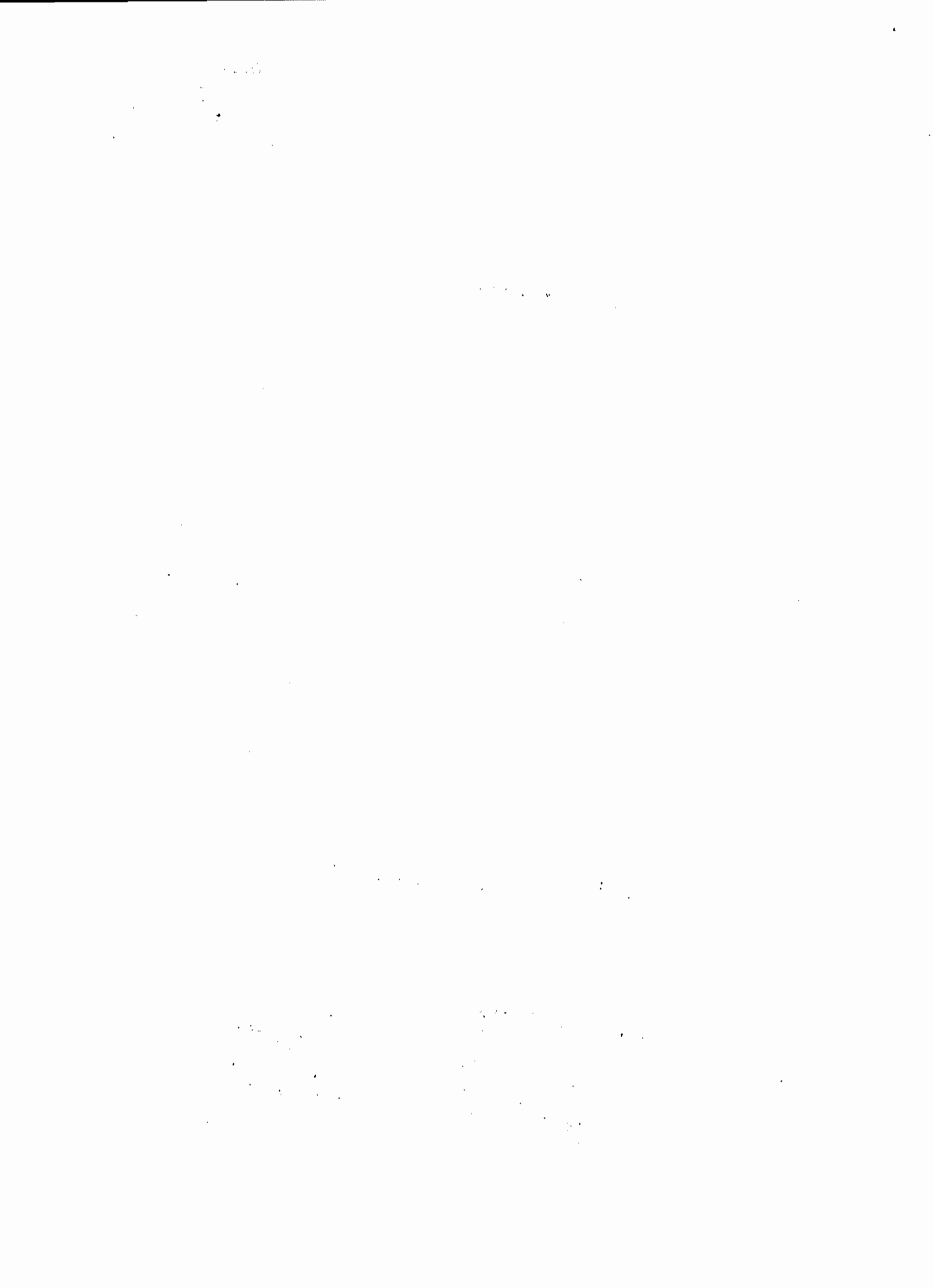
PROVISIONAL SUMMARY RECORD OF THE SEVENTH MEETING  
held at Santiago, Chile  
on Monday, 10 December 1962, at 10.10 a.m.

