USAID'S STRENGTHENING PUBLIC FINANCIAL MANAGEMENT IN LATIN AMERICA AND THE CARIBBEAN (PFM-LAC)

Paraguay Revenue Brief

Prepared by: Luis F. Paniagua & Anton Kamenov

January 2014

Contract Number : AID-OAA-I-12-00036/AID-OAA-TO-13-00030

This publication was produced for review by the United States Agency for International Development. It was prepared by Deloitte Consulting LLP.

Strengthening Public Financial Management in Latin America and the Caribbean

Paraguay Revenue Brief

Program Name:	USAID Strengthening Public Financial Management in Latin America and the Caribbean (PFM-LAC)
Sponsoring USAID Office:	USAID/LAC/RSD/BBEG
Contract Number:	AID-OAA-I-12-00036/AID-OAA-TO-13-00030
Contractor:	Deloitte Consulting LLP
Date of Publication:	January 17, 2014

Authors	
Luis F. Paniagua Revenue Specialist USAID/PFM-LAC lupaniagua@deloitte.com	Anton Kamenov Senior Advisor USAID/PFM-LAC akamenov@deloitte.com

Paraguay

Summary

- Over the 2003 to 2012 period, Paraguay's total tax revenue increased by 3.6% of GDP due to an ambitious government reform program to address public sector weaknesses, including improving tax collections and strengthening the tax administration. Paraguay's tax structure shifted to rely more heavily on taxes on income and profits and on goods and services, which increased by 1.1% and 2.8%, respectively.
- A recent study[1] found Paraguay's tax effort[2] to be on par with other countries in Latin America and the Caribbean (LAC). Paraguay's tax effort is 59.3% of tax capacity, whereas the average of the surveyed LAC countries is 61.1%. The country's tax capacity, at 25.8% of GDP, is moderately lower than the average tax capacity of all other surveyed LAC countries, which is 33.5%.
- Personal income tax (PIT) revenue effort and productivity figures in Paraguay are not available, as the PIT regime was only established in 2012. The maximum personal income tax rate is well below the regional, income group, and world averages.
- Paraguay's corporate income tax revenue effort is modestly below the regional, income group, and world averages, while its productivity figures are significantly above the averages. The corporate income tax rate is significantly below the regional, income groups, and world averages.
- Revenue effort for the value added tax (VAT) is broadly in line with the income group and world averages and slightly below the regional average, while VAT productivity figures are significantly above the regional, income group, and world averages. The VAT rate is slightly below all comparator groups.
- Suggested areas for further investigation include:
    - The impact of the newly implemented personal income tax of 2012.
    - The impact of the agriculture fiscal reform of 2012.
    - The high productivity of corporate and value added taxes.

---

[1] Pessino, Carola and Ricardo Fenochietto (2010), "Determining countries' tax effort", *Hacienda Pública Española / Revista de Economía Pública,* 195-(4/2010): 65-87, Instituto de Estudios Fiscales. "Tax capacity" is the maximum tax revenue that can be generated given the country's economic, social, institutional, and demographic characteristics. "Tax effort" is the ratio of actual revenue to tax capacity.

[2] The definition of "tax effort" employed in the aforementioned study differs from the definition of revenue effort employed further below in this paper.

Major Developments and Features of Current Tax System

Evolution of Revenue

Paraguay's total tax revenue increased by 3.6% of GDP between 2003 and 2012. This was primarily due to comprehensive tax reform in the mid-2000's. Revenue from taxes on income and profits, as well as on goods and services, both showed gains over the past decade.

- Revenue from taxes on income and profits increased by 1.1% of GDP over the period.
- Revenue from taxes on goods and services increased by 2.8% of GDP.
- Revenue from taxes on international trade decreased by 0.1% of GDP.

