Tax Digitalization: Latin America leads the change

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When it comes to the digital evolution of tax compliance process, Latin American countries are blazing the path forward. Tax authorities in the region's largest countries are investing heavily in technology, ramping up their ability not just to access more business information in real time but more importantly to unlock the value of such data, gaining greater insight into the tax payer's financial and tax position.

These developments bring new challenges for multinationals operating in the region. The new demands are compelling them to adapt to the new ways of interacting with tax authorities in the different markets or face significant penalties, increasing operational risk across the region.

This article explains why Latin American tax authorities have leapt ahead of their global peers in embracing technology and how they are using it to shift compliance into a digital, real-time realm. We also discuss how multinationals are adapting to the new environment. Finally, we offer a glimpse of what the future may hold for tax functions in the region.

Tax compliance in Latin America: digital solutions for unique problems

For the past decade, governments worldwide have been under pressure to raise funds for much-needed social programs and infrastructure improvements — but for governments of Latin America, the pressure for resources to fund sustainable development and poverty reduction has been more extreme.[1] As a result, Latin American governments have gone that much further to develop policies to improve compliance, curb tax evasion and boost collections.

Latin American countries also seem to struggle with more pervasive tax evasion than other regions. The average value added tax (VAT) evasion rate among Latin American countries is an estimated 27.8 percent of GDP. Evasion rates for corporate and personal income tax are even higher, reaching 48.9 percent and 44.3 percent respectively.[2] In 2015, the overall cost of non-compliance was pegged at 2.4 percent of GDP for VAT and 4.3 percent of GDP for income tax, for a combined revenue cost to Latin American governments of 340 billion US dollars (USD).[3]

This extreme tax leakage has driven the region's tax authorities to develop and adopt ever more sophisticated responses. Among these solutions, Latin American tax authorities have moved quickly to take advantage of new technologies to improve access to tax sensitive data and have a better handle of said information. As a result companies are being required to provide digital tax filings and documentation in a rising number of Latin American tax jurisdictions. The highly heterogeneous environment, where the level of digitalization of the tax authorities and country-specific requirements vary from jurisdiction to jurisdiction, doesn't make things any easier.

For example, countries like Chile have pioneered the introduction of electronic invoicing and the online filing of VAT returns (see table on page 3). More recently, in some larger countries, like Brazil or Mexico, the e-invoicing system requires a digital stamp from the tax authority before the invoices can be submitted to the provider or customer, giving tax authorities real time access to transaction information. Mexico is taking digitalization even further, requiring not only invoices or tax returns but also accounting records and other tax disclosures to be filed in standard electronic format (i.e. XML).

But accessing the data was just the beginning. The implementation of Big Data solutions, together with the use of advanced analytics is allowing revenue authorities to extract more value out of this data. In Brazil, for example, the tax authorities have implemented Big Data technology through its Public Digital Bookkeeping System (SPED, by its Portuguese acronym). The system allows the tax authorities to run cross-checks on information collected through e-invoicing, providing insight on mismatches across different filings, emerging trends and uncommon variances.

For tax authorities, these systems deliver advantages beyond filing and payment compliance. For example:

— Real-time access to transactional data increases transparency, providing tax authorities with a much more detailed picture of taxpayers' accounts and dealings.

— Data analytics can be employed to check the quality of taxpayer data by benchmarking it against taxpayers with similar characteristics.

— By combining data analytics with other tools, tax authorities can sweep through masses of taxpayer data to not only cross-check reported purchases against reported sales but also to identify broader patterns and anomalies and detect areas of non-compliance risk.

— The tax authorities can then zero in on these risk areas to select cases for audit, optimize debt management processes and design taxpayer communications to encourage compliance.

— Governments can also use this data to understand the impact and effectiveness of newly implemented tax policy changes.

Latin America is just the tip of the iceberg. Tax authorities around the world are closely watching developments and outcomes of the digitalization process in this region. Similar changes can be expected in the near term globally (e.g. in Russia and Singapore).

[1] Economic Commission for Latin America and the Caribbean, *Fiscal Panorama of Latin America and the Caribbean 2017*, at p 38.
[2] See note 1, at p 43.
[3] See note 1, at p 44.

