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THE HARMONIZATION OF INDIRECT TAXES IN THE ANDEAN COMMUNITY

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SUMMARY

After a long process that began in October 1998, on July 12, 2004 the Andean Community (CAN) approved Decisions 599 and 600 on, respectively, the harmonization of value added tax (VAT) and excise type taxes (ET).

The only precedent for the agreement on tax harmonization in the CAN is the European Union (EU) experience. In the case of the Andean countries, designing the harmonized VAT also entails adopting international best practices.

The main technical characteristics of the long-term convergence of national laws on VAT are: (i) reducing distortions so as to ensure competitiveness (economic efficiency); (ii) horizontal equity among taxpayers by limiting exemptions so as to foster sectoral neutrality; (iii) favoring coordination among the various tax jurisdictions on the basis of the principle of “non-discrimination” between national and foreign production; and (iv) the adoption of specific regulations to protect taxpayers rights without constraining the powers of the tax authorities.

This study describes the background to the agreement; the importance of harmonizing indirect taxes (VAT and ET) for economic integration; the current significance of tax revenues in the Andean countries; multilateral negotiations on this matter and the lessons learned; and the economic bases and technical-taxation elements of the harmonized VAT.

INTRODUCTION

The approval of Decisions 599 and 600 on the Harmonization of Substantial and Procedural Aspects of Value Added Taxes and the Harmonization of Excise Type Taxes (VAT and selective taxes) by the Commission of the Andean Community is a notable victory for the Andean integration process and sets a precedent in the developing world. The Decisions amount to an agreement on how to design national laws on a modern and administratively coordinated VAT, as well as joint rules on excise taxes.

These accords sprang from the political will of the Andean authorities working in this field, the countries’ technical capacities, and the catalyzing role played by the political authority of the Andean Community’s General Secretariat (GS), which received technical support from the Inter-American Development Bank (IDB). Representatives of the five member countries’ Finance Ministries and Taxation Directorates participated actively and enthusiastically in these efforts. The process began with a background study commissioned using funds from an IDB regional technical cooperation project, followed by three negotiating rounds and eight meetings of experts and officials organized by the GS.[1]

[1] With the financial and technical support of the IDB through the Special Initiative on Trade and Integration.

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I. Background

The harmonization of value added and excise taxes has been a priority for the Andean Community countries since October 1998, when the Advisory Council (comprising the Finance Ministers, Central Bank Governors and officials from the economic planning institutions) instructed the General Secretariat to identify the stages of and submit a proposal on the later harmonization of indirect taxes.

More precisely, however, the legal framework for harmonization in the area of fiscal policies, including tax policies, stems from the Cartagena Agreement of 1969. According to the Article 3 of the Agreement, the mechanisms to achieve its goals include the gradual harmonization of economic policies, while Chapter IV addresses the harmonization of economic policies and the coordination of development plans.[2]

In that chapter the CAN member countries are instructed to coordinate their development plans in specific sectors and gradually to harmonize their economic and social policies by means of planned activities. There is an explicit reference to exchange rate, monetary, financial and fiscal policies.

To put these mechanisms into effect it was decided that the Commission of the Andean Community,[3] at the initiative of the General Secretariat (GS) and taking into account the status and requirements of the subregional integration process, as well as balanced compliance with the Agreement's mechanisms, would approve the regulations and fix the schedule for the gradual harmonization of economic legislation.

It should be noted that the Decisions on the harmonization of indirect taxes are not the first to have been approved by the Commission in the tax area. Previous decisions in this field evidence the Andean Community's authority in tax matters. By way of illustration, note the following Decisions:

- Decision 330 of October 22, 1992 on the elimination of subsidies and the harmonization of incentives to intra-subregional exports. This Decision establishes the regulations that harmonize the reimbursement of export taxes. Those regulations specify what kind of exemptions, reimbursements or deferrals are deemed to be tax-related subsidies, and bars the member countries from using such mechanisms for intra-subregional exports.[4]

- Decision 338 of July 2, 1996 on the harmonization of indirect taxes as incentives to goods exports. This Decision establishes the regulations that harmonize the reimbursement of all indirect taxes levied on the acquisition of raw materials, intermediate inputs and capital goods consumed or used in the production, transportation, and marketing of exported goods.

[2] Agreement on Andean Subregional Integration – the Cartagena Agreement. See Articles 54, 57, 58 and 59.
[3] An institution of the Andean Community comprising a plenipotentiary representative of each of the member countries, which expresses its rulings by means of Decisions.
[4] Articles 12 and 16 of Decision 330.

- Decision 578 of May 4, 2004 on the regime to avoid double taxation and prevent tax evasion. This Decision seeks to avert double taxation on the same earnings or holdings at the Community level and replaces Decision 40, which was approved in 1971.

II. THE IMPORTANCE OF HARMONIZING INDIRECT TAXES

The harmonization of indirect taxes will help to:

(i) facilitate the economic integration of the countries of the Andean subregion;
(ii) eliminate restrictions on external trade;
(iii) create juridical stability; and
(iv) enhance tax collection.

II.1 How does it facilitate economic integration?

An answer to this question requires attention to a number of issues. Integration is a process that comprises the following stages:

a. Free trade area. Several countries agree to eliminate trade restrictions, wholly or partly, so that goods and services originating in any of the member countries can move freely among them.

b. Customs union. The member countries, in addition to allowing the free movement of goods produced in any of them, establish a common external tariff. Hence all third countries that want to sell in the markets of the members are subject to the same kind and level of tax.

c. Common market. The members of a common market agree to eliminate the barriers that hamper the free movement of all factors of production: goods and services, capital and people.

d. Economic union. In addition to allowing the free movement of goods, services, capital and people, and to adopting a common external tariff, the member countries harmonize their economic policies.

In that context, indirect tax harmonization is necessary to consolidate the customs union that the Andean Community is at present, and to minimize asymmetries in the conditions of competition caused by very dissimilar indirect tax regimes. Moreover, the harmonization of indirect taxes will make possible later progress on the abolition of internal bilateral customs facilities, and is conducive to the creation of a common market.[5]

II. 2 How does it help eliminate restrictions on external trade?

The harmonization of indirect taxes makes it possible to correct the distortions in intra-Andean trade that spring from the peculiarities of each tax regime governing

[5] The Tenth Andean Presidential Council set this goal in May 1999. It has been reaffirmed by the Council on several occasions.

VAT and ET. In recent years, several disputes among the members have been resolved only after lengthy legal proceedings. Harmonization would help lessen such clashes, which are summarized below:

Implicit VAT. In August 1999 the Colombian-Ecuadorian Chamber of Commerce and Industry Corporation lodged a complaint against Colombia's levying of a tax on VAT-exempt goods (termed an "implicit VAT"). The tax was imposed to equalize the competition conditions for domestically-produced and imported goods.

The problem stemmed from the VAT exemptions[6] for certain goods. VAT on the acquisition of certain inputs for the exempted and nationally-produced good is transferred to its cost and then to its price; if the same good is imported, the VAT paid on the acquisition of inputs is reimbursed by virtue of the principle of destination. Hence, if product X is VAT-exempt in Colombia but not in Bolivia, the Bolivian product X enters Colombia without paying the VAT on the inputs used to produce it, while the Colombian product X has to include in its costs (and thus in its price) the VAT levied on the inputs.

In this respect the decision of the CAN's General Secretariat[7] was that the "implicit VAT" was a tax and that it should not be imposed. Colombia's justification for levying the tax was to equalize the competition conditions stemming from the VAT exemptions, by requiring payment of a tariff that replicated the tax imposed on domestic producers.

Note that this distortion would not arise if product X were to be taxed in both countries, nor if it were tax-exempt in both. In other words, the non-harmonization of VAT exemptions changed the relative prices of goods in favor of imports taxed in the exporting country.

The imposition of specific differential taxes. In September 2000 Venezuela lodged a complaint against Peru's imposition of specific taxes on cigarettes. The tax was determined by the number of countries in which the products are sold. As a result of this system, all brands manufactured abroad faced a higher tax than all those made in Peru, giving rise to differential treatment of domestic and foreign cigarettes.