Paraguay Government Current Revenue
(% of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Taxes on Income & Profits	1.5%	1.8%	1.8%	1.6%	1.8%	1.9%	2.8%	2.2%	2.4%	2.6%
Taxes on Goods and Services	5.4%	6.2%	6.4%	6.5%	7.0%	7.3%	7.5%	8.1%	8.1%	8.2%
Taxes on International Trade	1.6%	1.9%	1.5%	1.5%	1.2%	1.3%	1.2%	1.6%	1.6%	1.5%
Other Taxes	0.3%	0.4%	0.5%	0.8%	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%
Total Tax Revenue	**8.7%**	**10.3%**	**10.1%**	**10.5%**	**10.1%**	**10.7%**	**11.6%**	**12.0%**	**12.1%**	**12.3%**

Source: Economic Comission for Latin America and the Caribbean, CEPALSTAT

Summary of Reforms

Over the past decade, Paraguayan tax reforms have attempted to increase tax revenues by favoring taxes that are easier to collect and have larger tax bases, reducing the corporate income tax rate, and addressing internal aspects of the tax administration.[3] Major reforms in 2004 simplified the system by reducing the number of taxes from approximately 150 to 9, rearranging tax legislation, and shifting the focus of taxation toward indirect taxation.

- In 2004, the Fiscal Adjustment Law broadened the VAT tax base by introducing a tax on services, rentals, and transportation, and reduced exemptions on basic goods and oil products.
- The 2004 reforms introduced a new personal income tax and lowered the corporate income tax rate from 30% in 2004 to 20% in 2005, and to the current rate of 10% by 2006. The reform also established a new small business tax of 10% and a 1% property tax.[4] The law's passage was controversial and spurred protests, prompting the government to postpone implementation until 2013.

[3] Ferrario, Caterina. Tax Systems and Tax Reforms in Latin America: Paraguay. Società Italiana di Economia Pubblica, August, 2006. http://www-3.unipv.it/websiep/wp/548.pdf
[4] Ibid.

- In addition, several special tax regimes were abolished through the 2004 reform, such as the elimination of a five-year tax holiday on first-time investment, and elimination of dividend, profit, and bond exemptions.
- Following the 2004 reform, the tax administration focused on modernizing procedures and operations, improving control over goods and revenue collection, and addressing key human resource issues.
- In August 2012, the government enacted the long-delayed personal income tax bill, instituting a 10% rate on taxable income in excess of 10 times the monthly minimum wage. A differential tax rate of 8% is applied when income is below 10 times the minimum monthly wage.
- In 2012, the government approved a major fiscal reform directed toward the dominant agriculture sector, which in 2011 accounted for 20% of GDP, but only 0.5% of total revenue collection. The reform extended the VAT to primary production and introduced a 10% profit tax on commercial farmers, as well as new agricultural taxes.[5]

Tax System Profile (2010-11)

The tables in Annex 1 provide a high-level description of Paraguay's tax system and draw comparisons with the Latin America and Caribbean (LAC) region, low-middle-income (LMI) countries,[6] and the rest of the world. The data in this section are from the 2012-2013 release of USAID's Collecting Taxes database.[7] **The most recent comparative data in this section are from fiscal year 2011 and do not reflect the most recent reforms or data discussed above.**

Revenue Effort

- "Revenue Effort" is the amount of revenue as a share of GDP.
- Paraguay's overall tax revenue effort is 12.1% of GDP, which is below the income group and world averages of 16.4%, and 17.9%, respectively, and significantly below the LAC regional average of 19.5%.
    - While tax revenues have been growing in recent years, Paraguay's overall tax revenue effort remains one of the lowest in Latin America.
- An estimate of Paraguay's personal income tax revenue effort is not available, as Paraguay's personal income tax regime took effect only recently, in August 2012.[8]
- Corporate income tax revenue effort, at 2.4% of GDP, is below the LAC regional, income group, and world averages of 3.7%, 3.6%, and 3.3% respectively.

[5] Economist Intelligence Unit, Paraguay Country Report, 2013.
[6] Derived from the World Bank's Country and Lending Group classifications, http://data.worldbank.org/about/country-classifications/country-and-lending-groups.
[7] USAID's Collecting Taxes Database, http://egateg.usaid.gov/collecting-taxes.
[8] KPMG Flash: Paraguay. http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/flash-international-executive-alert/Documents/flash-international-executive-alert-2012-213-nov.pdf

- The revenue effort from VAT, at 6.2% of GPD, is in line with the corresponding comparator group averages, which lie between 6.0% and 6.4%.

