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OAS/IDB/ECLA JOINT TAX PROGRAM

CONFERENCE ON FISCAL POLICY

Santiago, Chile, 5-14 December 1962

PROVISIONAL SUMMARY RECORD OF THE EIGHTH MEETING

Held at Santiago, Chile

on Monday, 10 December 1962, at 3.35 p.m.

Chairman: Mr. MAGAÑA

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Note: Participants wishing to submit corrigenda to their statements in this summary record for inclusion in the final printed version are requested to do so in writing to the Editorial Section through the Conference Officer (Miss Eyzaguirre) during the Conference. Subsequent corrigenda should be sent to the Editorial Section, ECLA, Providencia 871, Santiago, not later than 31 December 1962.

PERSONAL INCOME TAX IN LATINA AMERICA (continued)

Mr. GNAZZO thought that the Conference should state its position clearly in regard to personal income tax. There was a tendency for the participants to give undue importance to administrative problems and to overlook the fact that the essential aim was to define personal income tax as an instrument of fiscal policy. Mr. Goode, for instance, had mentioned several prerequisites for the successful application of the tax, which fell into the same vicious circle in that they could not be applied for want of suitable administrative machinery. He agreed with Mr. Naharro that the prime objective of income tax was to promote economic development. The Conference should therefore decide in favour of a solution in absolute terms which would state clearly whether income tax was an appropriate instrument for Latin America or whether others should be sought.

With respect to the imputed rent of owner-occupied property, he thought that the taxable rent should be based on a minimum figure.

Mr. BACA concurred with the fundamental points made by Mr. Goode, and congratulated him on his understanding of the real situation in the region, which he appeared to have grasped more clearly than other non-Latin American writers. Taxable income should be fixed at a higher minimum level than in the more developed countries and at rates that did not exceed 50 or 60 per cent. Foreign experts often recommended a taxable minimum of 200 per cent of per capita income, forgetting that in Latin America the annual average was 200 dollars and that if taxation was based on 400 dollars, it would mean whittling away what was a bare subsistence level. They also tended to forget that the purchasing power of money was much greater in the more developed countries than in Latin America, particularly in so far as services such as health and education were concerned. He believed that the minimum taxable income limit ought to be fixed between 500 and 600 per cent of per capita income; he had therefore been surprised to hear that in Mexico, according to Mrs. Navarrete, the limit was 500 Mexican pesos (40 dollars). In Costa Rica the Treasury had found that it was unprofitable to tax income in the lower brackets, although the minimum had been set at 63 dollars.

/He disagreed

He disagreed with Mr. Goode on the treatment of foreign investment, because the Latin American countries were not exporters of capital. The effect of the system in force, whereby capital could enter Latin America tax-free, was to make a present to the Treasury of the country exporting the capital. What was needed in such cases was an over-all solution, not bilateral or temporary agreements.

Mr. VEGA referred to two specific points that had been raised by Mr. Goode: (a) the imputed rent of owner-occupied property; and (b) incentives. The former was obviously taxable income, and where it had been exempted from taxation, the reasons had been of a social and not a fiscal nature. His impression was that Mr. Goode was in favour of allowing a deduction for the unpaid balance of debt on housing. To him that seemed unfair, since the same argument would warrant income from capital loaned and invested in an industry being exempt from taxation.

With respect to incentives, there were many possibilities, but in the case of income tax they should be applied ex post facto and should consist in tax rebates on savings used for investment, instead of for consumption. Capital formation in the country concerned would thus be promoted, and there would be no risk of an inordinately large proportion of savings being channelled into the infrastructure projects for which the public sector was properly responsible; on the contrary, productive undertakings would be encouraged.

Mr. MATUS, after describing Mr. Goode's paper as very general in character, said that the income-elasticity of income tax in Latin America was very low on account of inflation, since there was a time lag between the dates when the tax liability was incurred and when it was payable. He thought that an attempt to increase elasticity might result in a loss of equity.

In his view, there were flaws in Mr. Goode's argument in relation to loss of savings, and although it was true that consumption remained relatively constant when income rose, that applied only to income steps,

/and no

and no importance would therefore attach to a decrease in the savings of a single household, since it was total savings that mattered. The vital point was that the progressiveness of the tax system should be reasonable.

In connexion with the use of taxation to provide incentives, he felt that it was necessary to define incentives in general, and pointed out that their aim was to bring the behaviour of the private sector into line with development requirements. There were other ways of modifying the behaviour in question, such as incentives designed to alter the structure of consumption, which did not present the same administrative difficulties as tax incentives.

He did not agree with Mrs. Navarrete's contention that taxation of the lower income groups was a useful source of revenue, since, in his opinion, various alternative patterns of taxation would have to be applied in the case of low incomes.