The General Secretariat ruled that a system of specific taxes that was determined by the number of countries in which the cigarettes were sold amounted to discriminatory treatment, one that affected cigarette exports from the subregion to the Peruvian market.[8]

The inclusion of tariffs in the VAT tax base in a free trade area. In October 2001, Peru lodged a complaint against Venezuela because of the system used to calculate the VAT tax base for products imported from the subregion. The base included the value of the tariff, although the latter was not applied to imports from the subregion because of the free trade area among the Andean countries. This regulation could

[6] In the terminology of Decision 599, exclusions entail the exemption from or removal of the tax established or allowed by law on a given good or service. The reimbursement or rebate of the tax paid is not permitted.
[7] See Resolution 311 of November 3, 1999.
[8] See Resolution 504 of April 30, 2001.

have led to Venezuelan goods facing a lower tax than imports from the subregion, thereby conferring protection on national production.

The General Secretariat's decision was that this system entailed discriminatory taxation on imports from the other Andean countries.[9]

VAT exemptions dependent on the origin of the product. In August 2002, Colombia lodged a complaint against Venezuela's system of VAT exemptions because such exemptions for imports were only granted if Venezuela did not produce the same goods, or if there was insufficient domestic production. This practice has an effect equivalent to a tariff and contravenes the principle of national tax treatment for the subregion's imports, as enshrined in the Cartagena Agreement.

The CAN's General Secretariat ruled that the practice should cease.[10]

II. 3 How does it favor greater juridical stability?

The stability of rules is one of the most important factors in investment-attraction. Such stability tends to be undermined frequently because of the member countries' need to raise tax revenues so as to reduce their deficits and lower their debt levels. In some countries, juridical stability is guaranteed only for a group of taxpayers who can reach agreements on the matter, thereby enabling them to stabilize the tax system in place at the time they invest.

Supranational norms such as Community Decisions offer a more effective guarantee of stability, since they apply to all the subregion's taxpayers and cannot be altered unilaterally by one country. In the final analysis, compliance is guaranteed by the Court of Justice of the Andean Community, which averts contradictions among the domestic regulations of the member countries.

II.4 How does it strengthen tax collection?

In a subregional context of fiscal fragility, the harmonization of indirect taxes, on the basis of the negotiating process itself, has allowed governments to become more familiar with best practices in tackling tax evasion. During the negotiations, for example, Peru included in its legislation the withholding system used in Ecuador. Venezuela and Ecuador have established a simplified system for small taxpayers that is already operating in Peru; and Colombia has made substantial progress in rationalizing VAT exemptions.

Additionally, the process facilitates voluntary compliance with the rules when a taxpayer is present in more than one country, since all countries have similar (if not identical) tax rules.

[9] See Resolution 594 of February 2, 2002.
[10] See Resolution 677 of November 26, 2002.

III. MACROECONOMIC ASPECTS OF HARMONIZING INDIRECT TAXES: THE IMPORTANCE OF VAT IN THE ANDEAN COMMUNITY

This section briefly describes some fiscal indicators that reveal the significance of indirect taxes in the tax systems of the CAN member countries.

VAT is the main tax in all the CAN countries, and recent years have seen improvements in VAT collection throughout the Community. In all of them except Colombia the share of indirect taxes in tax revenues exceeds 50%; in Ecuador and Venezuela[11] it surpasses 60%, which underlines the importance of harmonizing the technical aspects of these taxes. Because trade liberalization has brought about a decline in tariff revenue, and because high levels of tax evasion lower the income tax take, VAT and excise taxes are the most important levies in the Andean countries' tax structure.

As regards the VAT's productivity,[12] which reflects the tax administrations' effectiveness in collection and the scope of the tax base, there have also been improvements in recent years, although these have been less marked than those evident in tax collection. Only Ecuador has attained a productivity level of 50%. This indicator is important in assessing the fiscal impact of harmonization.

Tax Revenues as a % of GDP

	2000	2001	2002	2003
BOLIVIA				
VAT	5.7	5.8	6.3	6.3
ET	1.3	0.9	0.7	0.8
Tax revenues	13.6	13.0	13.3	13.7
Indirect taxes/tax revenues	51.7	51.1	52.9	51.8
COLOMBIA				
VAT	4.9	5.6	5.6	6.2
ET	0.5	0.5	0.5	0.5
Tax revenues	11.0	13.2	13.5	14.3
Indirect taxes/tax revenues	48.8	45.9	45.2	47.1
ECUADOR				
VAT	5,8	7.0	7.0	6.5
ET	0.6	0.9	1.1	1.0
Tax revenues	11.7	12.3	12.5	12.0
Indirect taxes/tax revenues	54.1	63.9	64.0	63.1
PERU				
VAT	5.2	5.1	5.1	5.4
ET	1.8	1.9	2.1	2.1
Tax revenues	12.3	12.5	12.1	12.9
Indirect taxes/tax revenues	57.6	55.9	59.8	58.7
VENEZUELA				
VAT	4.2	4.4	4.3	4.8
ET	0.4	0.0	0.5	0.5
Tax revenues	8.0	8.8	8.5	8.7
Indirect taxes/tax revenues	57.3	50.2	56.4	60.7

Source: Member countries' central banks and tax administrations.

[11] Not including oil income.
[12] Derived by dividing the net effective rate (VAT collection/GDP, in this case) by the nominal rate (here, the prevailing average rate).

VAT: Nominal Rates and Productivity (%)

	2000	2001	2002	2003
BOLIVIA				
Effective VAT rate (1)	5.7	5.8	6.3	6.3
Nominal rate (2)	14.94	14.94	14.94	14.94
Effective rate/nominal rate	38.4	38.7	42.4	42.4
COLOMBIA				
Effective VAT rate (1)	4.9	5.6	5.6	6.2
Nominal rate (2)	15.0	16.0	16.0	16.0
Effective rate/nominal rate	32.5	34.7	35.1	38.9
ECUADOR				
Effective VAT rate (1)	5.8	7.0	7.0	6.5
Nominal rate (2)	12.0	12.0	12.0	12.0
Effective rate/nominal rate	48.3	58.4	58.0	54.6
PERU				
Effective VAT rate (1)	5.2	5.1	5.1	5.4
Nominal rate (2)	18.0	18.0	18.0	18.3
Effective rate/nominal rate	29.1	28.3	28.6	29.7
VENEZUELA				
Effective VAT rate (1)	4.2	4.4	4.3	4.8
Nominal rate (2)	15.2	14.5	14.9	16.0
Effective rate/nominal rate	27.4	30.4	29.0	30.0

(1) VAT collection/GDP.
(2) Average rate during the year.
Source: Member countries' central banks and tax administrations.

IV. BRIEF DESCRIPTION OF THE PROCESS OF HARMONIZING INDIRECT TAXES

The harmonization of indirect taxes in the CAN countries began with the mandate of the Advisory Council of the Ministers of Finance or the Treasury, Central Bank Governors and officials of the economic planning institutions, issued at its second meeting in October 1998. Through this mandate the Council instructed the General Secretariat to identify the stages of and submit a proposal on the later harmonization of indirect taxes. The mandate was ratified by the Council itself in its fourth meeting (2000).

For the purposes of the present study, the five stages described below were identified in this process.

IV.1 Study phase

The CAN's General Secretariat, using resources from an IDB technical cooperation project, commissioned a background study on the harmonization of indirect taxes. The study was submitted in September 1999.[13] Later, the GS commissioned a second study to underpin the formulation of a proposal on harmonization with draft Community regulations. This second study put forward a comprehensive proposal on the harmonization of indirect taxes and was structured as follows:

- Analysis of fiscal conditions in each of the member countries;
- Analysis of the technical and administrative aspects of indirect taxes in each country;

[13] See Mauricio Plazas Vega, "Condiciones para la armonización tributaria en los Países Andinos, en lo que atañe a los impuestos indirectos".

- Review of the documents on other integration experiences in the tax area;
- Various rounds of discussion with the fiscal and technical authorities of each country's central bank;
- Recommendations that jointly amounted to a proposal on a model VAT for the subregion;
- Quantification of the proposal's fiscal costs; and
- Drafting Decisions on VAT and ET.

This study[14] was submitted to the consideration of the member countries in July 2002. The consultants preparing both studies were in constant contact with officials of the economy ministries and tax administrations in the member countries.