Tax Structure

- The maximum personal income tax rate, at 10%, is significantly below the LAC regional, income group, and world averages, which are in the 27% to 28% range.
- Paraguay's corporate income tax rate, at 10%, is significantly below the LAC regional, income group, and world averages, which are in the 24% to 27% range.
- The VAT rate, at 10%, is moderately below the regional, income group, and world averages, which are in the 13% to 14% range.
- The tax wedge on labor income, at 23%, is broadly in line with the world average of 22.4% and slightly above the regional and income group averages of 20.1% and 19%.

Revenue Productivity

- "Revenue productivity" measures the revenue share of GDP mobilized for each point of the tax rate. An estimate of Paraguay's personal income tax productivity is not available, as Paraguay's personal income tax regime became effective only recently, in August 2012.
- Corporate income tax productivity, at 0.24, is well above the regional, income group, and world averages, which range from 0.15 to 0.17.
- Paraguay's VAT productivity, at 0.62, is significantly above the regional, income group, and world averages of 0.47, 0.44, and 0.42, respectively.

Tax Administration Structure

- The *Subsecretaría de Estado de Tributación* (SET) is responsible for administration of taxes in Paraguay. SET is a division of the Ministry of Finance. Customs duties are collected by the General Customs Service.
- Tax administration in Paraguay is organized along functional lines and includes a Large Taxpayer Unit (LTU).
- The SET's ratio of active taxpayers to staff, at 478 taxpayers per staff, is above the income group average of 349 taxpayers per staff, but significantly below the LAC regional and world averages of 982 and 677, respectively.

Taxpayer Burden and Corruption Evidence

- The 2010 World Bank Enterprise Surveys indicated that the percentage of Paraguayan business taxpayers "expected to give gifts in meeting with tax officials" was 14.6%, which was significantly above the LAC regional average of 6.1%, and in line with the world average of 14.1%.

- The 2014 World Bank Doing Business survey estimates that the average time to pay taxes expended by a medium-sized company in Paraguay amounted to 384 hours per year, which is in line with the LAC regional average of 369 and above the world average of 285 hours per year.

ANNEX 1: Paraguay's Collecting Taxes Indicators

Total Tax Revenue	TAXY[9]
	Tax Revenue as % of GDP (%)
Paraguay	12.1
Latin America and the Caribbean[1]	19.5
Low-Middle-Income Economies[2]	16.4
World	17.9

Company Income Tax	CITR	CITY	CITPROD
	Tax Rate (%)	Revenue as % GDP (%)	Revenue Productivity
Paraguay	10.0	2.4	0.24
Latin America and the Caribbean[1]	27.2	3.7	0.15
Low-Middle-Income Economies[2]	24.7	3.6	0.17
World	24.1	3.3	0.15

Income Taxes on People	PITMINR	PITMAXR	PITMINL	PITMAXL
	Minimum Tax Rate (%)	Maximum Tax Rate (%)	Minimum Income Level (Multiples of GDP per capita)	Maximum Income Level (Multiple of GDP per capita)
Paraguay	8.0	10.0	4.51	5.63
Latin America and the Caribbean[1]	13.4	27.5	0.52	3.58
Low-Middle-Income Economies[2]	10.4	27.3	0.44	7.04
World	10.9	27.8	0.40	6.38

[9] A glossary of terms for the selected indicators is found in Annex 2.