Chairman: Mr. MAGANA

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Personal income tax in Latin America

NOTE: Participants wishing to make corrections in the provisional summary record of their statements, for inclusion in the final printed report, should submit them in writing to the Editorial Section, either through the Conference Officer (Miss Eyzaguirre) during the Conference, or subsequently, by post, before 31 December, addressed to The Editorial Section, ECLA, Avenida Providencia 871, Santiago, Chile.



## PERSONAL INCOME TAX IN LATIN AMERICA (CPF-DB-2, CPF-DB-2/Add.1, CPF-DB-2/Add.2).

Mr. GOODE introduced his paper (CPF-DB-2). The practical question was how the personal income tax could be made more effective in Latin America. It was a form of tax that was based broadly on capacity to contribute, it could reduce excessive inequality, and it could provide an elastic yield responsive to increases in real output and inflationary increases in money incomes. Although the tax had been criticized as tending to curtail savings, the evidence to support of that contention was not persuasive: moreover high savings ratios were possibly less characteristics of high incomes in under-developed countries than in countries with a long capitalist tradition. Moreover other factors, such as the security of property, the prospective rates of inflation, investment opportunities, the taxation of corporations, fiscal deficits, and government investment, might all have a greater impact on the national saving ratio than the taxation of individuals. It was true that the income tax lent itself to excessive progression, but that was an argument against abuse of the tax, not against the tax. There was no scientific method of forecasting the reaction of individuals to progressive taxation, but he agreed with Mr. Harberger that if rates were moderate, and there was due regard for certain aspects such as the definition of net income, adequate allowance for capital consumption, etc., there was not much danger of an adverse effect on incentives to work or invest.

However, the income tax was likely to lose its characteristics in the absence of certain pre-conditions, which included a predominantly monetary economy, a high literacy rate, accounting records that were predominantly honest and reliable, extensive voluntary compliance by taxpayers, a political system not dominated by the rich, and an honest and efficient administration. The last condition was as essential as the others, but perhaps easier to bring about in the short run. In the light of those requirements, Latin American countries differed considerably in the extent to which they were equipped to make effective use of the personal income tax.

With respect to tax design, he thought it was now widely recognized that a global tax had substantial advantages over a schedular form of tax;

the two might be used jointly, but a schedular tax alone was likely to operate unfairly and ineffectively.

There were a number of reasons for taxing capital gains as a form of income; it was not only correct in principle, but restricted speculation.

In several Latin American countries income from foreign sources was not subject to domestic taxation, because the tax principle invoked was taxation of income at the place of origin, instead of the place of residence of the recipient. There was no reason why countries should not tax both income generated within their borders and income received from foreign sources by residents. Even in the absence of tax treaties providing for exchange of information on income paid or credited to nationals of the taxing country, such information could be provided on a unilateral basis, provided there was a serious intention of using the information to good purpose.

Omission of the imputed rent of owner-occupied dwellings from the income tax base results in inequities between owners and tenants and between investors in dwellings and in other assets, and encourages a relatively less productive type of capital formation. However, in practice there were few countries in Latin America with property valuations that would provide a satisfactory basis for assessment of imputed rent under the income tax.

With respect to personal exemptions and allowances, administrative considerations should probably prevail in most Latin American countries at present. It would not be possible to bring exemptions down to a level as low, in relation to per capita national income or the socially acceptable minimum, as the ratios prevailing in more industrialized countries.

In setting rates, it was preferable to establish a fairly high beginning rate, to reduce the number of payments too small to cover the cost of collection. Upper rates should not be too high, and in Latin America appropriate rates would be considerably lower than in such countries as the United Kingdom or the United States. He considered that the incomes of husbands and wives should be aggregated, otherwise the tax would be less progressive than it appeared.