IV.2 Political awareness-raising phase

This phase consisted of a new round of discussions[15] and two technical seminars. In February 2003, the IDB expressed its interest in continuing to support the harmonization project. Hence representatives of the Bank, the GS and the consultants traveled to each member country to receive general comments on the status of the project and its prospects. The following month, at the "Workshop on the Fiscal Impact of Integration" in the headquarters of the GS, one of the panels addressed the importance of the project on the harmonization of indirect taxes.

As a result of the evaluation of the visits and the workshop, the GS decided that the member countries were fully willing to start negotiations on harmonization and convened the first meeting of government experts on the harmonization of indirect taxes.[16]

IV. 3 Negotiating phase

Eight meetings of government experts were held between April 2003 and July 2004. They were organized as follows:

- The venue rotated so that each country could increase its number of representatives when it acted as host.
- Generally, each country was represented by two delegates: one from the treasury or the finance ministry responsible for devising tax policy, and another from the tax administration.
- The GS always acted as the moderator of the meetings.
- At least one IDB expert as well as one consultant were present at the meetings.
- The meetings sought to build consensus among the delegates on each of the issues addressed by reviewing the articles in the draft Decisions.
- Following each meeting the agreements reached were included in a report that was submitted for the approval of the participants.

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[14] Luis Alberto Arias and Mauricio Plazas Vega, "La armonización tributaria de los impuestos indirectos en los países de la Comunidad Andina: Elaboración de recomendaciones y normativas sobre armonización de tributos indirectos", SG/di 428, July 5, 2002.
[15] In the study phase the consultants made two trips to all the member countries.
[16] This first meeting was held on April 24-25, 2003 in Lima, Peru, at the headquarters of the General Secretariat.

IV. 4 Political decision-making phase

Following six of the eight expert meetings, with the draft Decisions on the VAT and ET practically agreed upon, the GS convened a meeting of Vice-Ministers of the Economy and Directors of Tax Administrations at its headquarters in February 2004. At that meeting, all the objections pending from the technical level were resolved. The meeting also gave rise to some important definitions and agreements that enabled the draft Decisions to be polished and completed. They were as follows:

a. The VAT ceiling was set.
b. A single general rate was approved and, optionally, a single preferential rate. The latter could not be less than 30% of the former.
c. There would be no further exemptions of goods and services following approval of the community norm.
d. The gradual dismantling of existing exemptions until only the usual exemptions remained.
e. Creation of a follow-up mechanism to monitor the progress made by the member countries in gradually dismantling the existing exemptions.

In the same meeting the GS was instructed to prepare a report on how the Decisions would be transposed into each country's domestic law, and thus on their entry into force.

IV. 5 Phase of juridical analysis of transposition into domestic law

Following the meeting of Vice-Ministers of the Economy and Directors of Tax Administrations, the only pending issue was the juridical analysis of how the norms should enter into force. In that regard it is worth noting that, in line with Article 3 of the Agreement on the Creation of the Andean Community Court of Justice,[17] Commission Decisions can enter into force directly[18] or as a result of their express transposition into each country's domestic legislation. In the opinion of the GS, since both options are juridically valid, the decision as to which option should be taken was essentially political.

In the end, it was decided to transpose the norms into each member's domestic law if the countries had made constitutional provision for such an option. Hence the Decisions will enter into force on the first calendar day of the month following the date on which the final legal instrument is deposited with the GS.

Because of the scale of the changes involved in VAT harmonization, which are described in more detail below, the Community norm is designed to be applied gradually and entails lengthy periods (up to 10 years) for the countries to make the

[17] Decision 472
[18] From the date of its publication in the Official Gazette of the Andean Community or a later date if the Decision itself so stipulates.

necessary legislative adjustments in matters that have or could have a significant impact.

V. LESSONS LEARNED

In short, the following lessons can be derived from the long process of harmonization.

a. Close collaboration between a political organization (the CAN's General Secretariat), which had the power to convene relevant actors and institutional operating mechanisms, and a development organization (the IDB), which provided technical and financial resources, catalyzed the authorities' political will and the management capacity of the technical specialists in the member countries.

b. The result was a VAT and legislation on substantive and procedural matters that is of the highest international quality (the best to date if it were in force), since it includes international best practices.

c. The support of the countries' technical specialists led to the creation of a group of experts who (because of their analysis, discussions and proposals) are familiar with the countries' problems and with their (and international) best experiences.

d. Progress was made on coordination, in a spirit of integration and cooperation among the authorities, some of which used this mechanisms to further reforms that are complex in their own countries.

e. The countries now have a firm reference point, the result of negotiations and concessions among peers, in a framework of best practices, that offer benefits to a community of partners and also to each member country.

VI. SUBSTANTIVE TECHNICAL ASPECTS OF THE HARMONIZED VAT

VI.1 Objectives

The goals of harmonizing indirect taxes in the Andean countries were twofold:

i) To improve the structure of the VAT in each country by adopting international best practices in this field while preserving national autonomy to manage the rates.[19] To that end, priority was accorded to inter-sectoral neutrality and to simplicity that facilitated administration; administrative mechanisms to help counter evasion were devised.

The tax is regressive on income but is progressive on consumption, according to a series of studies in Latin America.[20] Hence, if most VAT resources come

[19] Within the maximum limit of 19% for the general rate, and if there is a preferential rate it shall not be less than 30 percent of the general rate.

[20] J. Roca, and H. Vallarino, "Incidencia Distributiva de la Política Fiscal en Ecuador", document prepared for the Salta Project, June 2003; E. Engel, A. Galetovic and C. Raddatz, "Taxes and Income Distribution in Chile: Some Unpleasant Redistributive Arithmetic", NBER Working Paper Series, December 1998; J. Sintiere, J. Gómez Sabiani and D. Rossignolo, "Impacto de los Impuestos sobre la Distribución del Ingreso en la Argentina en 1997", study prepared for the Secretariat of Economic

from tax on consumption among the higher-income sectors, targeting those resources (through public spending) on the most vulnerable sectors of society can lead to a progressive fiscal mix of VAT revenues and social expenditure.

Additionally, the member countries retain enough fiscal autonomy to establish the fiscal mix: collecting VAT by setting the tax rates, and the level and type of public spending they deem most proper in economic, social and political terms. By setting similar tax bases, moreover, the countries can compete for final consumption by virtue of the rates.[21]

ii) To facilitate intra-subregional trade and guarantee the conditions of competition. As is widely known, VAT allows countries to cease exporting taxes. Using the method of credit for invoicing on the basis of consumption, the tax on inputs can be reimbursed by the tax authorities in the case of exports of goods and services. Moreover, this fosters transparency in international competition because tax reimbursements to exporters are determined by the real tax base. In other words, in effect they pay the VAT on their inputs but the VAT cannot mask hidden subsidies.

The breadth of the tax bases, both the general rate and another that is no less than 30% of that (as stipulated in the corresponding Decision), fosters the competitiveness of domestic production on an equal footing with imports. In an integrated market with a zero tariff, intra-sectoral trade harms national producers if it is VAT-exempt. This is because the import enters the country without payment of the VAT reimbursed by the tax authorities in the country of origin, and thus the national producer cannot discount the VAT on purchased inputs (because the finished product is exempt). The damage is greater the less the degree of vertical integration in the good’s (or the service’s) production process. With practically all goods and services being taxed, national producers will be able to discount the VAT on their inputs and the imported good will pay VAT at the same rate, putting them on the same footing to compete.

VI.2 Technical features

The only precedent for the extent of the agreement on tax harmonization in the CAN is the EU experience. The VAT includes international best practices that lessen distortions and ensure the member countries’ competitiveness (economic efficiency), horizontal equity among taxpayers, and coordination among the various tax jurisdictions.

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and Regional Planning, February 2000; G. Jenkins and C. Kuo, “Is the ITBIS Regressive in the Dominican Republic?” document prepared for the government of the Dominican Republic, July 2004; José Roberto Afonso, Erika Amorim Araujo and Salvador Werneck Vianna, “Carga Tributária Indireta no Brasil: Análise da Incidência Efetiva sobre as Famílias”, Inter-American Development Bank, Economic and Social Studies Series, February 2004.

