THE 1841 FOUNDATION

Bases and starting points for a necessary and immediate tax reform

Introduction:

The fact that the so-called "*Ley Bases*" was rejected by the Lower Chamber of the national parliament, even though it included a long-needed reduction of the size of the government, is a new demonstration that the real discussion Argentina needs to have is about its tax regime in general and, more in particular, about the Co-participation Law, which has been, and continues to be, extremely harmful for the growth of the country.

As it is with other stable, prosperous, federal jurisdictions, Argentina will only achieve economic success if there is tax competition between provinces and municipalities.

It is not feasible to have a federal State with strong bureaucracy in each province that sees the Central Government then share with the provinces almost 60% of the taxes collected.

A complete lack of alignment in the nation's objectives with those of the provinces discourage the reduction of public spending in the provinces, making them dependent on the central government to a degree that they almost become parasites.

As an alternative to this and perhaps even more practical, at least initially, Swiss-style decentralization is a very good model to follow.

In this scenario, the tax reform should specify that states/provinces have certain revenue sources that they can raise and spend (constrained, of course, by tax competition). The central government should have a different source of revenue. It is important to note that, whilst Switzerland has some crosssubsidies from rich cantons to less-rich cantons, the Central Government plays a rather modest role and there are of course important restrictions on such redistribution.

Discarding the possibility of a serious discussion in this regard, that progressive model is what the country really needs.

The best alternative possible here is to modify the national tax matrix totally, by eliminating taxes on net worth and transactions while focusing on income and consumer taxes and creating an automatic system for a continued lowering of tax rates, to the extent that the amounts of taxes collected remain unchanged.

The main objective with this reform is to allow individuals greater control over their net worth and greater freedom, while at the same time, strengthening the private sector. It is critical to note that a strong and vibrant private sector is the only driver to economic strength and prosperity.

In the end, is it not true that a country's tax system reveals the respect that its government has for private property, and also for the rights of individuals.

National taxes

Of the 45 taxes currently applicable in Argentina, only 4 of them should continue to exist, and in some cases, subject to substantial improvements in their application. If the current Government feels the need to keep several more taxes, which we in principle do not recommend.

We do, however, note that there are other taxes that can continue, and we will discuss them later in this document.

The list in full:

1. Tax on income of resident individuals and undivided estates (includes "tax on financial profits").
2. Tax on profits of partnerships, including permanent establishments, companies, and exploitations by individual enterprises (includes "additional tax on distribution of profits").
3. Emergency lien on prizes from certain games involving sports contests and draws.
4. Specific tax on betting activities.
5. Indirect tax on online betting.
6. Tax system for dependent employees: contributions.

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8. Independent workers system
9. System for personnel of private homes
10. Simplified system for small scale taxpayers (self-employment tax)
11. Special contribution on the capital of cooperative organizations
12. Extraordinary contribution on the capital of cooperative organizations and financial and/or credit union savings institutions, or insurance and/or reinsurance entities
13. Tax on sales of real estate of individuals and undivided estates.
14. Tax on credits and debits in bank accounts and other transactions.
15. Tax on electrical power.
16. Additional emergency tax on cigarettes.
17. Special tobacco fund.
18. Tax on tickets to cinema exhibitions.
19. Tax on recorded videos.
20. Tax on audiovisual communication services.
21. Value Added Tax.
22. Tax on personal property.
23. Tax on tobacco.
24. Tax on alcoholic beverages.
25. Tax on beers.
26. Tax on alcoholic beverages, syrups, extracts, concentrates and mineral waters.
27. Tax on luxury objects.
28. Tax on automotive vehicles, motorcycles, and vessels.
29. Tax on sports and recreational vessels and aircraft.
30. Tax on electronic products.
31. Tax on insurance.
32. Tax on cellular and satellite telephony.
33. Surcharge on natural gas.

34. Trust fund for subsidies of household gas consumption.
35. Tax on liquid fuels.
36. Tax on carbon dioxide.
37. Imports rights.
38. Exports rights.
39. Statistics Fee.
40. P.A.I.S Tax.
41. Tax on fares going abroad (National Tourism Fund).
42. ANAC Safety Fee.
43. Aviation Safety Fee.
44. Airport use Fee.
45. Migrations Fee.

So, which of these taxes should continue to exist?

The answer is simple – only four of them are relevant and recommended.

- Tax on income of resident individuals and undivided estates, which should include all types of individuals (this would imply the elimination of the small-scale taxpayers, the tax system for the self-employed, and as soon as a labor and social security reform is treated, the taxes paid by employees on their salaries would also be eliminated). This tax could possibly be renamed as Income Tax of Natural Persons, as is the case in countries like Uruguay and Spain. Tax brackets should be reduced to three or four from day one.

- Tax on profits of partnerships, including permanent establishments, companies, and exploitations by individual enterprises, which should provide for the possibility of deducting expenses referred to the business activity involved through an easier procedure, and obviously with the chance of deferrals in cases of reinvestment.

- System for dependent employees: social security contributions (while the social security and labor reforms that the country is obviously in urgent need for are not implemented).

- Value Added Tax. It is obvious that, upon the possibility of eliminating co-participation, this tax would become a provincial tax. Ideally, it should be replaced by a general sales tax in order to have fewer exceptions in its application, while turning unnecessary specific taxes on the sale of certain articles.

Considering the bureaucracy overload and the tax burden to which Argentinean taxpayers are exposed, such change would surely prove impressive.

It should be noted that the difference as far as tax collection is concerned (even without considering the advantages in collection that both lower taxes and system simplification entail) is not significant.