/There was

There was no doubt that the personal income tax deserved a substantial place in the revenue system of Latin America, but the considerable advantages of such a tax could not be obtained without sustained thought and effort. Above all there must be restraint in order to avoid excessive rates and over-refinements.

Mrs. NAVARRETE, presenting her comments (Doc. CPF-DB-2/Add.1), said that she was in general agreement with the paper and would confine herself to the question of the establishment and effectiveness of a personal income tax in under-developed countries. The objections against such a tax could be classified as theoretical or economic, administrative or practical and political; and she laid special stress on the administrative type, examining the case of non-agricultural wage earners, agricultural taxpayers, and non-agricultural entrepreneurs, pointing particularly to the low real capacity of the agricultural taxpayers, at any rate in Mexico. She believed it self-defeating to impose high rates on enterprises and low rates on the income received by their owners, who usually formed part of a privileged social class though the enterprise itself performed the productive work. She therefore believed that the tax burden on enterprises should be reduced, provided foreign firms whose owners did not reside in the country did not receive the same treatment. She was opposed to granting preferential treatment to income derived from capital not previously taxed (interest, royalties, fees for technical services, rents, etc.); she was also opposed to imputed house rentals being included in the taxable base, although it might be taken into account in calculating national income.

She considered that, in the future, the most pressing tax reforms would revolve around the income tax and should tax personal income derived from capital in a progressive and efficient manner. A great effort should also be made to improve the administrative machinery so that taxes actually collected would come as near as possible to what was expected and all taxpayers in similar situations would receive equal treatment.

/Mr. FLORES

Mr. FLORES, introducing the written comments on Mr. Goode's paper which he and Mr. Moises Beatriz had presented jointly (CPF-DB-2/Add.2), said that Mr. Goode had accurately analysed the causes of the relatively unsuccessful imposition of the personal income tax in Latin America. A pragmatic consideration of conditions in Latin American countries must lead to the conclusion that forms of taxation had to be adopted in those countries which were adapted to their economic and social environment, even if that meant a departure from the traditional tax structure. Moreover, the simpler the income tax imposed the better. The social, economic and administrative structure in Latin America, and the type of taxpayers in the countries concerned, precluded the application of complicated forms of taxation such as those used in the more developed countries. Preferential tax treatment should be granted in favour of investment in specific economic activities as a means of directing the economy towards more advanced systems conducive to economic development.

Mr. MOISES BEATRIZ, continuing the presentation of the joint paper, observed that a progressive tax on net wealth was being applied with some success in a few Latin American countries. Such a tax was to be recommended in countries where conditions were least suitable for an effective income tax.

With respect to capital gains and losses, he had no hesitation in supporting the application of a tax on capital gains in Latin America. Provided that some capital gains were exempted, the tax would reduce purely speculative investment which did not contribute to national income. He would exempt income from capital derived from the sale of securities, particularly by small shareholders. Care should be taken in imposing a capital gains tax in order to avoid the unfortunate consequences which might result from lack of experience or foresight.

Mr. NAHARRO, intimating that he was in general agreement with the paper, went on to refer to the possibility of income tax being either from the point of view of revenue designed strictly collecting

or to provide a system of incentives to guide economic development in a particular direction. Without prejudice to the idea of dissecting it over the long-term with an eye to its yield in order not to distort the revenue-producing aims inherent in it, it might be used as a short-term instrument to promote development, by means of a suitable system of deductions and exemptions. In that regard, he favoured total exemption of certain forms of savings, limiting the taxable base to the income spent, despite Mr. Goode's objections to such exemption and even recognizing that savings were not forthcoming in sufficient quantities for development. Precisely, to ensure that they reached the desired level, it would be advisable to create additional incentives in favour of savings invested in development activities favourable to capital formation.