[21] *Ibid.*

To those ends the authorities have devised an economic strategy based on the following:

a) The billing credit system used in each stage of production averts the accumulation of taxes, which is a feature of sales taxes or income taxes that discriminate against specialized firms and favor those that are vertically integrated; and

b) Recovery of the VAT in investment and exports ensures that the burden falls solely on consumption[22] and is unaffected by the tax rates that might have been applied in the intermediate stages of the production chain.

On these bases, the main technical-taxation characteristics of the long-term convergence of national laws on VAT are:

i) Adoption of a common list for the exemption of goods and services, which in fact simply takes account of a minimum number of possible exemptions (goods imported by diplomats and donations; and sensitive services: education, healthcare and internal passenger transport;[23] these remain subject to domestic law);

ii) A sharp decline in exemptions, which favors sectoral neutrality;[24]

iii) Adoption of a zero-rate system solely for exports of goods and services so that competitiveness is unaffected;

iv) In cases of multiple rates, their reduction to a maximum of two so as to facilitate VAT administration;[25]

v) The adoption of specific regulations to protect taxpayers' rights without limiting the power of the tax authorities;

vi) The creation of mechanisms for the coordination of international operations on the basis of the principle of "non-discrimination" between national and foreign production; and

[22] Note that this ensures that the tax is consumption-based but its effect will depend on the market for the good and service in question and the inputs needed to produce it, since the taxes can be carried forward (consumption) or backwards (production factors).

[23] Based on the three fundamental reasons (Allan Tait, *The Value Added Tax: International Practice and Problems*. International Monetary Fund, 1988) for allowing services possible exemptions (see point c of Article 23 and Article 25): those related to education, since it is socially beneficial; ii) those related to health and national passenger transport, so as to reduce the degree of regressivity; and iii) financial intermediation services because of the administrative difficulties involved in taxing them.

[24] Taxing the activities of state institutions: a) when they are competing with the private sector or b) redistribution, the purchase of goods and services for distribution. According to the final paragraph of Article 25, the only exemptions are for: c) regulatory activities, d) beneficial services (education and healthcare) and e) collective services – which do not include the principle of exclusion and do not compete in consumption (for more detail see Satya Poddar, "Exemptions under the Sixth Directive: Issues and Options. Ernst and Young, mimeo, January 2002).

[25] Administrative simplicity was preferred over considerations related to the efficiency of differentiating rates (for a more extensive discussion, see Liam Ebill, Michael Keen, Jean-Paul Bodin and Victoria Summers. *The Modern VAT*. International Monetary Fund, 2001).

vii) The adoption of impartial procedures that foster the economic integration process.

VI.3 Main components of the harmonized Andean VAT

There follows a more detailed description of the technical features of the harmonized VAT:

VAT variant. The VAT adopted is predominantly a consumption tax, in which capital goods are taxed but the timely reimbursement of the tax credit (that is, the VAT paid on the acquisition of such goods) is guaranteed. In any case, the member countries can immediately reimburse the VAT paid.[26] The members whose procedures are not in line with this agreement must adapt to it within six months of the Decision's entry into force.[27] Adoption of a VAT that ensures timely reimbursement or application of a tax credit for capital goods will ensure the VAT's greater efficiency and obviate distortions in relative prices.

Principle of the VAT. The authorities have ratified the use of the principle of destination. In other words, imports are taxed but exports are not. Since the five member countries are currently using that principle, this technical element takes immediate effect.[28] In the future, for the purposes of completing the Andean Common Market, consideration will have to be given to the use of what is termed "suspended VAT", similar to that used by the EU since 1993.[29] It is advisable that the member countries' tax administrations devote resources to studying that system, although note should be taken of the desirability that the VAT be levied at the origin and that a system of clearing houses be instituted among jurisdictions. The severe disadvantage of this principle, which was originally conceived in the EU, is that the countries are unwilling to cede sovereignty in tax collection.

Method of calculation. The authorities have ratified the common practice of determining the tax to be paid in each period as the difference between the accrued taxes and the taxes collected, which confer the right to a tax credit. This practice will come into immediate effect. It will pose problems for none of the member countries because both the method of calculating the tax credit and the subtraction method, used in Bolivia, follow this rule in determining the tax to be paid.

Number of rates. The countries have agreed to use a maximum of two rates, one general and the other preferential; the latter cannot be less than 30% of the former. The preferential rate can be applied to goods and services that are exempt when the

[26] Peru and Venezuela offer immediate reimbursement for some investments.
[27] This technical element has been included in Article 28 of Decision 599.
[28] This technical element has been included in Articles 22 (goods) and 24 (services) of Decision 599. Immediate effect means as soon as the Decision enters into force.
[29] This is a system governing the temporary deferral of VAT in intra-community operations. The supply of goods among the member countries should not include VAT on sales in the source country, on condition that the buyer in the destination country is listed in the VAT register and the goods leave the national territory. Intra-community goods purchases (former imports among the members) are taxable in the country of consumption and must be acknowledged by the buyer on his or her tax return.

Decision enters into force.[30] Hence those member countries that now have multiple rates, such as Colombia, will have to reduce them to two. There is a 10-year deadline for implementing this requirement.

VAT rate. The countries have agreed to set a VAT ceiling of 19 per cent. If some countries exceed that rate they must make the necessary adjustments within the 10-year period.[31]

Exemptions. The countries have agreed on the gradual elimination of exemptions for goods and services[32] in a maximum of 10 years. At the end of that period, the only VAT-exempt goods will be donations of imports for the public sector to be used in education and healthcare; goods imported by diplomatic missions and international organizations; and education, healthcare, land passenger transport services and financial intermediation.[33]

Zero-rate regime. The members have agreed to apply the zero-rate regime only to exports of goods and services, and to offer a five-year adaptation period to countries (such as Colombia) that use it for other goods, as well as to those countries (almost all the members) that do not use it for services exports.[34]

Treatment of services exports. Common criteria have been adopted for operations such as services exports. As mentioned, these will be subject to the zero-rate regime.[35] The criteria will have immediate effect.

VAT on transport. In the area of international cargo transport there is agreement to apply rules for the transition to the zero-rate regime, although no deadlines have been set. The criteria for international passenger transport have been unified. The service can only be taxed in the country where the journey starts. Countries have 10 years to adapt to this regulation.[36]

Significant progress has also been made on the harmonization of the VAT's administrative aspects:

VAT declaration. It has been agreed that the fiscal period for the declaration shall not exceed two months. This agreement will take effect immediately.

[30] See the second paragraph of Article 19 of Decision 599.
[31] See the first paragraph of Article 19 of Decision 599.
[32] Goods exemptions will use the Andean tariff nomenclature by 2006 at the latest.
[33] See Article 23 for the exemptions on goods and Article 25 for those on services. It should be noted in the case of financial services that the possible exemption of financial intermediation services leads to tax accumulation when the exemption is conferred on a taxed organization, cascade effect, and to a lower tax than that due when used by final consumers. The problem of determining the base by means of implicit prices (differential margins) triggered by the double flow of services provided in financial intermediation (services to lenders and borrowers) can be mitigated using more complex administrative methods but cannot be resolved (see Howell Zee, "A New Approach to Taxing Financial Intermediation Services under a Value-Added Tax", IMF Working Paper WP/04/119, July 2004
[34] See Article 20 of Decision 599.
[35] See Article 13 of Decision 599.
[36] See points 1 and 2 of Article 14 of Decision 599.

Invoicing requirements. The countries have agreed, with immediate effect, to harmonize the minimum requirements that must be included in invoices.[37]

Withholdings. The VAT levied on purchases by public organizations can be withheld, as can that on taxpayers classified as “large” or “special”, or that the tax authorities characterize as withholding agents.

Finally, it has been agreed that the member countries will institute follow-up mechanisms, no later than 90 days after the Decision’s entry into force, with a view to the biennial review of progress made on the gradual dismantling of exemptions.

[37] See Article 37 of Decision 599.