Indeed, the Organisation for Economic Co-operation and Development (OECD) is encouraging tax authorities to adopt emerging technologies to improve their tax administration. In a 2016 report,[4] the OECD says:

"The successful application of information technology will determine the future success of revenue bodies in managing compliance risks and meeting rising service expectations... (T)he introduction of Big Data technology, combined with advanced analytics and increased digital presence... offer the opportunity to consider moving more to a real-time tax system and to explore new options for managing taxes, countering fraud, dealing with the shadow or hidden economy and assessing how assets are actually being used."

As the use of data and analytics continues to spread, the OECD says in a second report, "…(A)dvanced analytics is becoming a cornerstone capability for operational and strategic decision-making in tax administrations."[5]

[4] OECD, *Technologies for Better Tax Administration: A Practical Guide for Revenue Bodies*, May 2016.
[5] OECD, *Advanced Analytics for Better Tax Administration: Putting Data to Work*, May 2016.

Electronic invoicing systems in selected Latin American countries

Argentina

— E-invoicing is now mandatory for all corporate tax payers.

— Monthly sales and purchase reports must be filed electronically, providing detail on all transactions.

Brazil

— E-invoicing approved in 2008.

— Tax authorities validate invoices before they are issued to buyers, making a huge dent in non-compliance.

— Brazil's tax authorities employ powerful D&A tools to mine this transactional data. The system can cross-check data across all filings of the same taxpayer.

— Data mismatches now drive more than 90 percent of tax audits in Brazil.

Chile

— In 2004, Chile was among the first countries to introduce electronic invoicing.

— Most corporate taxpayers are required to submit e-invoices, only optional for very small companies.

Colombia

— Voluntary e-invoices implemented for large companies, with plans to make e-invoicing compulsory in 2019.

— Some large taxpayers already getting ready to comply.

— Similar to Brazil and now Mexico, tax authority validates the invoice.

Mexico

— Mexico introduced e-invoicing in 2014.

— Recently, similar to Brazil, invoices now require the Mexican tax authorities' electronic seal to be valid (otherwise the recipient of the invoice cannot use it to claim input VAT).

— Mexico is taking the digitalization process further, with not only tax returns being filed in XML format, but also accounting records and other reporting obligations.

Source: KPMG International, 2018

How are international companies in Latin America responding?

As tax systems shift into the digital domain, operational risk for multinationals operating in LATAM has risen sharply over the last few years. Responding to tax digitalization is becoming a matter of survival for these organizations, forcing tax departments and the entire finance organization to adapt. Failing to respond can expose the company to severe financial penalties and reputational harm.

So what concrete measures are being taken by multinationals in the region today? The experience of KPMG member firms in Latin America and KPMG International research show that forward-thinking tax functions in Latin America today are investing in technology, increasing governance and centralization, and changing the mix of their people's skills.

Investing in technology to improve data quality

Transactional information is the starting point for most tax compliance obligations. Just as Latin American tax authorities are focusing digitalization toward accessing this data, companies are increasingly looking for technology solutions that can ensure the quality of tax-sensitive data. These solutions include data collection engines, which can read a company's enterprise resource planning system, extract data for tax compliance, and return it compliance-ready without human intervention. As a result, advancing technology is dramatically improving the quality and visibility of tax data and enhancing compliance for many Latin American tax functions. As electronic invoicing and reporting requirements lead them to automate their tax compliance, they are also working to replicate the data gathered by the tax administrations.

Once data is available, D&A solutions can help in running sanity checks to further ensure consistency and quality, and to provide further insight and value to support the overall tax strategy of the entire organization. This is key for companies doing business in countries like Brazil, for example, where software solutions can run cross-checks similar to those run by SPED to verify the data's quality. Access to invoice-level data can also support the tax function in producing reports that identify risks, opportunities and strategic decision making.

Increase centralization and governance

At this point in the article, one idea should be clear: data should be one of the cornerstones around which the modern tax organization should be designed and developed. How to access tax-sensitive data in the most efficient way and ensuring consistency and quality has become a matter of survival.