Personal Income Tax	PITY	PITPROD	SSR	WEDGE
	Revenue as % GDP (%)	Revenue Productivity	Mandatory Combined Social Contribution Rates (%)	Combined Rate of Personal and Labor Taxation (%)
Paraguay	N/A	N/A	23.0	23.0
Latin America and the Caribbean[1]	4.1	0.15	17.1	20.1
Low-Middle-Income Economies[2]	4.6	0.17	18.1	19.0
World	5.5	0.22	20.8	22.4

Value Added Tax	VATR	VATY	VATGCR	VATPROD	THRESHOLD
	VAT rate (%)	Revenue as % GDP (%)	Gross Compliance Ratio (%)	Revenue Productivity	Mandatory registration/ filing (annual turnover in USD)
Paraguay	10.0	6.2	79.1	0.62	0
Latin America and the Caribbean[1]	13.5	6.4	66.2	0.47	34,149
Low-Middle-Income Economies[2]	13.1	6.0	69.3	0.44	56,881
World	13.8	6.1	65.9	0.42	57,598

Tax Administration	Tax Staff	Payer to Staff	Function	LTU	Customs
	Tax staff per 1000 population	Number of tax payers per tax staff	Functional Organization (1 = Yes, 0 = No)	Large Taxpayer Unit (1 = Yes, 0 = No)	Customs and Tax Administration Combined (1 = Yes, 0 = No)
Paraguay	0.14	478	1.00	1.00	0.00
Latin America and the Caribbean[1]	0.33	982	0.80	0.78	0.30
Low-Middle-Income Economies[2]	0.35	349	0.91	0.89	0.22
World	0.65	677	0.88	0.81	0.30

Footnotes:

1. LAC countries include: Anguilla, Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bermuda, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Uruguay, and Venezuela.
2. Low-Middle-Income Countries include: Armenia, Bhutan, Bolivia, Cameroon, Cape Verde, Congo, Rep, Cote d`Iviore, Djibouti, Egypt, El Salvador, Georgia, Ghana, Guatemala, Guyana, Honduras, India, Indonesia, Kiribati, Kosovo, Lao P.D.R, Lesotho, Mauritania, Micronesia, Moldova, Mongolia, Morocco, Nicaragua, Nigeria, Pakistan, Papua New Guinea, Paraguay, Philippines, Samoa (Western), Senegal, Solomon Islands, Sri Lanka, Sudan, Swaziland, Syrian Arab Republic, Timor-Leste, Ukraine, Uzbekistan, Vanuatu, Vietnam, West Bank/Gaza, Yemen, Rep, and Zambia..

ANNEX 2: Collecting Taxes Indicators Glossary

CITR is the general rate applied for the corporate income tax. In most countries, only one corporate income tax is applied to corporate profits. In most countries, business enterprises that are owned by sole proprietors or unincorporated partnerships pay tax under the personal income tax system.

CITY is the level of corporate income tax collections as percentage of GDP.

CITPROD represents how well the corporate income tax does in terms of revenue collection, given the tax rate. CITPROD is the portion of GDP in revenue that is mobilized for each point of CIT rate.

PITMINR is the lowest non-zero positive tax rate applied to the lowest income group in the personal income tax system.

PITMINL is the lowest level of income at which the lowest marginal personal income tax rate (PITMINR) is imposed, expressed as a multiple of per capita GDP.

PITMAXR is the highest tax rate applied under the personal income tax system.

PITMAXL is the lowest level of income at which the top marginal personal income tax rate is imposed, expressed as a multiple of per capita GDP.

PITY is the level of personal income tax collections as percentage of GDP.

PITPROD provides an indication of how well the personal income tax in a country does in terms of producing revenue. PITPROD is the portion of GDP in revenue that is mobilized for each point of the average PIT rate.

SSR is the combined rate for employer and employee social security contributions.

WEDGE is an estimate of the overall taxation of labor income, represented as a percentage of gross salary. It combines social contributions with personal income tax. The tax wedge represents the ratio of total labor taxes to total labor costs to the employee.

VATR is the general rate at which most goods and services are taxed under the value added tax system. Most countries have a variety of reduced rates for certain basic goods, such as basic food stuffs. Also, all countries have a zero rate on exported goods.

VATY is the level of VAT collections as a percentage of GDP.

VATGCR is the VAT gross compliance ratio which is the ratio of potential VAT collections—if all final household consumption had been taxed at the standard rate--to actual VAT collections.