Mr. JARACH, referring to what Mr. Goode had said about the taxation of income from foreign sources, pointed out that the main reason for the attitude of Latin American countries had been a reaction against the position of the capital-exporting countries, which had based the tax on the place of residence of the recipient instead of on the place of origin of the income. The situation had now changed for Latin America, in that capital for investment was being sought, and that domestic capital tended to leave the country because of inflation or other reasons, and consequently a new approach was required. In some Latin American countries nationals were taxed while foreigners were exempt, which was obviously unfair.

Another point he would like Mr. Goode to clarify was the question of tax havens against a progressive income tax provided by holdings companies, which might purport to represent investment by foreigners when they did not. There was a need for international co-operation to prevent such an asylum from taxes on income and wealth.

Although there was a case for taxing imputed income from owner-occupied houses, it was necessary to guard against loopholes enabling taxpayers to report tax losses in this connexion that could be offset against other income.

Although a Latin American himself, he supported the views of those outside Latin America who did not have much faith in tax incentives.

/One important

One important reason, which had not been mentioned by Mr. Goode, was that the incentive effect was sometimes more apparent than real; if the reduction in government revenue led to a budget deficit and consequent inflation, the result was to transfer the burden to other classes, and the total effect was disincentive. Moreover, the reductions tended to affect income taxed at high marginal rates, rather than the average levels, and were hence regressive.

Mr. VIDAL said that, in his opinion, the desirability of an income tax with limited progressive rates had been sufficiently well established, and he wondered whether it might be possible for legislation to take into account a system of periodic adjustment of such rates in relation to currency devaluation, in order to prevent rates from remaining stagnant, to the detriment of the taxpayer, as was the case in his country. Regarding the unitary or schedular system, he agreed with the general feeling in favour of the former, although he believed that some decision would have to be taken on the matter of including the sale of bearer securities as personal income. With regard to taxation of income from domestic investment abroad, he said that such income was taxed in his country but, in his opinion, the flight of capital was not strictly a tax problem; he recalled that there had been some suggestions made in that connexion at the meeting of the Latin American Centre for Monetary Studies (CEMLA) in Mexico.

He agreed with Mrs. Navarrete regarding imputed rentals which in practice were distorted in an ad valorem assessment of dwellings. Yachts, race-horses, etc., were in the same situation, not being taken as income. They were capital investments, and until fair standards were available, they should be subject to the appropriate taxation as property. Moreover, in the case of dwellings -- which usually paid land tax -- they should not be doubly taxed with income tax, particularly if the income was fictitious.

Referring to tax incentives, he agreed with Mr. Naharro regarding exemption of income from savings, but only where they were invested in industry, housing, etc., in a manner determined in advance by the State. Individuals, i.e., private activity, should above all be given the opportunity of helping in the task of economic development. The State should only step in when they did not do so, levying a tax on over-all personal income, in compliance with its social responsibilities.

/Mr. KALDOR



Mr. KALDOR agreed with most of the proposals made by Mr. Goode with respect to the personal income tax. The tax should be comprehensive, free of loop-holes, broadly based, and should include capital gains, which would be taxed as income. The tax rates should be moderate. That applied equally to the developed and under-developed countries. High marginal rates (in some cases they were as high as 90 per cent) made the tax virtually impossible to administer, and thus shielded persons in the higher income brackets, as had been the case in the United Kingdom and the United States.

Mr. Goode had perhaps not dealt sufficiently with the basic requirements of an effective personal income tax in Latin America as it related to capital income. Wages and salaries presented no problem since evasions was most apt to be engaged in by persons with income from capital. Such income would be difficult to tap unless the tax administration had full knowledge of the total wealth owned by individuals. As long as income could be concealed through such systems as bearer shares in corporations, a capital gains tax would be difficult to apply. The Latin American countries should create a system by which the total assets owned by a taxpayer were known and their value could be reasonably ascertained. That might be achieved through requiring a declaration of wealth from individuals as was done for corporations. Such a declaration would include an annual declaration of purchases and sales of capital assets, properly assessed at their market value.

