



**Evaluation of the
Structure and
Performance of the
Brazilian Tax System**
White Paper on Taxation in
Brazil

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Abstract^{*}

This study performs an up-to-date diagnostic of the Brazilian tax system in order to provide a basis for reform discussions among technical analysts, authorities and congressmen. It is based on the analysis and categorization of information on taxation in Brazil. Its focus is on the current characterization of the tax system, rather than its evolution, within the limits of available statistics. Tax revenues, addressed in the first part of the study, are its principal focus. We sought to describe the current tax structure in a detailed manner, identifying every tax and contribution and grouping each tax by the level of government collecting it or using the funds after transfer. For the principal taxes (federal taxes and state VAT), we also classify them by type of collection and by sector of economic activity. In the second part, the study addresses the topics most discussed or cited in the tax debate, such as questions of competitiveness, equity, and division of resources among the different spheres of government. The objective of this study is to consolidate the literature on these subjects, with emphasis on a statistical survey of the available sources.

Keywords: Tax system, tax reform, federalism, subnational taxation

JEL Codes: H2, H71

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ACRONYMS

AFE - Financial Assistance to States (*Auxílio Financeiro aos Estados*)
AFM - Financial Assistance to Municipalities (*Auxílio Financeiro aos Municípios*)
BCB - Central Bank of Brazil (*Banco Central do Brasil*)
BGU - Federal Balance Sheet (*Balanço Geral da União*)
CEF - Federal Savings Bank (*Caixa Econômica Federal*)
CGSN - SIMPLES Steering Committee (*Comitê Gestor do Simples Nacional*)
CIDE - Contribution for Intervention in the Economic Domain (*Contribuição de Intervenção no Domínio Econômico*)
CNI - National Confederation of Industry (*Confederação Nacional das Indústrias*)
COFINS - Contribution for the Financing of the Social Security (*Contribuição para o Financiamento da Seguridade Social*)
CONFAZ - National Council of Financial Policy (*Conselho Nacional de Política Fazendária*)
CPMF - Provisional Financial Transaction Contribution (*Contribuição Provisória sobre Movimentação Financeira*)
CSLL - Social Contribution on Net Income (*Contribuição Social sobre Lucro Líquido*)
CSS - Social Contribution for Health (*Contribuição Social para a Saúde*)
CTN - National Tax Code (*Código Tributário Nacional*)
DENATRAN - National Transit Department (*Departamento Nacional de Trânsito*)
DPC - Directorate of Ports and Coasts (*Direção de Portos e Costas*)
DPVAT - Mandatory Insurance Against Personal Injury caused by Motor Vehicle (*Seguro Obrigatório contra Danos Pessoais Causados por Veículos Automotores de Vias Terrestres*)
DRU - De-earmarking of federal revenues (*Desvinculação das Receitas da União*)
ESAF - Public Finance Administration School (*Escola de Administração Fazendária*)
FAPI - Individual Retirement Fund (Fundo de Aposentadoria Programada Individual)
FEX - Export Incentive Fund (*Fundo de Incentivo às Exportações*)
FGTS - Severance Pay Fund (*Fundo de Garantia do Tempo de Serviço*)
FGV - Getulio Vargas Foundation (*Fundação Getúlio Vargas*)
FIESP - Federation of Industries of the State of São Paulo (*Federação das Indústrias do Estado de São Paulo*)
FIRJAN - Rio de Janeiro Federation of Industries (*Federação das Indústrias do Rio de Janeiro*)
Finbra - Brazil's Finances (*Finanças do Brasil*)
Finsocial - Social Investment Fund (*Fundo de Investimento Social*)
FIPE - Institute of Economic Research (*Fundação Instituto de Pesquisas Econômicas*)
FPE - State Revenue-Sharing Fund (*Fundo de Participação dos Estados*)
FPEX - Exporting States Revenue Sharing Fund (*Fundo de Participação dos Estados Exportadores*)
FPM - Municipal Revenue-Sharing Fund (*Fundo de Participação dos Municípios*)
FUNDEB - Fund for Maintenance and Development of Basic Education and Enhancement of Education Professionals (*Fundo de Manutenção e Desenvolvimento da Educação Básica e de Valorização dos Profissionais da Educação*)
FUNDEF - Fund for Maintenance and Development of Fundamental Education and Enhancement of Teaching (*Fundo de Manutenção e Desenvolvimento do Ensino Fundamental e de Valorização do Magistério*)
HDI - Human Development Index
IBGE - Brazilian Institute for Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*)

ICM - Tax on the Circulation of Goods (*Imposto sobre Circulação de Mercadorias*)