VATPROD is a measure of how well the VAT produces revenue for the government, given the VAT rate. It is the portion of GDP in revenue that is mobilized for each point of VAT rate.

Threshold indicates the amount of annual turnover, in US $ terms above which taxpayers must register for VAT and file regular VAT returns.

Functional Organization is a binary indicator where 1 indicates that the tax administration is organized along functional lines.

Large Taxpayer Unit is a binary indicator where 1 indicates that there is a large taxpayers unit.

Customs and Tax Administration Combined is a binary indicator where 1 indicates that revenue is administered jointly by a single customs and tax administration.

ANNEX 3: Paraguay Tax Highlights

Paraguay Highlights

Currency: Paraguayan Guaraní (PYG)

Foreign exchange control: No

Accounting principles/financial statements: Paraguayan GAAP, based on IAS/IFRS. Financial statements must be prepared annually.

Principal business entities: These are the corporation, limited liability company, partnership and branch of a foreign corporation.

Corporate taxation:

Residence – Residence is determined in order of priority according to: (1) the place of a company's management or direction; (2) the place where a company's main activities are carried out; and (3) the location of a company's representative address.

Basis – Corporate income tax is levied on a territorial basis. Tax is due, with some exceptions, on business income derived from activities performed, property situated or economic rights used, in Paraguay, regardless of the domicile, residence or nationality of those participating in the operations or where contracts are concluded.

Taxable income – Taxable income is the difference between total earnings from commercial, manufacturing and service activities less expenses incurred to derive the income.

Taxation of dividends – Dividend distributions are subject to a 5% corporate income tax.

Capital gains – Capital gains derived from the sale of fixed assets, immovable property and securities are taxed as ordinary income at the standard corporate rate.

Losses – The carryforward and carryback of losses is not permitted.

Rate – 10%

Surtax – No

Alternative minimum tax – No

Foreign tax credit – No

Participation exemption – No

Holding company regime – No

Incentives – Companies operating in free zones benefit from reduced taxation. A maquiladora regime also exists.

Withholding tax:

Dividends – Dividends distributed to a nonresident are subject to a 15% withholding tax.

Interest – Interest paid to a nonresident is subject to a 30% withholding tax, which is imposed on 50% of the payment, resulting in an effective rate of 15%. The rate on payments to a financial institution is 6%.

Royalties – Royalties paid to a nonresident are subject to a 30% withholding tax imposed on 50% of the payment, resulting in an effective rate of 15%.

Branch remittance tax – Profits remitted to a head office are subject to a 20% withholding tax, in addition to the 10% corporate tax, resulting in an effective rate of 30%.

Other taxes on corporations:

Capital duty – There is no capital duty per se, but certain fees (e.g. registration and publication) are levied on the formation of a company.

Payroll tax – No

Real property tax – Real property is subject to an annual tax collected by the local authorities at a rate of 1% (0.5% for certain rural property) of the cadastral value. Various real estate surtaxes also apply for specific types of property, and there is a 0.3% tax on the transfer of immovable property (calculated on the higher of the transaction price or the cadastral value of the property).

Social security – The employer's contribution to social security is 16.5% of an employee's total salary (including bonuses, premiums, etc.). The employer also must withhold the employee portion (9%).

Stamp duty – No

Transfer tax – No

Other – Some small and agricultural businesses fall under special regimes other than the corporate income tax regime.

Anti-avoidance rules:

Transfer pricing – No

Thin capitalisation – No

Controlled foreign companies – No

Other – No

Disclosure requirements – No

Administration and compliance:

Tax year – The tax year generally coincides with the calendar year, but certain industries are required to use specific tax years.

Consolidated returns – Consolidated returns are not permitted; each company must file a separate return.

Filing requirements – A company must make 4 advance payments based on the previous tax year's liability. A return and balance sheet, at a minimum, must be filed for corporate income tax purposes. In general, the return is due within 4 months of the end of the taxpayer's tax year, but the taxpayer's identification number determines the exact due date.