ANNEX

DECISIONS 599 AND 600[38]

[38] Official translation as published in the English version of the CAN GC website: http://www.comunidadandina.org/endex.htm

Decision 599

Harmonization of Substantial and Procedural Aspects of Value Added Type of Taxes

THE ANDEAN COMMUNITY COMMISSION IN EXTENDED MEETING
WITH MINISTERS OF ECONOMY, FINANCE AND TREASURY,

HAVING REVIEWED: Article 3, items a), b), e); Article 54, Item e); and Article 58 of the Cartagena Agreement. Articles 3 and 4 of the Treaty for the Creation of the Court of Justice of the Andean Community. Decision 388 and Article 13 of Decision 330; and, in the exercise of the attributes prescribed in Items a), b) and f) of Article 22 of the Cartagena Agreement;

WHEREAS: The 2nd Meeting of the Advisory Council of Ministers of the Treasury and Finance, Central Banks and Individuals Responsible for Economic Planning of the Member Countries, held in October 1998, requested the Andean Community's General Secretariat to begin studies related to the issue of indirect taxes within the framework of the Andean Integration process, particularly with respect to value added type of taxes;

In the 11th Andean Presidential Summit, held in May 1999, the Presidents of the Member Countries set a goal for the establishment of a Common Market by 2005;

The Advisory Council of Ministers of the Treasury and Finance, Central Banks and Individuals Responsible for Economic Planning, in its 4th Meeting, held in June 2000, ratified its mandate to deal with the indirect taxes issue, within the framework of Andean Integration;

The harmonization of tax policies will not only guarantee competition conditions between the Member Countries, preventing the introduction of obstacles to intra-community trade currents, but also offer greater legal security and stability to domestic tax systems;

Value added type taxes exist in all Andean countries and they can be considered as being consolidated in their tax systems;

Technically, it is advisable to promote the neutrality of the value added type of tax, so as to not cause distortions in the economy;

The harmonization of value added type of taxes must be understood as a gradual process, which must be administered by each Member Country within the terms defined in this Decision;

Not included in the scope of application of this Decision are tax free zones and regimes, or any geographical or regional benefits or regimes included in each country's internal legislation, which will be governed by domestic laws and other special regulations;

Any differences in the fiscal treatment procedures for indirect taxes in the Andean countries, may produce distortions in the intra-community market;

A current regulation on procedural matters, substantiated by an analysis based on studies and proposals of the different Andean countries, could be very convenient for tax collections in each of the Member Countries;

DECIDES:

Chapter I
Scope of application and definitions

Article 1.- Scope of application.
This Decision regulates the substantial aspects and the procedures applicable to the value added type of taxes to be harmonized in the Member Countries' tax systems, in order to facilitate compliance with the objectives and commitments of the Andean Community. Any matters not regulated in this Decision will be governed by the internal laws of each country.

Article 2.- Definitions: For the purposes of this Decision, and of the rest of the community provisions regulating matters associated with the harmonization of indirect taxes of the Member Countries, the following terms will have the following meanings:

Cause: This is the moment when the tax obligation is produced by the generating act described in the legislation. The occurrence of the generating act for the value added type of taxes subject matter of this Decision, is instantaneous, even if its determination, settlement and payment take place during periods.

Right to deductions or tax credits: The right of a debtor to deduct from any taxes generated by the taxable transactions carried out, any taxes repercuting or transferred due to the purchase or import of goods or the use of services.

Right to repercussion or transfer: The right of a debtor to transfer the tax to the buyer or user of the subject matter good or service.

Demandable tax debt: This is the total amount determined by the debtor or by the Tax Authority, which the debtor must pay after the expiry of the term granted for compliance with the tax obligation and which is not under dispute.

Domiciled or Resident: This will be defined according to the definitions prescribed in each internal legislation.

Exclusion: Not being subject to, or being exempted from the tax established or permitted by law, with respect to a given good or service, according to which, the rebate or deduction of repercuted taxes is not permitted.

Export of Goods: The actual and permanent transfer of goods sent abroad from the customs territory.

Zero Rate system: Tax exemption established by law with respect to a given good or service, according to which, the rebate or deduction of repercuted taxes is permitted.

Services: Any activity, task or job carried out by an individual or legal entity, or by a de facto association, without an employment relationship with whomever contracts the execution, which turns into an obligation to perform, without consideration to the fact that it encompasses the predominance of the material or intellectual factor and which generates a consideration, either in money or in kind, regardless of its name or form of remuneration, including leasing of movable and immovable property and any other assignment for use, for a fee, of trademarks, patents, copyrights and similar, among others.

Debtor: This is the debtor of the substantial tax obligation. It includes the terms “taxpayer” and “person responsible or substitute”, with the latter term including earnings and withholding agents.

Article 3.- Andean harmonization system concerning indirect taxation on consumption.
The harmonization system of indirect taxes on consumption for the Member Countries consists of the following taxes:
1. Value added type of taxes, and
2. Excise type of taxes.

Article 4.- Terms.
For the purposes of this Decision, terms will be counted as follows:
a) Year terms and month terms will be continuous - or calendar – ending on the equivalent day of the respective year or month. Any term ending on a day which the month does not have, will be understood to end on the last day of such month.
b) Terms expressed as number of days will be counted as business days, unless specified that they are continuous or calendar days.

c) In all cases, any terms ending on a non-business day will be extended until the immediately following business day.

TITLE I
THE SUBSTANTIAL ASPECTS OF VALUE ADDED TYPE OF TAXES

Chapter II
Generating Act

Section I
Material Aspect of the Generating Act

Article 5.- Taxable goods and services.
Value added type of taxes are generated when there is a sale or transfer of goods, a provision or use of services within the country, in accordance with Article 12 of this Decision, and import of physical movable property.
Temporary Provision.- Member Countries applying as of the effective date of this Decision, a different rule for taxing services, may continue to do so up to ten (10) years after the effective date of this Decision.

Article 6.- Business Reorganization.
Value added type of taxes will not be produced as a result of the merger, take over, split or transformation of companies and other forms of corporate reorganization.

Article 7.- Sale or transfer de businesses, successions, assignment or transfer of securities and contributions of property to economic entities.
Value added type of taxes will not be produced:
a) In the sale or full transfer of businesses;
b) In the transfer of property by succession;
c) Assignment or any other type of transfer of shares actions, units, or securities;
d) Contribution of property to companies being incorporated by persons not subject to such tax; and,
e) Temporary contribution of assets to consortiums, joint ventures and other business associations or similar economic entities and their return to the contributing entities.
Temporary Provision.- Not withstanding the provision of the previous paragraph, any Member Countries which on the effective date of this Decision tax some of the transactions stipulated in this Article, may continue to do so.

Article 8.- Responsibility for VAT in the provision of services by non-resident or non-domiciled parties.
In the case of taxable services provided by persons who are non-resident or non-domiciled in the country where the service is used, the user or beneficiary of the service will be considered a debtor.

Article 9.- Removal of property.
With regard to the removal of property by a VAT debtor, for any purposes different than the taxed activity, the tax will be applied over a taxable base consisting of the commercial value of the property. The removal of property which is useless or which is not subject to be sold, due to any justified reasons, according to the internal legislation of each country, will not be taxed.

Article 10.- Construction services and sale of immovable property.
The legal systems of each Member Country must implement adequate mechanisms for the determination of the taxable base corresponding to the provision or use of construction services.
Value added type of tax may only be applied to the first sale of the immovable property.
Temporary Provision.- Notwithstanding the provisions of the previous paragraph, any Member Countries which as of the effective date of this Decision taxed the second and subsequent sales of immovable property, may continue to do so.

Section II
Personal Aspect of the Generating Act

Article 11.- Economic Combinations.

For the purposes of this Decision, the economic combinations listed below, among others, will be liable to tax in the event of carrying out transactions subject to the tax:
1. Joint ownerships.
2. Consortiums or temporary partnerships.
3. Association agreements, joint ventures and other business cooperation agreements.
4. De facto associations.
5. Illiquid or non-divisible successions.
6. Separate assets existing by virtue of trust deeds.
7. Funds of any nature.

Section III
Territorial Aspect of the Generating Act

Article 12.- Rules for the definition of the territory of the services.
For the purposes of the value added type of taxes regulated by this Decision, for services which provision or execution crosses national boundaries and which are listed below, the following rules must be taken into account:

1. The following services will be deemed to have been provided or used in the place where they are physically carried out:

a) Loading and unloading, transfer, stevedoring and storage of goods;
b) Artistic, sport and culture related services.