As a result, the new compliance framework brings additional pressure to implement more severe governance and control policies and to further standardize ways of working, with the ultimate goal of supporting the new data requirements.

For many multinationals with presence in the region, this adds just another reason for further investing on the centralizing processes and roles part of the tax function, increasing its integration with the overall finance organization. As a result, and despite the fact that the centralization of tax processes in LATAM has been traditionally more challenging than other regions — mainly due to the lack of harmonization among local regulations — many US and UK headquartered multinationals have taken a step forward and have integrated a large part of their tax function in shared service centers that now host the owners of the tax compliance processes for several markets in the region.

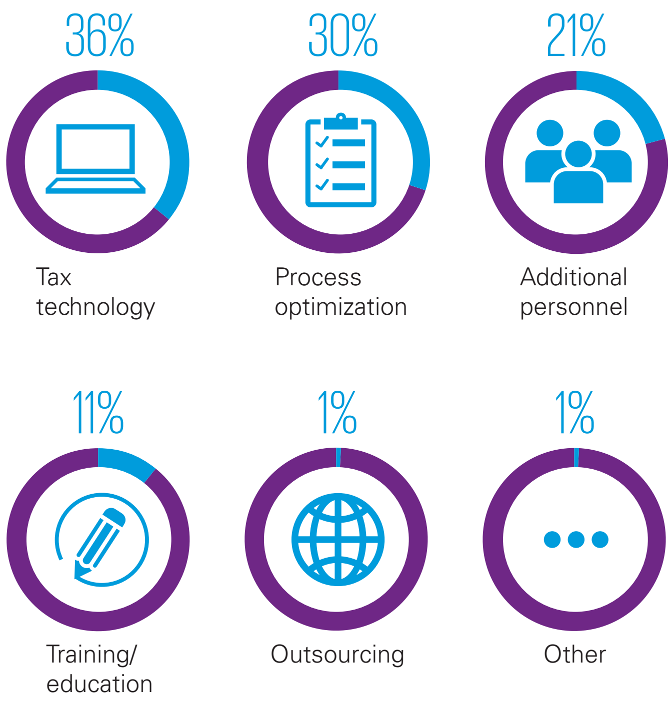
Investing in new skills

Tax functions need broader skill sets to derive the most benefits from investments in technology, centralization and data and analytics. While tax technical capabilities are still a top priority, when it comes to compliance, tax teams in Latin America are broadening their skills to include tax technology and softer skills, such as general business acumen, finance and project management. One key element of the new tax professional profile is a heavier accounting background, allowing them to understand tax implications of transactional-level data or the key elements of tax accounting in a multinational context that might involve handling more than one accounting principle.

In addition to hiring and training staff, many Latin American tax departments are supplementing their in-house skills by co-sourcing resources from tax providers. As complexity and operational risk increases, organizations have less incentives to develop and keep non-core business functions in house and the demand for co-sourcing or outsourcing support increases.

The trends described above are in line with some of the key findings of the KPMG International's 2017 Latin America Tax Benchmarking Survey[6] conducted among 80 tax leaders of organizations across Latin America:

If you received a generous budget increase to invest in one key area of your tax department, where would you invest?



Source: 2017 Latin America Tax Benchmarking Survey, KPMG International

As many Latin American tax functions work to evolve their systems and processes to keep pace with complex compliance demands, their investments in technology, processes and people are laying a foundation for success in the years to come.

[6] KPMG International, A look inside tax departments in Latin America and how they are evolving, Global Tax Benchmarking series, 2017.

The future of the tax administration and finance teams in Latin America

As tax system digitalization continues and Latin American companies implement solutions in response, what does the future hold for tax functions in the region in the next 5 or 10 years?

While predicting the future is difficult, the transformations being undertaken today are expected to change tax functions and the tax environment in the region in four key ways:

Tax authorities and tax functions will devote less human resources to tax compliance.

Tax professionals with a new blend of skills will add more value.

Global tax functions and activities will become ever more centralized.

External service providers will develop new ways to deliver resources.

