June 7, 2004

MEMORANDUM

FOR: Mission Directors in the Bureau for Latin America and the Caribbean

FROM: Regional Inspector General/San Salvador, Steven H. Bernstein

SUBJECT: Survey of Payments for Value Added Taxes to Governments in Latin America and the Caribbean (Report No. 1-598-04-002-S)

This report presents the results of our survey. This is not an audit report and does not contain any formal recommendations for your action.

One mission provided very brief comments on the report. USAID/Dominican Republic stated that, in general, it appears that the Latin America and the Caribbean region has been very effective in dealing with the Value Added Tax issue. Due to the brevity of the comments, we are not including a separate appendix containing management comments.

I appreciate the cooperation and courtesy extended to my staff during the survey.

Background

During an April 2003 risk assessment of USAID/Mexico, RIG/San Salvador noted that USAID/Mexico was reimbursing its partners between $420,000 and $735,000 per year for Value Added Tax[1] (VAT) payments made to the Mexican Government. These payments were being made contrary to the terms of the 1951 bilateral agreement between the U.S. and Mexican governments. We believed this issue

[1] A Value Added Tax is a tax added each time a product is resold, or when value has been added. (The exact legal definition would depend on the specific country.) The cost of goods and services in countries with Value Added Tax already includes this built-in tax. In contrast, a sales tax is added when the good or service is sold at the retail point, and the tax is added to the retail price.

could be systemic for the missions in the Bureau for Latin America and the Caribbean (LAC) and decided to conduct a survey on the matter.[2]

The fiscal year 2003 Foreign Operations Appropriations Act emphasized the longstanding principle that U.S. assistance should not be taxed by foreign governments by stating, "None of the funds appropriated by this Act may be made available to provide assistance for a foreign country under a new bilateral agreement governing the terms and conditions under which such assistance is to be provided unless such agreement includes a provision stating that assistance provided by the United States shall be exempt from taxation, or reimbursed, by the foreign government, and the Secretary of State shall expeditiously seek to negotiate amendments to existing bilateral agreements, as necessary, to conform with this requirement." The Appropriations Act also stipulated that, after February 20, 2003, no funds could be obligated on commodities financed by U.S. assistance under new bilateral agreements[3] or new framework bilateral agreements[4] that do not include a provision for the exemption or reimbursement of VAT and customs taxes. The Act stipulated that 200 percent of the unreimbursed taxes assessed during the February 20, 2003 to September 30, 2003 timeframe be withheld, of which half would be available for reprogramming and half would be returned to the U.S. Department of Treasury.[5] In addition, USAID's Automated Directives System contains provisions stating that foreign assistance funds cannot be utilized to make tax payments to foreign governments.

In April 2002, USAID's Administrator's office sent a questionnaire to mission directors to collect information on VAT payments made to foreign governments. The survey, from the USAID Deputy Administrator, stated that "A basic tenet of U.S. economic assistance programs since their beginning has been that goods and services funded by the U.S. government are generally not subject to local taxation." The results of the questionnaire disclosed that 13 out of 16 missions in the Latin America and Caribbean region were located in countries that had VAT.[6] No formal report resulted from this effort.

2 In March 2004, USAID/Mexico reported that it, in conjunction with the Embassy, completed negotiations that will allow for VAT exemptions in the near future. USAID/Mexico has not provided our office with the timeframe for this process.

3 Bilateral agreements between USAID and a foreign government (or a subdivision thereof, as in the Ministry of Health, or a local or state government or agency) finance activities in furtherance of a strategic objective or for other purposes. Bilateral grants range from grants financing specific objectives and limited scope grant agreements to Strategic Objective Agreements, commodity import program grants and cash transfer grants.

4 Framework bilateral agreements between the U.S. Government and the host government establish the USAID mission as a special mission; identify the privileges and immunities to be provided to USAID personnel; implement USAID's long-standing policy that assistance should be exempt from host government taxes by setting forth the privileges and exemptions from taxes and duties for USAID-financed supplies and services and USAID contractors and recipients; and list other general terms and conditions for USAID assistance.