If a distinction had to be made between income from labour and from property, it could not be done by levying two different schedular rates on income but only by applying an annual tax on net wealth combined with a tax on personal income. Property holders should be taxed on the basis of their holdings as well as on their income from property. A combined tax on net wealth and on income would facilitate the keeping of records of individual capital assets and of changes in such assets and would be a means of preventing evasion. The problem in Latin America was not only to institute tax reform in order to tax income now excluded from taxation but also to include existing income which escaped the tax net.

/He agreed

He agreed with Mr. Goode that the imputed rental value of owner-occupied dwellings should be part of taxable income. It had been so considered in the United Kingdom but the tax on the imputed rental value of homes in that country was about to be abolished because there seemed to be an irrational feeling about a tax of that kind.

Mr. HARBERGER observed that the Latin American countries could be among the world's leaders in tax reform. They could not only apply what was being done in other areas but could also point the way. That was particularly true of the taxation of capital gains, which should be taxed as income at the same rate as the personal income tax. It had been argued that to do so would be unfair where the capital gains were obtained in a single year. That objection could be overcome by a simple averaging device.

He wished to emphasize the importance of maintaining a broad base for the personal income tax. A narrow base would require high rates, whereas the rates could be lower if the tax base was broader.

He disagreed with some of the points made by the commentators on Mr. Goode's paper. Mrs. Navarrete, for instance, had objected to the imputed rental from owner-occupied dwellings being considered as income for tax purposes. He did not see why a person living in his own home should be favoured over someone living in a rented dwelling. He agreed, however, that imputed income from other sources should be considered in the same way as the imputed rental income from owner-occupied dwellings.

Mr. Flores and Mr. Moises Beatriz advocated exemption from the capital gains tax of income from the sale of securities. He could not support that view. There were two types of capital gains. On the one hand, there was income from changes in the relative market supply and demand and from increases in the value of some goods. Those might be considered accidental gains. On the other hand, capital gains might be deemed to be normal in the case of corporations which reinvested their profits and it would be wrong to exempt their securities from the capital gains tax.

/He did

He did not share Mr. Naharro's views with respect to incentives to savings, which were not very responsive to the rate of interest. All tax incentives had the effect of raising the rate of interest but savings would not be considerably reduced if there were no tax incentives. If Governments could invest their tax revenue in the private sector by purchasing shares, they would be contributing to an increase in total national savings more than by granting tax incentives.

Mr. PIEDRABUENA felt that the suggested system of first raising the income ~~tax and then~~ admitting a system of exemptions under the heading of tax incentives to promote certain types of investments was contradictory. In his opinion, it was preferable to establish moderate rates of a general nature really likely to be complied with and to suppress all exemptions in personal income tax; however, he would not advocate the same procedure for corporate income tax. In any event, if such exemptions were admitted, it should be compulsory to declare exempted income, in order not to destroy the progressivity of the tax. It was not easy to agree on a definition of personal income or to determine its scope. As to casual capital gains, they should be incorporated into income without prejudice to the possibility of making allowances based on the number of years that had elapsed since the investment was made. The introduction of imputed rental could give rise to great injustice. In conclusion, he states that he was in favour of considering over-all wealth as a taxable base.

Mr. LESSA said the redistributive effect of the income tax had to be balanced against the incentive effect. If the State was to act as the executor of development policy, it must have some means of influencing the private sector, and ensuring that investment was directed to development ends. However, incentives could be established on a progressive basis, with lower exemptions for the higher income brackets. Exemptions should only be allowed for investment in development, and failure to meet the requirements of development planning should be punished by withdrawal of the exemptions.

/Mr. HERSHEL

Mr. HERSCHEL was of the opinion that the advantages mentioned by Mr. Goode did not really exist, in view of the seemingly inevitable lack of flexibility of the income tax patterns which Mr. Goode attributed to the tax. With regard to exemptions, like Mr. Jarach he had no faith in the results of a policy of tax incentives, which any way would make the taxable base narrower.