1. Less resources will be devoted to tax compliance.

The implementation of new data technologies and the use of advanced analytics is allowing revenue bodies to extract more value from existing data today. With tax systems moving into an era where authorities can access business information in real time, it is not hard to imagine a future in which the tax authority collects raw financial and transactional data from companies and presents the tax return back to the company. For both tax authorities and taxpayers, the involvement of people in the compliance process will be increasingly limited to high-level review and strategic analysis functions.

Further, as other advances like artificial intelligence and robotics are increasingly applied to tax, opportunities for tax authorities to improve their efficiency can multiply through better management of taxes, better understanding of taxpayers' behavior, more predictive insights for fighting tax evasion, and more tightly targeted audit efforts.

2. Tax professionals with a new blend of skills will add more value.

As technology gives tax functions more visibility and control over their company's tax data and automates tasks, in-house tax professionals will be freed from routine tax compliance activities. At the same time, they will face new demands to improve data collection processes across the finance organization and to work with data and analytic tools to turn financial information into actionable insight. These demands will spur organizations of the future to seek a new type of tax professional with expansive knowledge of technology, tax and accounting, and how they can interact to improve their organization's data quality and decision making.

3. Global tax functions and activities will become more centralized.

As centralization of finance and tax functions continues, organizations of the future will realize more of the traditional benefits that centralization brings, including standardization, efficiency and economies of scale. However, the advent of fully digitalized tax systems will raise complex new operational risks. Companies will be compelled to respond with structures that promote connectivity across the entire finance organization and allow the implementation of systems and process that ensure the quality of tax-relevant data.

For multinational companies, the evolution of regulations that foster the exchange of information among tax authorities reinforces the benefits of investing in centralized sourcing models, such as shared service centers, which can serve multiple jurisdictions and ensure filings across countries and business units are consistent.

4. External service providers will craft new ways to deliver resources.

The new era will challenge external tax service providers like KPMG member firms to maintain their position at the forefront of tax technology developments. Technology will shift tax compliance from a specialized service to an automated commodity, and companies will seek providers who go beyond compliance and deliver additional value. Service providers will need to offer data and analytics solutions not only to ensure data quality and consistency but also to transform data into insights that support strategic planning decisions. Further developments of artificial intelligence will also change the way tax providers are resourced and provide value.

Conclusion

The speed of tax transformation in Latin America depends on many factors, including how quickly tax regulations are adapted to technological change. In Mexico, for example, the progress of digitalization may slow as the government debates concerns over policy matters such as:

— whether the tax authorities should be able to notify the taxpayer before they use information acquired through e-invoicing in tax audits

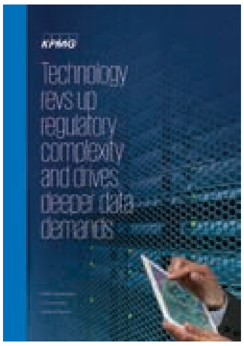
— whether this use would breach Mexico's 5-year statute of limitation period.

Further, companies operating in countries with complex regulatory environments need to invest more time and resources. In Brazil, for example, companies seeking to more fully automate the production of VAT returns may see their implementations delayed due to the country's complex and diverse regulatory framework (e.g. where different states tax similar transactions differently).

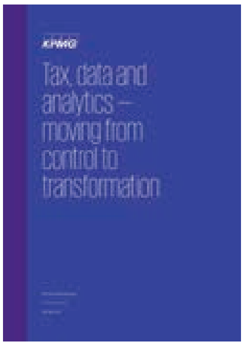
Regardless of the pace of change, the overall direction seems clear. With technology automating routine compliance activities and opening access to richer, deeper levels of transaction data, tax authorities and tax functions will evolve and become more adept at applying technological tools, like data analytics and artificial intelligence, to derive strategic insights and value.

As tomorrow's tax functions take shape, it's an exciting time for tax authorities and tax professionals in Latin America and globally. With the region emerging as the testing ground for digitalized tax solutions, the world's tax authorities and companies are watching developments in Latin America to see how they may affect the future in their own countries.

Further reading



Technology revs up regulatory complexity and drives deeper data demands



Tax, data and analytics — moving from control to transformation

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