5 Our survey did not focus on whether funds were obligated in accordance with the fiscal year 2003 Foreign Operations Appropriations Act or on whether the 200 percent penalty was assessed. Rather, our survey focused on the LAC missions' actions to eliminate VAT or to be reimbursed in a timely manner.

6 Our survey showed that 14 of the 16 missions in the Latin America and Caribbean region were located in countries that had VAT. The difference was due to the tax in the Dominican Republic, as the tax had characteristics of both a sales tax

On February 20, 2004, the U.S. General Accounting Office (GAO) issued a report entitled *Foreign Assistance: USAID and the Department of State Are Beginning to Implement Prohibition on Taxation of Aid.*[7] Our survey expanded on GAO's report and the USAID's administrator's survey by identifying what actions missions in Latin America and the Caribbean had taken to eliminate VAT or to be reimbursed in a timely manner. The purpose of this memorandum is to report the results of our survey.

Appendix I contains a discussion of the survey's scope and methodology.

Discussion

Eleven out of the 16 USAID missions in Latin America and the Caribbean either paid no VAT to host governments, or were reimbursed in a timely manner. In three countries, missions either paid VAT to host governments without getting reimbursed or received reimbursement in an untimely manner. These three missions have taken action to eliminate VAT payments or receive reimbursements sooner, but their efforts have been unsuccessful. Two missions, USAID/Honduras and USAID/Guyana, were in countries that did not have a VAT.

Of the three missions cited above, two have not fully eliminated VAT payments and one was not receiving VAT reimbursements in a timely manner, as illustrated in Table 1 (page 4). Specifically, in Brazil and Haiti, the host governments did not fully exempt or reimburse VAT; while in Peru, the processing time for VAT reimbursements exceeded the standard of 120 days set by Department of State guidance.[8] Based on USAID/Peru's survey response, the delay in processing VAT claims was beyond the control of Mission or Embassy staff and was under the control of the USAID grantees. The reasons cited for the delay were the late presentation of operational plans by grantees to the Government of Peru, outdated grantee registration with the Government of Peru (renewal is required every two years), late presentation of VAT claims, and submission of invoices that did not comply with current legislation.

and a value-added tax. When the Mission replied to the April 2002 questionnaire, USAID considered it to be a sales tax. However, as the Mission further analyzed the tax, it changed its view and then considered it a value added tax.

[7] The report number was GAO-04-314R.

[8] The Department of State cable number 273956, entitled "Restriction on Taxing Foreign Assistance – Section 579 of the FY 2003 Foreign Operations Act," dated September 26, 2003, provides sample text for a "Model Provision for Agreements" to be negotiated by U.S. Government agencies. Such text states that the foreign country imposing duties "shall provide reimbursement *within 4 months* [emphasis added] from the date of assessment to the Government of the United States or its agents (including recipients) for, at a minimum, VAT and customs duties that are imposed [or may be subject to a withholding penalty on future U.S. assistance]."

Table 1 - VAT Status for the Latin America and the Caribbean Missions				
Mission	**Eliminated VAT or Reimbursed in a Timely Manner**	**VAT not Eliminated or Reimbursed**	**Late Reimbursement**	**Not Applicable (No VAT)**
Bolivia	X			
Brazil[9]		X		
Colombia	X			
Dominican Republic	X			
Ecuador	X			
El Salvador	X			
Guatemala	X			
Guyana				X
Haiti		X		
Honduras				X
Jamaica	X			
Mexico[10]	X			
Nicaragua	X			
Panama	X			
Paraguay	X			
Peru			X	
Totals	11	2	1	2

The three missions have taken actions to address the VAT exemption or reimbursement, as noted below:

- USAID/Brazil has conducted periodic negotiations over several years designed to obtain full VAT exempt status, but these negotiations have not been successful. It did not anticipate obtaining full exempt status in the near future due to jurisdictional issues between the country's federal, state, and in some cases, municipal levels. The Mission expressed that it has sought to limit purchases subject to VAT. For fiscal year 2003, it stated that VAT payments to Brazilian federal, state and municipal governments totaled less than $100,000, or less than one percent of its portfolio.