In the year 2023, the four taxes proposed accounted for more than 75% of the country's overall amount of taxes collected:

- IVA: 34.41% of all taxes collected.
- Gains: 20.43%, even when, during the last quarter, many workers ceased to pay this tax, as a consequence of Mr. Massa's "*Platita Plan*".
- Social security contributions: 21.60%

Then the difference, **without considering the positive effects of a reform like the one proposed,** would only be 24.66%, 8 billion dollars, or two points of the country's GIP.

Considering that the Government has expressed that they have already found a way to reduce the deficit to zero without increasing taxes, then settling for a 2% deficit should not be complicated. Many countries currently with 2% deficit do function and do continue to grow.

It extremely disappointing that the money the Central Government spends on public companies (US$12,000 millions), the money that is allocated to trust funds (US$3,400 millions) and other State entities (US$8,600 millions) as well as the funds it does not receive because of the special tax regime of Tierra del Fuego (between US$1,000 million and US$3,000 millions) are deliberately preventing Argentinian taxpayers from benefiting from a comprehensive tax reform that is designed to replace a disorderly, confusing, complex tax regime with terrible incentives into a logical, economically sound system that promotes the growth of the state and individuals.

In any event, if the Government does not agree with only choosing to keep four taxes, we note that these other taxes can be kept if need be:

1. The so-called "sin taxes" are a relatively benign way of raising revenue. Even though they do create restrictions to free will, they at the same time create incentives for people to behave in a way that reduces negative externalities which will be in most causes finance by the Government. Examples of these taxes, from the previous list we shared, are the following:
    - Specific tax on betting activities.
    - Indirect tax on online betting.
    - Additional emergency tax on cigarettes.
    - Special tobacco fund.
    - Tax on tobacco.
    - Tax on alcoholic beverages.
    - Tax on beers.
    - Tax on alcoholic beverages, syrups, extracts, concentrates and mineral waters.

   Having said this, in an ideal tax system, "sin taxes" would be a good source for provincial revenue.

2. Whilst taxes on transactions and wealth are the most harmful ones, it would not be extremely detrimental looking at the big picture (which is the tax reform we are proposing) to keep them for a short period of time and not to exceed the present presidency.

   They are; a transfer tax on real estate, cars, motorcycles, vessels and aircrafts and a wealth tax of 1% only applicable to real estate with a market value higher than US$250,000.

<u>The "*Tablita Impositiva*":</u>

Even though eliminating taxes and simplifying the system are key factors, this is not where it ends. On the contrary, this is just the beginning.

There will be greater and further benefits if the tax reform to be implemented follows these general guidelines:

- For the case of VAT, there could even be an increase of one percent at this point, which would then equal the 22% applied in Uruguay. From then, for each year where tax collection –in inflation-adjusted amounts– is greater than, equal to, or only 5% lower than the previous year, VAT tax rates would decrease by 1% up to 15%, which is our target VAT tax rate.

- In the case of the income tax, there should be an immediate decrease of the maximum income tax on natural persons to 30%, and an additional reduction of 2% for each year where tax collection is greater than, equal to, or only 5% lower than that corresponding to the previous year, and up to 20%. For the case of corporate gains, the immediate reduction of the maximum to 15%, and a decrease in tax brackets by an additional 1%, provided that tax collection is greater than, equal to, or only 5% lower than that corresponding to the previous year, and up to 10%.

- In the case of income tax on natural persons, if after reaching the minimum tax rate of 20% the tax collected continues to increase for two consecutive years, then a flat tax is to be implemented with that tax rate. Flat tax has many advantages, but we do not think that it can be achieved today when so many tax rates coexist.

The tax system proposed implies applying, in a dynamic manner, the learnings from the Laffer Curve, with automatic adjustments that do not depend on the governments in place, nor on new legislative decisions.

The Laffer Curve is a tool that works and is useful regardless of the ideology of the current government. What I mean by this is that all governments should use it when defining their tax system. According to their ideology, some will use it to find the point at which state revenue is maximized without "*killing*" taxpayers (the "revenue maximizing point" on the graph), while others will seek a much lower point on the curve (the "growth maximizing point"), aiming to maximize the portion of revenue that remains in the hands of the private sector without "*killing*" the state. Obviously, we lean towards this second type of government.

Whilst there are various examples that underscore that the Laffer Curve works, one of the most recent ones was the Tax Reform undertaken by Donald Trump during his Presidency.

After the Tax Cuts and Jobs Act of 2017, the Congressional Budget Office projected tax revenues for 2018-2027 would drop by US$1.1 trillion. However, the reality showed that the entire US$1.5 trillion tax cut was paid for by higher revenues and better nominal GDP, even after adjusting for recent inflation.

This tax system we propose brings legal security and aligns interests between taxpayers and the Internal Revenue authorities.

Additionally, the law that would bring this system forward should imply a minimum period of validity of ten years, with the impossibility of being amended by a majority smaller than two thirds of the votes of each chamber of parliament. Although the viability of this may be arguable from the viewpoint of Argentina's constitutional law, it would at least be valid by way of commitment towards the country's citizens.

Whilst this document focuses only on taxes, because the local parliament has shown very little initiative in passing laws that will cut expenditures, it should be noted that there are two broad and important points about fiscal policy that cannot be ignored:

1. it is impossible to have good tax policy if there is a bad spending policy (i.e. big government); and
2. adopting a "spending cap amendment" requiring that the Government cannot spend more than its income would be a good idea. This is a rule that has been added to the constitutions of Hong Kong and Switzerland and it is a much better option than the alternative "balanced budget amendment", which is also better of what the county currently has.