Mr. GOODE said that he would confine himself to commenting on the most important points that had been raised during the discussion.

With respect to the question of tax incentives, he said that it was apparent from the observations that had been made that the Latin American countries had more confidence in the ability of incentives to stimulate development than was the case in some of the more developed countries. Without exploring the reasons for the difference in opinion, he would point out that in the United States the public finance experts had less confidence in tax incentives than business groups or the public in general, probably because they could see more clearly the difficulty of devising a sound plan and administering it. In addition, as one speaker had pointed out, it was necessary to determine the area to which tax incentives might appropriately be applied, which involved the definition of a new firm and a new industry, etc. Nor should it be thought that a system of incentives was the easiest way to promote development. From his own observation, it had often failed to give good results. In fact, they were more effective in influencing the allocation of resources among different uses than in increasing the

/over-all amount

over-all amount of investment or savings. It should be realized that if one form of investment was encouraged over another, the social gain achieved was simply the difference between the product gained from the favoured activity and the product that would have been obtained from the activity it had supplanted.

As regards the question of income from foreign sources, he had not alleged that the flight of capital from Latin America to other regions was attributable to tax considerations alone. It was, however, anomalous that countries needing revenue should give better treatment to those who invested their capital abroad rather than at home. He had taken what was perhaps an opportunistic standpoint in urging Latin America to apply the double taxation principle, in other words, to tax capital at its place of origin and place of receipt in common with a number of capital-exporting countries. Although the majority of the participants did not seem to agree with him, he hoped that they would give further consideration to his suggestion.

He did not attach as much importance to the question of imputed rent of owner-occupied property as some of the other participants. But he did feel that property of that kind was tantamount to a source of income for the owner and, if not taxed, would lead to inequity between owners and tenants. He agreed that all consumer durables should receive the same treatment as houses, but did not feel that the argument should be extended to include cash balances, as Mrs. Navarrete had suggested, since such balances were presumably held in order to take advantage of investment opportunities, and if investment income was taxed upon accrual, the effect would be the same as taxing the gains accruing to the holder of a cash balance.

With respect to the interesting suggestion of tax exemptions for shareholders to stimulate investment, he would be loath to go as far as the speaker because of the possible repercussions on income distribution and because it was more equitable to tax income than consumption. A stronger case could be made for selective exemptions, but it would be difficult to decide what type of saving should be promoted or to determine the net increase in saving obtained thereby from one year to the next.

/As regards

As regards taxation of net wealth, he would merely say that he thought there was a great deal to be said in its favour, since the subject would be thoroughly discussed at the forthcoming meeting. He pointed out that it would be desirable to have complete information on a person's net wealth by means of balance-sheets to supplement information on income.

He thought that capital gains should be taxed at the same rate as other types of income provided that the whole tax was not imposed in the year that they accured. In view of the difficulty of referring to tax returns for past years, he suggested that capital gains might be taxed over a period of years by arbitrarily setting the annual rate on the basis of a third or a fifth of the entire gains. In that way, some measure of tax relief would be obtained.

With respect to price level changes, he did not think that allowance should be made for changes in the value of money from year to year, but admitted that countries suffering from inflation might find revaluation socially expedient.

Finally, he was convinced that a well-administered income tax withholding at source would have elasticity of yield, although it had been pointed out at the meeting that the assertion was disproved by experience.

Mr. RAPOPORT explained that in Argentina the system of declaring net wealth in tax returns was already in force.

The meeting was suspended at 4.40 p.m. and resumed at 5 p.m.

TAXES ON NET WEALTH, INHERITANCE AND GIFTS (CPF-DB-5T)

Mr. JARACH thought that before embarking upon an analysis of taxation on net wealth, inheritances and gifts it would be well to stress that the objectives of fiscal policy should be constantly borne in mind, together with the advantages and disadvantages of taxes in relation to those objectives.

It had been argued that taxation of the value of property chronologically preceded taxation of income, which was no doubt true of certain

/partial aspects

partial aspects of the former, but was not valid in the case of a global tax net wealth, which presented all the administrative difficulties associated with income tax. In his view, therefore, the net wealth tax could only be applied in countries which already had some income tax experience. Nor could a tax on net wealth be regarded as a substitute for income tax, but rather as supplementary to it. The replacement of one tax by another should be approached with the utmost caution, and with due regard to its economic repercussions and its effects on the attainment of fiscal policy objectives.