Mr. MONTERROSO agreed, in general, with the opinions set forth by Mr. Goode in his paper, except on a few points, for example, where imputed rentals on dwellings were concerned, a matter on which he shared the objection raised by Mrs. Navarrete. The social need for promoting the construction of housing, which was generally accepted and in itself constitutes sufficient argument against Mr. Goode's view, should be taken into account. While it was true that there appeared to be too many luxury dwellings in Latin America, it should not be forgotten that they were also subject to the real estate tax. Only the imputed rental based on the cadastral value of the dwellings was acceptable.

With regard to income from foreign sources, if the intention was to promote the repatriation of capital, it would be ineffective to tax it in the country of destination if that country allowed the deduction of taxes paid in the country of origin.

Mr. JATAR, referring to a tax on imputed income from owner-occupied dwellings, agreed with Mr. Kaldor that such a tax would not be very useful in a country which already applied an effective tax on wealth, although it was essential, even if defective, where wealth was not effectively taxed. In that connexion, he felt strongly that luxury housing should be reduced in Latin America since it did not contribute to economic development.

With regard to capital gains, some participants had argued that a tax on capital gains should be applied on a broad base to include income from securities. In Venezuela, the tax was confined to the revaluation of real property and did not cover income from shares and bonds.

He agreed with Mr. Goode that there were certain risks to granting tax exemptions and deductions but felt, as did Mr. Goode, that the possibility of providing for such exemptions and deduction should not be rejected out of hand. They might, for instance, be applied to income which was reinvested and might also be useful to encourage savings.

Mr. RIOFRIO recalled the theoretical and legislative background of presumptive income which he felt had more and greater disadvantages than advantages, and family income. In regard to casual capital gains, he called attention to the wasting effect of inflation upon them. He believed that income from foreign sources should not be taxed at the place of domicile, but at the source.

Mr. DESCARTES agreed with Mr. Goode and Mrs. Navarrete on the importance of establishing a tax on personal income in Latin American countries based on relatively moderate rates of taxation. Such a tax was essential in Latin America, even if applied within a narrow range. He supported Mr. Kaldor's suggestion of an annual declaration of wealth, but observed that even the more developed countries had found it virtually impossible to institute such a method. However, he agreed that an attempt to require an annual declaration of wealth should be made by the Latin American countries.

With respect to Mr. Goode's suggestion concerning the imputed rental from owner-occupied dwellings, he thought that the Latin American countries would do better to concentrate on other more positive aspects of the personal income tax.

The question of the taxation of foreign enterprises, he thought, should be dealt with through treaties between the countries concerned.

With regard to tax incentives, he agreed with the view expressed by Mr. Mendive in his paper (CPF-DS-5) that the solution applied in Puerto Rico, in view of its special position in the American market, could only partly serve as a model for Latin America as a whole. Even in Puerto Rico, incentives had had to be granted and an aggressive campaign undertaken to seek out industrialists and to offer them tax incentives. The field of tax incentives was a difficult and dangerous one for Latin America and should be entered into with extreme caution.

Mr. CASAS referred particularly to income from the agricultural sector, which had certain peculiar characteristics, and to the disadvantages of granting preferential treatment to that sector for tax purposes. In support of his views he mentioned the experience of Colombia,

/where investments

where investments in agriculture were used as a form of evasion. With regard to the relative advantages or disadvantages of the schedular as compared with the global system, he pointed out that in the recent Colombian tax reform the latter had been preferred because of its simplicity and its traditional roots. However, the schedular system might well be acceptable so as to reduce personal exemptions. Taxing of presumptive income had given satisfactory results in Colombia, although it should be recognized that the revaluation of real estate and perhaps the tax on capital gains which accompanied it helped to obtain such results.

The meeting rose at 1.45 p.m.