2. Services provided from abroad, which are used or enjoyed by residents or persons domiciled in a Member Country, will be considered to have been provided in this country's jurisdiction; such as those mentioned below:

a) Licenses and permits for use and exploitation, in any manner, of physical and intangible assets;
b) Professional services such as consultancy, advisory and auditing;
c) Leasing of physical movable property used in the territory of the Member Country;
d) Services related to translation, text correction or composition;
e) Insurance services related to assets located in the territory of the Member Country;
f) Services carried out on physical movable property, which remain or operate in the territory of the Member Country;
g) Services associated with satellite connection or access, regardless of the location of the satellite;
h) Satellite or cable television services enjoyed in the Member Country;
i) Telecommunication services.

3. Services carried out over immovable property will be deemed to have been provided in the place where they are located.

Article 13.- Exports of Services.
In addition to the requirements set forth in the internal legislation of each Member Country, for an operation to be considered as an export of services, the following conditions must be met:

a) The exporter must be domiciled or be a resident in the exporting country;
b) The user or beneficiary of the service is not domiciled or is a resident in the exporting country;
c) The use, taking advantage or exploitation of the services by the user or beneficiary fully occurs abroad, even if the provision of the service takes place in the exporting country;
d) The payment made as a consideration for such service is not charged as a cost or expense in the exporting country by the companies or individuals carrying out activities or business therein.
For the purposes of the value added type of taxes regulated in this Decision, services exports will be subject to the Zero Rate system.

Temporary Provision.- Notwithstanding the provisions of the previous paragraph, any Member Countries which as of the effective date of this Decision, impose taxes on exports services or subject them to a regime other than the Zero Rate system, may continue to do so up to six (6) years after the effective date of this Decision.

Article 14.- Transport Services.
The following rules will apply to transport services:

1. International freight transport services, including the transport of parcels, packages, documents or correspondence, will be subject to the zero rate system.
2. In the case of international passenger transport services, the tax will only occur in the country of original embarkation and in its favor, according to the rate and other rules in effect therein at the time of embarkation.
3. Domestic freight transport and air passenger transport will be taxable with the value added type of tax.
4. Other types of domestic passenger transport services will be subject to the internal regulations of each Member Country.

Temporary Provision.- In international freight transport services, including the transport of parcels, packages, documents or correspondence, any Member Countries which as of the effective date of this Decision have different rules, may continue to apply them. Any reform conducted with respect to the treatment of this service will be done to apply the zero rate system.

Nevertheless, any Member Countries which as of the effective date of this Decision exclude international freight transport services from the ambit of the tax, may tax such services with a regime other than the zero rate system. Subsequent reforms will institute the zero rate system.

Any Member Countries which as of the effective date of this Decision, have different rules for the cases prescribed in Points 2 and 3, may continue to apply them up to ten (10) years following the effective date of this Decision.

Section IV
Temporary Aspect of the Generating Act

Article 15.- Cause of the tax.
Value added type of taxes will be instantaneously produced, and at the following times:

1. In the sale or transfer of goods and provision of services, except in the case of the public utilities, with the full delivery of the good or completion of the service. Nonetheless, Member Countries may have the tax to be produced at the time of the issuing of the respective receipt for the total amount or at the time of the full payment total for the good or service, whichever occurs first. In cases of partial delivery, partial payment or issuing of receipts for partial amounts, the legislation of each country will regulate the time of occurrence of the tax obligation.
2. In successive chain of title agreements, as each canon or installment is demandable and in proportion thereto. Yet, the Member Countries may prescribe for the tax to be caused at the time of the issuing of the respective receipt or at the time of payment for the good or service, whichever occurs first.
3. In the case of the public utilities, in accordance with the provisions of the internal legislation of each Member Country.
4. In imports, when the goods are cleared into the country.
5. In the use in the Member Country of services provided by persons who are non-domiciled or non-resident, at the time of the provision of the service, on the date of registration of the respective receipt by the beneficiary of the service or on the date when the consideration is paid, whichever occurs first.

Article 16.- Amendments to the current system.
Regulatory amendments implying changes to the amount of tax to be paid, may only be applied as from the fiscal period following the date when the corresponding fiscal regulations were passed.

Temporary Provision.- Any Member Countries which as of the effective date of this Decision have regulations considering different methods for implementation, than those prescribed in this Article, may continue to apply them.

Chapter III
Taxable Base

Article 17.- Taxable Base.
The taxable base in value added type of taxes includes the main expense as well as any accessory or complementary expenses, even if the latter are separately billed or agreed to and, although independently considered, they are not subject to the tax. Accordingly, among others, the taxable base will consist of the expenses related to hauling, transport, installation, assembly, insurance, financing expenses and arrears charges, as well as fees, whether agreed, arranged or generated as accessory or complementary elements of the main operation.

Amendments to the value of the operation and any deductions which may be agreed upon thereafter, as per normal commercial practices, will cause the corresponding adjustment to the taxable base, on the date when they take place.

The taxable base for imports will consist of the customs value of the goods, plus the customs duties and taxes to be paid, and any other expenses incurred by the importer to clear customs and which is shown on the import declaration or equivalent document.

In any cases not stipulated in this Article for the determination of the taxable base, the Member Countries will apply their internal legislation.

Temporary Provision.- Any Member Countries not applying the adjustments to the taxable base for deductions made after the business transaction from which they originate, will not be obliged to abide by the provisions of the second paragraph of this Article.

Article 18.- Taxable base in barter cases.
Value added type of taxes will be produced for each one of the parties to a barter. The taxable base will correspond to the value assigned to each of the bartered goods, value which, in any case, may not be lower than the commercial value. The same rule will apply in the case of services.

Chapter IV
Rates

Article 19.- Rates.
Value added type of taxes will have a general rate, which may not exceed 19%, including all surcharges or extras, other than excise taxes.

Member Countries may fix a single preferential rate, which may not be less than 30% of the general rate, to tax any goods and services which as of the effective date of this Decision are excluded.

Temporary Provision.- Member Countries will have a term of ten (10) years, counted as from the effective date of this Decision, to adapt their legislation to the provisions of this Article.

Chapter V
Exclusions and Zero Rate System

Article 20.- Zero Rate System for the Tax.
The Zero Rate system will only be applied for the export of goods and services.

Temporary Provision.- Member Countries must adapt their legislation to this effect within five (5) years counted as from the effective date of this Decision.

Article 21.- Nomenclature for the exclusion of goods.
The exclusion of goods will be based on the Andean Tariff Nomenclature, to at least eight (8) digits, which could be coded, if necessary.

Temporary Provision.- Member Countries must adapt their internal legislation to this methodology within two (2) years, counted as from the effective date of this Decision.

Article 22.- Principle for taxing goods
In all Andean countries, the principle of "taxing in the destination country" will prevail. Therefore:

a) All imports of goods are subject to the tax, unless they are excluded goods.
b) Exported goods will be subject to the zero rate system.

Article 23.- Exclusion of goods.
As from the effective date of this Decision, Member Countries may not create new exclusions of goods, or expand the existing list in their internal legislation.

As from the beginning of the eleventh (11th) year since the effective date of this Decision, they may only maintain the following exclusions:

a) Goods imported by diplomatic or consular missions, or by their duly accredited diplomatic personnel, subject to international agreements and to reciprocity rules.
b) Goods imported by international organizations and their personnel with the rank of duly accredited international officials, who have signed immunity and privilege agreements.
c) Imports of donated goods deriving from abroad and destined for the public sector and non-profit private organizations, aiming at health, education and common utilities; duly verified and authorized by the competent authority in each country.
d) Luggage, whether accompanied or otherwise, as typified in the national legislation.

Therefore, Member Countries must gradually get rid of all exclusions of goods, which are not included in the previous items.

Article 24.- Principle for taxing Services.
In all Andean countries, the principle of "taxing in the destination country" will prevail, save for the provisions of Article 13. Therefore:

a) Tax will be applicable to the services referred to in Point 2 of Article 12 of this Decision.
b) The Zero Rate system will be applied to the exported services referred to in Article 13 of this Decision.

Article 25.- Exclusion of services.
As from the effective date of this Decision, Member Countries, may not create new exclusions of services, or expand the existing list in their internal legislation, save in the cases noted in the following paragraph.