ICMS - Tax on the Circulation of Goods and the Provision of Communication and Transportation Services (*Imposto sobre Circulação de Mercadorias e Prestação de Serviços de Comunicação e de Transporte*)

IEDI - Institute for Studies in Industrial Development (*Instituto de Estudos para o Desenvolvimento Industrial*)

II - Import Tax (*Imposto de Importação*)

IMF - International Monetary Fund

INCRA - National Institute for Colonization and Agrarian Reform (*Instituto Nacional de Colonização e Reforma Agrária*)

INSS - Brazilian Social Security Institute (*Instituto Nacional de Seguridade Social*)

IOF - Financial Operations Tax (*Imposto sobre Operações Financeiras*)

IPCA - Broad Consumer Price Index (*Índice de Preços ao Consumidor Amplo*)

IPI - Manufactured Goods Tax (*Imposto sobre Produtos Industrializados*)

IPMF - Provisional Tax on Financial Transactions (*Imposto Provisório sobre Movimentação Financeira*)

IPTU - Urban Real Estate Tax (*Imposto Predial e Territorial Urbano*)

IPVA - Vehicle Tax (*Imposto sobre Propriedade de Veículos Automotores*)

IR - Income Tax (*Imposto de Renda*)

IRPF - Personal Income Tax (*Imposto de Renda da Pessoa Física*)

IRPJ - Corporate Income Tax (*Imposto de Renda da Pessoa Jurídica*)

IRRF - Withholding Tax (*Imposto de Renda Retido na Fonte*)

ISS - Municipal Service Tax (*Imposto sobre Serviços*)

ITBI - Real Estate Transmission Tax (*Imposto sobre Transmissão Intervivos*)

ITCD - Tax On Inheritance and Gifts (*Imposto sobre Transmissão Causa Mortis e Doação*)

ITR - Rural Real Estate Tax (*Imposto Territorial Rural*)

LDO - Budget Guidelines Law (*Lei de Diretrizes Orçamentárias*)

LRF - Fiscal Responsibility Law (*Lei de Responsabilidade Fiscal*)

MERCOSUL - Southern Cone Common Market (*Mercado Comum do Cone Sul*)

MPAS - Ministry of Social Security and Welfare (*Ministério da Previdência e Assistência Social*)

OECD - Organization for Economic Cooperation and Development

PASEP - Civil Servant's Asset Formation Program Contribution (*Programa de Formação do Patrimônio do Servidor Público*)

PIN - National Integration Plan (*Programa de Integração Nacional*)

PIS - Social Integration Program Contribution (*Contribuição para o Programa de Integração Social*)

PPA - Federal Multi-Year Plan (*Plano Plurianual*)

PRONAC - National Cultural Support Program (*Programa Nacional de Apoio à Cultura*)

PROTERRA - Land Redistribution and Agribusiness Program (*Programa de Redistribuição de Terras e de Estímulo à Agroindústria do Norte e Nordeste*)

RFB - Brazilian Federal Revenue Office (*Receita Federal do Brasil*)

RGPS - Social Security General System (*Regime Geral de Previdência Social*)

RPPS - Government Social Security System (*Regime Próprio de Previdência Social*)

SEBRAE - Brazilian Micro and Small Business Support Service (*Serviço Brasileiro de Apoio às Micro e Pequenas Empresas*)

SENAI - National Service for Industrial Training (*Serviço Nacional de Aprendizagem Industrial*)

SENAR - National Service for Rural Training (*Serviço Nacional de Aprendizagem Rural*)

SENAT - National Service for Transport Training (*Serviço Nacional de Aprendizagem do Transporte*)
SESC - Social Service of Commerce (*Serviço Social do Comércio*)
SESI - Social Service of Industry (*Serviço Social da Indústria*)
SEST - Social Service of Transport (*Serviço Social do Transporte*)
SINDIFISCO - National Union of Brazilian Revenue Office Auditors (Sindicato Nacional dos Auditores-Fiscais da Receita Federal do Brasil)
STF - Supreme Federal Court (*Supremo Tribunal Federal*)
STN - Brazilian Treasury Secretariat (*Secretaria do Tesouro Nacional*)
TEC - Common External Tariff (*Tarifa Externa Comum*)
TIPI – Rate Table of the Tax on Industrialized Products (*Tabela do Imposto sobre Produtos Industrializados*)
UF - Federative units (*Unidade Federativa*)
VAT - Value added tax

INTRODUCTION

A paradox: if one were to summarize taxation in Brazil in one word, this would be the most appropriate for the Brazilian tax system. The system has managed to increase the overall gross tax burden continuously since World War II, reaching a level greater than the average of developed economies and much higher than the average of emerging economies, and simultaneously has accumulated distortions that have made the poor quality of the taxes a greater challenge than the revenue collected. The problems include complexity, the heavy burden for the tax administration, the latent cumulativeness, the indirect burden on exports and productive investments, and even tax competition between states to an extent not seen in other federations, referred to by Brazilians as a “fiscal war.”

