Tax and digital transformation in Latin America

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As technology continues to evolve, its role in Latin American business functions has become essential. Companies increasingly leverage innovative technologies to enhance their growth, products and customer relationships, helping to streamline business functions and remain competitive.

However, this changing digital landscape has important tax implications for businesses across the region. As Latin American companies navigate new technologies, they must consider relevant jurisdiction-specific laws.

In this article, we explore the role of digital transformation in businesses and discuss some relevant issues related to local taxation in Brazil, Colombia, Perú and Chile.

Technology and digital transformation

Some sectors – for example, pharmaceuticals, chemicals, aviation and computer software – have historically invested in the internal development of new technologies because their products have relied on it. Other industries, however, primarily invest in digital innovation to improve their processes and customer relationships, often acquiring technologies from third parties.

Complex, cutting-edge technologies generally arise from research and development (R&D) activities. Large companies often dedicate internal resources to R&D while relying on local R&D tax incentives. Large businesses may also turn to universities, or other service providers, for their technological research, demonstrating the importance of an innovation network with defined contractual obligations and protections relevant to R&D.

Alternatively, large companies may acquire tech startups to harness their resources. A target company's intangible capital is an important factor in considering a merger or acquisition.

Other avenues for innovation, which are increasingly more common, arise from combining different technologies and/or writing computer software, taking into account the significance of changing algorithms.

However, not all technologies result in success. Newly developed resources are faced with technological risk and must prove themselves financially viable in order to be considered an innovation.

If a technology arising from R&D proves successful, it can usually be protected as a patent or as know-how (*ie*, a trade secret), allowing digital products to be licensed and used for the company's business purposes. Other technologies are protected by copyright, which is usually the case for computer software. Protection is important in case of litigation due to infringement of intellectual property rights.

These digital products, or intangibles, are rapidly becoming a differentiator for successful companies.

Digital transformation is the use of such technologies to improve business functions (eg, business processes, products and customs relationships), even if a company's products are neither digital nor offered under a digital platform.

The impact of digital transformation on tax

As the world grows smaller through technology and digital transformation, national borders, as well as customs clearance and duties, have become less of an obstacle in conducting business. This is especially true as new methods of payment and intangibles become more common.

This brings new concerns for nations, however, because the taxation of business activities is a primary source of tax revenue.

In the past, withholding income tax was the standard alternative to taxing foreign companies when they lacked a PE in a given country.

Furthermore, cash-strapped governments, not least in Latin America, see digital transformation itself as a new revenue opportunity. Many nations, including those in Latin America, continue to discuss digital taxes and to enact new legislation creating such taxes.

Brazil

Brazil, for example, focuses on withholding taxes and other taxes where the taxpayer is the contracting party. Brazil's Congress is also considering a digital tax on the gross revenues arising from digital services and digital advertising. Rather than creating a new withholding obligation, this proposal would make the foreign company the taxpayer.

The acquisition of technologies may be subject to a heavy tax burden in Brazil if the technologies qualify as services, but fewer taxes are imposed on royalties for intellectual property licensing. Some taxes are deducted from the agreed fee unless a gross-up clause applies.

Colombia

In Colombia, different national and local taxes should be considered in relation to the digital economy. Such taxes depend on a range of factors – for example, whether goods or services are being provided, the type of technology, or the location of the IP.

Foreign investors and Colombian businesses are generally accustomed to income tax and VAT concerning these matters. Other, more local taxes, on the contrary, may be regarded as controversial and even overreaching.

For instance, the Tax on Industrial, Commercial and Services Activities (in Colombia, *ICA*) levies the gross income obtained through the performance of such activities in a given Colombian municipality. The issue, particularly for digital businesses, is determining in which municipality the activity is performed (and whether the activity is performed in Colombia at all).

Regarding the provision of services through digital platforms, Law 1819 of 2016 establishes that income, for ICA tax purposes, is obtained in the municipality where the service is "performed." Even if this criterion is open to interpretation, certain decisions from Colombia's Highest Court clarify that the service is performed where the activities to provide the service occur, regardless of the consumer's location.

Nevertheless, some municipalities, such as Medellin, have enacted local rules establishing the opposite: that, in the case of digital services, income is obtained in the consumer's municipality. Hence, these opposing rules pose a challenge for digital service providers in Colombia, and the legality and constitutionality of said municipal rules may be seen as debatable.

Concerning the sale of goods through digital platforms, Law 1819 of 2016 establishes that, in direct sales to consumers through any electronic means (B2C), income is obtained in the municipality from which the products are dispatched. The main issue we have identified in these cases is that there is no clear rule applicable to sales to other businesses through digital means (B2B).

The Colombian Ministry of Finance has understood that the B2C rule applies in such cases. However, there are no clear grounds in this regard, and, in cases where the business does not have a commercial establishment in Colombia, income is regarded as obtained in the municipality where the sale is completed (*ie*, where the price and good are agreed).

While companies should plan to review this issue on a case-by-case basis, certain decisions from Colombia's Highest Court suggest that, in each instance, the company should consider the location in which:

- The purchase orders are received, approved and declined
- The inventory is managed and approved and
- The orders are coordinated.

Perú and Chile

In the cases of Perú and Chile, certain national taxes (ie, income tax and VAT)apply to the transfer of technology and the provision of digital services. However, no local taxes apply.

Conclusion

Prudent companies doing business in Latin America are also paying attention to local taxation rules in Brazil, Colombia, Perú and Chile discussed above.

Overall, the creation or acquisition, protection and use of technologies, including tax aspects and the taxation of foreign companies' use of digital technologies in the countries where a company's customers are located are important considerations in today's business world.

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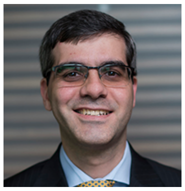

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