As from the beginning of the eleventh (11th) year since the effective date of this Decision, they may only maintain the following exclusions:

a) Services relating to education, health and national passenger transport, except for air services, according to the stipulations contained in the legislation of each Member Country; and,
b) Financial brokerage services.

Therefore, Member Countries must gradually eliminate any service exclusions not included in the above items.
Member Countries must establish in their legislation the tax treatment granted to administrative services provided with respect to licenses, records, registration and other similar services by government institutions in compliance with their purpose and duty, through which they earn rates, fees, levies or other similar forms of consideration. The said treatment may consider such services as being excluded or as transactions not generating value added type of tax**.**

Chapter VI
Determination of the Tax

Article 26.- Determination of Tax Payable.
The tax payable en each period of reference:

a) In the case of sale or transfer of goods, provision or use of services, it will consist of the difference between the taxes caused in the period and the repercuted taxes granting the right to tax deductions or tax credits.
b) In imports, it will be determined by applying in each transaction the tax rate on the corresponding taxable base.

Article 27.- Right to Tax Credit.
Right to tax credits are only earned from the purchase of goods and services meeting the formal requirements determined by each national legislation and the following substantial requirements:

a) They must be necessary for the undertaking of the debtor's business, according to the limitations or restrictions established by each national legislation.
b) They must be used in transactions on which value added type of tax must be paid, or in transactions subject to the zero rate system.

Article 28.- Tax credit from fixed assets or capital goods.
In the case of purchase or acquisition of fixed assets or capital goods, repercuted taxes grant the right to a tax credit for the debtor, in the same conditions as those referred to in the previous article, applying any of the following options, as they may be prescribed in the legislation of the Member Countries:

a) The deduction in the period in which the acquisition of the asset is verified, or in general, in which tax credits from repercuted taxes can be offset.
b) The rebate of the repercuted taxes, which could be carried out even if it did not produce any operations, or if they still are in the process of installation, assembly or commissioning.
c) The tax credit using the "prorrata temporis" system, according to which, the repercuted tax will be amortized throughout the useful life of the asset, based on its use by the debtor. If this deduction method is used, the balance to be amortized will be adjusted every month, according to inflation.

In cases a) and b), if the debtor disposed of the subject matter asset for a price which is lower than the purchase price, Member Countries may demand reimbursement of the portion of tax credit generated, as may be set forth in their legislation.

Temporary Provision.- Any Member Countries which as of the effective date of this Decision do not grant rights to tax credits for the purchase or acquisition of fixed assets or capital goods, may continue with this practice up to six (6) years after the effective date of this Decision.

Article 29.- Proportion of deductible taxes.
A tax credit originating from the acquisition of goods or use of services fully destined to transactions taxable at the general rate and to transactions subject to the zero rate system, may be deducted 100%.
Any Member Countries applying preferential rates may regulate the recovery of the tax credit in accordance with their internal legislation.

When used indistinctly in transactions taxed with the general rate and transactions subject to the zero rate system, or when excluded from the tax, and it is not possible to tax them directly to one another, the deduction will be performed on the basis of the tax credit component proportionally corresponding to the transactions taxed at the general rate and to the transactions subject to the zero rate system or which are excluded according to the legislation of each Member Country.

Chapter VII
Exceptions

Article 30.- Exceptions.
Notwithstanding the provisions of Articles 19, 23, 25 and 27 of this Decision, a Member Country may adopt the corrective measures required to deal with the existence or threat of a serious fiscal crisis at the Central Government level, or to handle national emergency situations, subject to prior authorization by the Andean Community's General Secretariat.

Whenever the situation stipulated in the above paragraph demands immediate action, the Member Country may apply the corrective measures which it may deem necessary, reporting them within a maximum of five (5) days, counted as from the date when the measures were adopted, to the Andean Community's General Secretariat, which in turn will issue an opinion within the following thirty (30) days, announcing authorization, amendment, or suspension.

Corrective measures applied in accordance with the above paragraphs:

1. Will be of a temporary nature and will be gradually removed as the situation which causes them improves;
2. Must not discriminate between Member Countries of the Andean Community;
3. Will not be adopted or maintained to protect any given sector.

TITLE II
PROCEDURAL ASPECTS OF VALUE ADDED TYPE OF TAXES

Chapter VIII
Filing of Tax Return

Article 31.- Filing of Tax Return.
Value added type of taxes will be settled by the debtor on the return forms made available to such effect by the Tax Authority of each Member Country.

The tax's fiscal period may not exceed two (2) months. Filing and payment will be made as stipulated in the respective legislation without exceeding the calendar month following the fiscal period.

Notwithstanding the provisions of the above paragraphs, each Member Country may fix different terms for the filing and payment of excluded or special transactions.

In the case of transactions involving import of goods, value added type taxes will be filed and paid for in accordance with the stipulations of the internal regulations of each Member Country.

Chapter IX
Drawback and Offsetting of Credit Balances

Article 32.- Right to Drawback from Exports.
Without prejudice to the regime applicable to fixed assets and capital goods, those liable for the tax which, due to the application of the zero rate system, result in credit balances deriving from exports in their tax returns, will have the right to recover such balance, in accordance with the internal legislations of each Member Country.

Each Member Country's legislation may establish the proportion with respect to the value of the exports subject matter of drawback.

The right to drawback of the value added type of taxes will be deemed to have been granted in cases where due to the method of contracting them with government, an alternative offsetting method has been agreed upon in agreements calling for the exploitation of non-renewable natural resources, paid in the acquisition of goods and services by the contracting company, whenever the Member Country so requires.

Temporary Provision.- Any Member Countries which as of the effective date of this Decision do not rebate the tax imposed on transactions relating to services used for exporting goods, may maintain this rule up to six (6) years after the effective date of this Decision.

Article 33.- Interest charged by the tax authority.
Whenever in the internal legislation there is no term set forth for drawback of the value added type of tax to exporters, after two (2) months have elapsed since the date of determination of the amount to be rebated by the Tax Authority, the debtor will earn interest at a rate prescribed in the internal legislation.

Temporary Provision.- Notwithstanding the provisions of the previous paragraph, any Member Countries which as of the effective date of this Decision do not recognize arrears interest for late return of credit balances may continue with this practice up to five (5) years after the effective date of this Decision.

Article 34.- Rejection of Drawback Applications.
The regimes of each Member Country must precisely establish the grounds for the rejection of applications due to formal causes. When an application must be rejected, the Tax Authority will cite the reasons behind such rejection, in a precise manner, indicating the form, conditions and terms available.

Article 35.- Refusal or Rejection of Drawback.
The tax authorities of the Member Countries will refuse a drawback when the right to the said drawback has not been verified, especially if the respective export transaction was not carried out. Drawbacks will also be refused, among other reasons, due to the following:

a) Late application, in accordance with the internal legislation of each Member Country.
b) The amounts requested have already been subject to previous rebate or offsetting, without prejudice to any corresponding legal sanctions.

Article 36.- Offsetting of Credit Balances.
Debtor credit balances relating to value added type of taxes with the right to drawback, may be offset by the Tax Authority against demandable tax debts administered by the same institution and corresponding to the same tax creditor.

Chapter X
Billing
Article 37.- Invoice Minimum Requirements.

For a deduction of a tax credit corresponding to transactions associated with the purchase of goods or use of services in the domestic market to be viable, it must be detailed in invoices meeting the requirements prescribed by each Member Country, which must contain at least the following information:

1. Full name or trade name and taxpayer's registration number or tax identification of the debtor carrying out the transaction subject matter of the tax.
2. Full name or trade name and taxpayer's registration number or tax identification of the party acquiring the good or service.
3. Breakdown of the tax generated.
4. Consecutive invoice number.
5. Date of issue.
6. Description of the goods or services acquired.
7. Total value of the transaction.

Member Countries must implement control systems for the printing, issuing and use of invoices, as may be deemed appropriate.

The Member Countries may establish exceptions to the obligation of billing and the above prescribed requirements, as well as authorize the issuing of equivalent documents, or create alternative control mechanisms.

Notwithstanding the above item Three, Member Countries may ignore this requirement if they have a system which will make it possible to know the value of the tax generated in each invoice.