There was no uniformity in the distribution of property and income, although Benini had suggested that if the latter increased in the geometric proportion of 2, the former increased at the geometric rate of 3. Were this so, even the application of a proportional tax on net wealth would result in practice in a form of progressive taxation. The advantages of the tax on net wealth over income tax could be summed up under the following heads: (a) it was more equitable, because it was applied as a function of real tax capacity and could not be shifted; (b) it enabled a clear distinction to be drawn between earned and unearned income; (c) it was neutral with regard to its effect on decisions to invest in enterprises involving differing degrees of risk; (d) it corrected distortions stemming from non-monetary psychological causes, such as a predilection for specific types of investment which were not particularly recommendable from the standpoint of their social usefulness; and (e) lastly, for the very reason that it fell upon potential rather than actual income, it implemented the principle termed "productivist" by the Italian school, whereby taxpayers who kept their capital product were rewarded and those held funds inactive or properties unproductive or underproductive were penalized.

As far as the practical difficulties of administering the tax in question were concerned, those of a technical nature were not excessive and might be over-estimated. It could be combined with a system of taxation on personal income based on yearly returns not only of income but of components of net wealth. As Mr. Rapoport had explained, tax returns of that type had been required in Argentina since 1957, although there was still plenty of room for improvement of the system. Returns of the type in question were also useful as controls in respect of the application of income tax.

/The chief

The chief difficulty lay in valuation, since it was very difficult to keep market values up to date. There was consequently a strong element of presumption in the net wealth tax, as distinct from income tax, where presumed values were reduced to a minimum. A system of making accurate valuations and of keeping them up to date would therefore have to be instituted, especially for periods of inflation.

In his opinion, the net wealth tax ought also to reach all kinds of unproductive assets, such as automobiles, parks, gardens, etc. Clearly, the same problems would arise in that connexion as in relation to the calculation of imputed income.

In countries where administrative technique had not yet reached a level high enough to permit of the introduction of the net wealth tax, taxes on real estate might still be levied. There again the problem of valuation arose, and in a more complicated form, because such taxes were generally applied by provincial or municipal authorities or others distinct from the central Government. The real estate tax was less equitable than the tax on net wealth.

Referring to taxes on inheritances and gifts, he expressed the view that they affected neither incentives nor savings, and could be considered as an alternative to the tax on the net wealth of natural persons. The main effect of the taxation in question was to secure the redistribution of wealth, and that was of great importance in Latin America, where wealth was over-concentrated. Payment of the tax did not affect enterprises except in the case of small individual businesses or partnerships. And even there its effects might be considered beneficial, if it resulted in the disappearance of enterprises so small that they were operating below the optimum-dimension level.

The tax on inheritances and gifts often aroused political opposition among the ruling classes, which were anxious to maintain the permanent dynastic ownership of real estate or businesses. To conceal hostility to the tax, collection difficulties, annoyances caused to small and medium-scale business enterprises and the resulting evasions were magnified.

Among the palliatives suggested to avert the effects of the inheritance tax was the so-called substitute tax that fell on the net assets of business

/enterprises. The

enterpises. The substitute tax could be partially shifted, and was therefore not as equitable as the tax on the net wealth of natural persons or the inheritance tax, nor did it contribute in the same way to the redistribution of wealth, or provided any incentive to economic development.

To sum up, in developing countries it would be desirable to apply income tax supplemented by the net wealth tax and others simultaneously fulfilling several objectives of fiscal policy.

Mr. CASAS said that, broadly speaking, he was in full agreement with Mr. Jarch's views. With regard to the tax on the net wealth of individuals, he did not share the opinion that such a tax was discouraging to the investment of small assets, because it was understood that there was an initial level of exemption and more lenient treatment was accorded. Nor did he agree that the tax in question increased the preference for consumer goods among low-income taxpayers; he considered that the composition of consumption would be modified in favour of non-durable goods which would escape taxation. That could be prevented by the establishment of certain exemptions.

He did not think there was sufficient justification for the tax on transfers. He considered that the transfer tax per se had no raison d'être, and that its only justification was its usefulness as a means of taxing occasional profits, and, in the Latin American countries, its advantages and importance in curbing speculation, channelling savings into productive investment and enforcing voluntary revaluation of real estate, thus improving the tax base for other property taxes.

He added two further considerations with respect to the tax on inheritances and gifts: (a) it was desirable to encourage the distribution of real estate, from the standpoint of its productive utilization, through preferential tax treatment in respect of transfers between living persons and quotas in relation to the inheritance tax; and (b) it was neither possible nor advisable to attempt to make the inheritance and gifts tax progressive.