Penalties – Penalties range from 4% to 14% of the total tax due, plus monthly interest at 1.5%.

Rulings – A taxpayer may request a ruling from the tax authorities on the tax consequences of a proposed transaction.

Personal taxation:

Basis – Tax is levied on Paraguayan-source (net) income from services and certain investments, provided the taxpayer's income exceeds the monthly minimum wage by a certain amount (i.e.108 times for 2011, to be reduced by 12 per year until the factor reaches 36 in 2017). The personal income tax, however, is suspended until 1 January 2013.

Residence – An individual is resident in Paraguay if he/she is in the country for more than 120 days in a calendar year or in the previous 12-month period.

Filing status – Joint filing is not permitted. Each person is subject to tax if his/her individual income exceeds the relevant threshold.

Taxable income – Income from services and certain investments are taxable. These items include: personal services income; benefits in kind; dividends, profits and share price surplus (50% if derived from a resident company/enterprise subject to corporate or agricultural income tax and 100% if the resident company/enterprise is not subject to corporate or agriculture income tax); certain capital gains (see under "Capital gains"); and interest, commissions and other income that has not been subject to the corporate or agriculture income tax. A nonresident that derives business or professional income in Paraguay is subject to withholding tax at an effective rate of 15% (30% of 50%) on the gross amount.

Capital gains – Capital gains from the disposal of real property located in Paraguay and shares of Paraguayan companies are subject to individual income tax if they are occasional; otherwise, the gains are subject to the corporate, agricultural business tax or small business tax. Capital gains derived by a nonresident are subject to tax at an effective rate of 15% (30% of 50%) on the gross amount.

Deductions and allowances – If directly related to the taxable activity generating domestic-source income, both domestic and foreign-source expenses are deductible. The taxpayer and his/her dependents are also entitled to personal deductions (education, health, clothing, recreation, charitable, etc.). A deduction of 15% of annual gross income is allowed if invested in certain entities where the taxpayer does not contribute to the social security system.

Rates – The rate is 10% if the income exceeds 120 times the minimum wage; otherwise, the rate is 8%.

Other taxes on individuals:

Capital duty – No

Stamp duty – No

Capital acquisitions tax – No

Real property tax – Real property is subject to an annual tax collected by the local authorities at a rate of 1% (0.5% for certain rural property) of the cadastral value. Various real estate surtaxes also apply to specific types of property and there is a 0.3% tax on the transfer of immovable property (calculated on the higher of the transaction price or the cadastral value of the property).

Inheritance/estate tax – No

Net wealth/net worth tax – No

Social security – The employee contribution is 9% (3% applicable to pension and retirement), based on total remuneration (including bonuses, premiums, etc.) and is withheld by the employer.

Administration and compliance:

Tax year – Calendar year

Filing and payment – The annual income tax liability must be paid when the annual tax return is filed (i.e. in June of the year following the tax year).

Penalties – Penalties range from 4% to 14% of total tax due, plus monthly interest at 1.5%.

Value added tax:

Taxable transactions – VAT is levied on the supply of goods and services, and the import of taxable goods and services.

Rates – The standard rate is 10%, with a lower 5% rate applying to supplies of basic foodstuffs, pharmaceutical products, interest and commissions on loans, and the transfer of the right to use goods or immovable property. Exports are zero-rated. Exemptions include raw farm products, some fuels, foreign currency, books and newspapers.

Registration – VAT registration is compulsory for all companies and unincorporated businesses whose taxable turnover exceeds a certain amount.

Filing and payment – VAT filing and payments are due monthly, with the due date determined according to the taxpayer's registration number.

Source of tax law: Law No. 125/91 on Tax Reform (including all fiscal taxes), Law No. 2421/04 of Administrative Reordering and Fiscal Adequacy

Tax treaties: Paraguay has 1 tax treaty.

Tax authorities: *Subsecretaría de Estado de Tributación*

International organisations: Union of South American Nations, Mercosur, OAS (Organization of American States)

SOURCE: Deloitte International Tax Source: Tax Highlights, http://www.deloitte.com/taxguides.