[9] The Government of Brazil exempts USAID personnel and office operations from taxes on gasoline (Brasilia only), airport departure, telephone and electricity. All other local USAID purchases require payment of VAT.

[10] Even before the completion of recent negotiations that will allow for VAT exemptions (footnote number 2), VAT reimbursements to USAID/Mexico were delivered in a timely manner.

- USAID/Haiti officials stated that they had an excellent working relationship with the new interim Haitian government. The Mission anticipates resolving the taxation issue promptly, through either an exemption system or a reimbursement mechanism.

- USAID/Peru has co-hosted a training meeting with Peruvian Agency for International Cooperation officials to provide instruction to grantees on the reimbursement process, held working sessions with Government of Peru tax authorities and the Peruvian Agency for International Cooperation to inform them of the Mission's concern regarding the reimbursement delays, and sent a letter to the Ministry of Economy to communicate that future aid could be cut if withheld taxes are not reimbursed, as established in the fiscal year 2003 Foreign Operations Appropriations Act. The Mission also recently negotiated with the Government of Peru tax agency and the Peruvian Agency for International Cooperation to allow for the reimbursement of VAT paid by for-profit contractors.

Conclusion

This survey was undertaken to determine what actions the missions have taken to eliminate VAT or ensure timely reimbursement. Whereas two countries did not have a VAT system, the survey found that 11 missions have either fully eliminated VAT payments to host governments or ensured reimbursement of VAT on a timely basis.

For the three missions that either paid VAT to host governments without getting reimbursed or received reimbursement in an untimely manner, additional steps are required to ensure conformity with U.S. Government policy. We suggest that these missions, directly or through their Embassy, continue negotiations with their pertinent host government to identify ways to either eliminate VAT or be reimbursed in a timely manner. We request that USAID/Brazil, USAID/Haiti and USAID/Peru notify our office of the corrective actions they intend to take, and the timeframes for such actions.

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Scope and Methodology

Scope

The Office of the Regional Inspector General in San Salvador conducted this survey to determine what actions missions in the Bureau for Latin America and the Caribbean took to eliminate VAT or to ensure timely reimbursement of VAT paid. The survey was conducted via electronic mail or telephone calls with all the LAC missions from our office in San Salvador, El Salvador between October 29, 2003 and May 5, 2004. Our review covered the time period of November 20, 2003 (receipt of the first VAT questionnaire) to April 19, 2004 (last clarification to questionnaire responses).

We did not perform tests to verify the accuracy of the data reported by the missions. In addition, the survey did not attempt to evaluate the effectiveness of the missions' actions to eliminate VAT or ensure its timely reimbursement.

Methodology

We reviewed applicable laws, regulations, policies and guidance issued by Congress, USAID and the Department of State. We reviewed the General Accounting Office's report titled *Foreign Assistance: USAID and the Department of State Are Beginning to Implement Prohibition on Taxation of Aid.* We interviewed USAID/El Salvador's staff personnel who processed VAT claims to understand the VAT reimbursement process. We reviewed a summary of the responses to the USAID Deputy Administrator's survey.

We developed a questionnaire to capture which actions the missions took to either eliminate VAT or ensure timely reimbursement, and reviewed the missions' responses. We sent the survey to all 16 LAC missions.[11] We used the 120 days stated in the Department of State's guidance[12] as our criteria for a timely reimbursement.

[11] The 16 USAID missions were located in Bolivia, Brazil, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay and Peru.

[12] See footnote number 8.