Mr. PORRAS said he was in entire agreement with the the theoretical principles propounded by Mr. Jarach in his paper. He wished to stress one aspect of the subject, however, namely, the extent to which application of

/the net

the net wealth tax would be feasible. The object of taxation in that instance would be the difference remaining after the subtraction of liabilities from assets, and it might be very difficult to compute that amount, especially as movable and intangible assets were easy to conceal. Moreover, the administration of the tax might imply such heavy expenditure that the financial results obtained would not be worth while. His emphasis on feasibility of application was based on his conviction that the role of an expert was not to formulate recommendations in a theoretical void. If the best was impracticable, the only thing to do was to accept the least unsatisfactory solution.

He attributed the difficulties of administering the real estate tax chiefly to its decentralized character. For example, in Ecuador the tax in question was in the hands of ninety-seven municipalities, not one of which had the slightest possibility of carrying out the land surveys required for accurate valuation. The same difficulty with respect to valuation would be encountered in estimating potential income from rural real estate, and while it was true that the system had been introduced in Chile, he did not think it could be adopted in Ecuador, where even the possibility of taking aerial photographs was limited by the poor light in some districts. He therefore thought that more careful study should be given to Mr. Harberger's proposals for a system of voluntary returns on the part of the landowner, with the modifications suggested by Mr. Kaldor.

He agreed with Mr. Jarach that a tax on the net wealth of business enterprises was undesirable and that its only justification would be the ease with which the resultant revenue could be collected. He also disapproved of the tax on transfers for a valuable consideration, because of the high degree of evasion to which it might lead.

Mr. PINTO considered that although in theory the same tax instruments were at the disposal of all countries, they should be assigned different weighting. In Latin America greater importance should be attached to the tax on property than in the more highly industrialized countries, for a number of reasons: the tax affected typical forms of hoarding which were not the most desirable from the standpoint of development; it was less

/difficult to

difficult to administer than income tax; and it had more powerful repercussions on the inequitable distribution of wealth.

From the social standpoint, the population should be divided into three groups or brackets, and different tax instruments should be applied to each.

(a) In the case of the highest social bracket, which consisted of 5 per cent of the total number of heads of households, absorbed 40 per cent of the national income and was capable of carrying 60 per cent of the tax burden, income tax should be applied, because that tax should be concentrated in the groups which could provide a worth-while yield; also a tax on assets in whatever form; and a tax on expenditure on luxury goods and services.

(b) The middle bracket, which comprised 35 per cent of heads of households, absorbed 40 per cent of national income and should contribute 30 per cent of tax revenue, would be subjected to a tax on expenditure on the so-called "non-wage goods", in Latin American terms, since that was a feasible way of collecting revenue and applying a form of income tax which would not have a heavy payroll incidence.

(c) The low-income group, which was constituted by 60 per cent of heads of households, absorbed 20 per cent of national income and should not contribute more than 10 per cent to tax revenue, would have to be taxed through expenditure, but with the exemption of certain goods such as foodstuffs.

As the income of the last-named group increased, its members would move up into the middle-income bracket and would pay tax in accordance with the tax instruments applied to that group.

Mr. DESAI wondered whether, in the case of death duties, instead of taking into consideration the net wealth of the decedent, it would not be preferable to apply the tax to the total net wealth of the beneficiary, including the inheritance. In Asia the practice of gifts in the donor's lifetime had become widespread, since after two years death duties were not payable.

/Mr. VIDAL

Mr. VIDAL considered that the main purpose of the substitute tax in Argentina and Uruguay was to prevent evasion in the case of bearer securities.

Mr. MATUS endorsed Mr. Pinto's suggestion, and regretted that he had not been able to comment on Mr. Harberger's paper on tax reform, since the chief criticism he would level against it was precisely that it did not take into account total fiscal structure and the social distribution of taxation. Thus, in the case under discussion it was less important to consider the details of the net wealth tax than to know what other taxes were associated with it in the system as a whole for the purposes of achieving the desired objectives.

Mr. COSCIANI, in reply to Mr. Desai, said that it was not always possible to determine on whom the burden of death duties fell. Among the wealthy groups the transfer of savings was a residual item; in the middle brackets there was some element of economic calculation. In any event, the tax might have two possible structures; it could either be progressively graduated according to the net wealth of the decedent or applied to the amount received by each heir.

Mr. BACA expressed surprise at what Mr. Desai said of gifts made during the donor's lifetime, since in Latin America they were also taxable.

Mr. HERSCHEL concurred with Mr. Pinto and Mr. Matus on the need for discussing the fiscal system as a whole, but in his view it was also useful to ascertain the effects and implications of each separate tax and the forms they assumed.

The Chairmen said that the comments formulated by Mr. Pinto, Mr. Matus and Mr. Herschel would be included in a cocument prepared for general discussion.

The meeting rose at 7 p.m.