Chapter XI
Withholding at Source

Article 38.- Withholding at Source.
The Member Countries may establish systems for withholding value added type of taxes to include, among others, the following cases:

1. Sale of goods or provision of services to the national government and other public sector entities; to taxpayers classified as “major” or “special; or, those indicated by the Tax Authority as withholding agents.
2. Payments or credits on account by entities managing debit or credit cards with respect to member establishments, concerning the transactions they carry out.

Chapter XII
Simplified Regimes

Article 39.- Small Economic Agent Regimes.
Notwithstanding the provisions of the preceding articles, Member Countries may introduce special regimes which will include value added type of taxes for small economic agents, simplifying their tax obligations, within the limits and conditions established by the Member Countries.

Chapter XIII
Term

Article 40.- Term.
In accordance with the provisions of Article 3 of the Treaty for the Creation of the Andean Community's Andean Court of Justice, this Decision will be incorporated to the internal laws of each Member Country whenever so prescribed by their constitutional legislation, coming into force on the first calendar day of the month immediately following the date of the last delivery of the corresponding instrument to the Andean Community's General Secretariat.

Temporary Provision.- Follow up Mechanism.
Member Countries will establish a follow up mechanism, within a term of ninety (90) days counted as from the effective date of this Decision, to verify every two (2) years, any gradual progress made in terms of compliance with the provisions of Articles 23 and 25.

Given in the city of Quito, Republic of Ecuador, on July 12, 2004.

Decision 600
Harmonization of Excise Type Taxes

IN EXTENDED MEETING OF THE ANDEAN COMMUNITY COMMISSION WITH THE MINISTERS OF THE ECONOMY, TREASURY AND FINANCE,

HAVING REVIEWED: Article 3, items a), b), e); Article 54, item e); and Article 58 of the Cartagena Agreement, Articles 3 and 4 of the Treaty for the Creation of the Andean Community Court of Justice, Decision 388, and Article 13 of Decision 330; and making use of the attributions specified in items a), b) and f) of Article 22 of the Cartagena Agreement; and

WHEREAS: All the Member Countries have excise type taxes that intend to influence consumption decisions to regulate them according to the society ideals and standing, and only in the second place for the generation of State revenues;

In other cases, different higher rates are imposed on the consumption of luxury or semi-luxury goods instead of other additional taxes to the VAT;

The community objectives of an interior market and neutrality in the circulation and consumption of goods and services advise on the use of an indirect tax system on consumption that follows the same basic guidelines and, as far as possible, without structural differences in the regulations of the Member Countries in order to give economic agents clarity and concurrent free and comparable conditions;

The different characteristics that the excise type taxes have in the legal systems of the Member Countries could be substituted with a more harmonic general system. Nevertheless, it is acknowledged that the Member Countries can impose excise type taxes on goods and services that are not the subject matter of this Decision, and therefore, not regulated by it;

In general, the Member Countries have similar national regulations for excise type taxes, and although the differences could cause distortions in the market they are by no means extreme ones;

Excise type taxes can be substituted for the added value type taxes applied with several different rates in some Member Countries;

Consequently, the conditions can be established in the Member Countries for an indirect tax system that is comparable and clear in its concept and scope;

The excise type taxes can include "ad valorem taxes" on the final price, or "specific taxes" that apply to physical units of the product, fixed money amounts periodically indexed to the inflation rate;

Tax immunity areas and systems are not within the scope of the application of this Decision, nor the benefits or systems of geographical or regional character contemplated in the national legislation of each country, which will be governed by the national systems and other special provisions;

DECIDES:

Chapter I
Scope of the application of the Decision

Article 1.- Scope of the application.
The purpose of this Decision is to harmonize the substantial aspects and procedures of "excise type taxes" (ISC) in the tax systems of the Member Countries and enforce the subregional integration policy.

Therefore, the Member Countries shall adopt their tax systems to this Decision in the terms contemplated therein, irrespective of the scope of the territorial application of such taxes.

The creation or modification of this type of taxes by the Member Countries should be adapted to this Decision and notified to the General Secretariat of the Andean Community.

Article 2.- Nature of the Tax.
"Excise type taxes" (ISC) are imposed on imports and on the domestic market consumption of specific goods and services, whether individually or with an additional or complementary character to the added value type taxes, and are single-phase taxes.

Chapter II
General provisions

Article 3.- General provision.
All compatible general provisions regulating the added value type taxes (VAT) are applicable to the "excise type taxes" (ISC), and specially the following:

a) The timeliness of their occurrence, without detriment to the single-phase system referred to in this Decision.
b) The territoriality principles.
c) The general aspects that regulate the taxable items in relation to the sale of goods and services on which such tax is imposed, and
d) The definitions of debtor in relation to the operations on which the tax is imposed.

Chapter III
Generating Act

Article 4.- Generation of the tax.
The excise taxes (ISC) are generated as a result of imports or the first sale or transfer made by the producer. The excise tax (ISC) on services is generated as a result of a performed service.

The following will be regulated by the national legislation of each Member Country:
a) The generation of excise type taxes in the cases in which it is presumed that a sale or transfer of goods has been made.
b) The generation of excise type taxes, when an economic connection exists between the buyer and the seller even though involving further commercialization steps.
c) The application of excise type taxes to other goods and services not contemplated in this Decision and on which the tax is imposed.
d) The cases in which certain goods and services are excluded, or tax credit or rebate rights are established.

Article 5.- Withdrawal of goods.
The withdrawal of goods by excise (ISC) taxpayers for any purpose other than the taxable activity shall give rise to the tax based on the commercial value of the goods. The tax shall not be imposed on the withdrawal of goods not used or not susceptible of commercialization for whatsoever justified reason according to the national legislation of each country.

Chapter IV
Taxpayers

Article 6.- Excise taxpayers
Without detriment to the rules established in the legislation of each Member Country relative to solidarity, economic relation, distortions of the market or special production and commercialization conditions, the following are excise taxpayers:

a) The producers of taxable goods.
b) The importers of taxable goods.
c) Supplier of taxable services.
d) The users or beneficiaries of the service, in the case of services rendered by non residents or entities not located in the country.

Chapter V
Tax Base

Article 7.- Tax base or magnitude
The excise tax base shall be defined in the national legislation of the Member Countries, ensuring that no discriminatory treatment may exist between domestic and imported products. Added value or excise type taxes should not be included in ad valorem tariffs.

Chapter VI
Tax burden

Article 8.- Tax burden.
The total tax burden should be harmonized considering added value and excise type taxes imposed at a national or regional level, to fix minimum rates in the Andean Community, three (3) years after this Decision enters into effect.

The first phase of the harmonization shall focus on tobacco, beer and alcohol products.

Chapter VII
Determination of the tax

Article 9.- Determination of the tax.
Excise taxes (ISC) shall be determined by applying directly the rate or fixed amount indicated for the taxable good or service in question to the tax base or magnitude or reference physical unit, as provided for in the national legislation of each Member Country.

Chapter VIII
Tax return

Article 10.- Tax return.
The taxpayers shall settle the excise taxes (ISC) to which they are subject in the tax return forms provided for that purpose by the Tax Authority of each Member Country.

The tax return and payment shall be made as established in the respective legislation, but no later than the following month after the end of the tax period.

In operations involving the import of goods, the excise tax (ISC) return and payment shall be made according to the national regulations of each Member Country.

The national legislation of each Member Country may establish special systems for account payments of the excise taxes.

Article 11.- Invoicing.
In each operation carried out involving goods and services on which excise taxes are imposed, the taxpayers should use a single invoice that discriminates the VAT and the excise tax (ISC). Such invoices shall fulfill the requirements set forth in Article 37 of Decision 599: Harmonization of Substantial Aspects and Procedures of the Added Value Type Taxes.

Chapter IX
Term

Article 12.- Term.
As established in Article 3 of the Treaty for the Creation of the Andean Community Court of Justice, this Decision shall be incorporated to the national legislation of each Member Country if so provided in its constitutional system, and will enter into effect the first calendar day of the immediately following month after the date of the last delivery of the respective instrument in the General Secretariat of the Andean Community.

Given in the city of Quito, Republic of Ecuador, on July 12, 2004.