The pillars of the current Brazilian tax system were defined at the beginning of the 1960s, when the Brazilian economy was underdeveloped, very closed to foreign trade, and suffering from high inflation, but the tax system was always highly decentralized. The post-1964 military governments centralized powers and revenues that the Constituent Assembly of 1987/88 then decentralized. However, the 1988 Constitution created, in practice, two parallel tax systems: one consisting of taxes whose revenues are shared with states and municipalities, and another consisting of social contributions, whose revenue is not shared. Since then, contributions have multiplied and the revenues collected through them have surpassed those of taxes, concentrating revenue. In this long period, the Brazilian economy and society have changed considerably, but the tax system has never undergone a wide-scale reform. This is not for lack of trying, since several legislative proposals have been made and failed to obtain support, though occasional specific measures have been approved, almost always resulting in an even greater increase in the tax burden.

The objective of this study is to prepare an up-to-date diagnosis of the Brazilian tax system in order to provide a basis for discussion on reform by technical analysts, authorities and congressmen. This shall be done based on a survey and categorization of information on taxation in Brazil. Its focus is on the current characterization of the tax system, rather than its evolution, within the limits of available statistics. Tax revenues, addressed in the first part of the study, are the main focus. However, this study seeks to describe its current structure in as detailed a manner as possible, identifying every tax and contribution, all revenue collected, and grouping them by level of government collecting them or using the funds after transfer. The principal taxes (Federal Taxes and State Value Added Tax) will also be classified by

type of collection and by sector of economic activity. In a second section, the study addresses the topics most discussed or cited in the tax debate, such as questions of competitiveness, equity and federal division of resources. The objective of this study is to consolidate the literature on these subjects, with emphasis on a statistical survey of the available sources.

1 - OVERALL TAX BURDEN

Adapting the concept of government take, common in oil and gas literature, the definition of tax burden used throughout this study is based on a fundamental concept: anything that the government legally collects from the economy—compulsorily—is a tax. The legal definition of a tax is not important here: whether it is called an *imposto* (tax), a *contribuição* (contribution) or a *taxa* (fee), or even if some service is provided upon payment.

The purpose of this chapter is to provide an overview of the Brazilian tax burden. Without describing the details of the system, we first present the methodology. In the second section we will address the historical evolution of the Brazilian tax burden. Later, a brief description of 2010 taxes will be provided. And, finally, a comparison of international tax burdens will be made.

1.1 - Methodology

The calculation of the tax burden presented in this study is based on (official) primary sources published regularly by Brazilian government institutions. As is well known, the tax burden is a simple ratio of the total revenue collected in a given location in a specific period and its Gross Domestic Product (GDP) in the same period.

The Brazilian GDP is an easily accessible variable: the Brazilian Institute calculates it quarterly and annually for Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*, or IBGE), as part of the National Accounts.¹ The Central Bank of Brazil (Banco Central do Brasil, or BCB), among other government agencies, also estimates the GDP.² Despite not being official, the Central Bank publishes the GDP figures monthly, rather than quarterly, as is the case with the IBGE.

Revenue collected is a bit more complex. Consolidated, reliable official data can be obtained, basically, from *two institutions, the Brazilian Revenue Office (Receita Federal do Brasil, or RFB) and the Brazilian Treasury Secretariat (Secretaria do Tesouro Nacional, or STN)*. The difference in the information from these sources is due to their differing calculation methodologies. The information from the RFB, based on gross revenues (without subtracting refunds and compensations) collected in that month (even if payment is made

¹ Available at: <http://www.ibge.gov.br/home/estatistica/indicadores/pib/defaultcnt.shtm>

² The central bank estimates GDP monthly within the scope of its Financial Notes to the Press. Available at: <http://www.bcb.gov.br/?ECOIMPrensa>.

only the following month), is managerial and not always precise (as in the case of judicial deposits). In addition to the revenue reports, the RFB also publishes a calculation of the tax burden, presented in Box 1.

STN, on the other hand, is responsible for federal accounting and also for consolidation of the balance sheets of all Brazilian government units, so its revenue figures are those used in the official rendering of accounts. Its figures represent net revenues, and thus correspond to what was effectively collected. This second primary source was that used in our calculations, more precisely the figures released by STN in three publications available on its website: The Federal Balance Sheet (*Balanço Geral da União*)³, State Budget execution (*Execução Orçamentária dos Estados*)⁴ and Municipal Finances (*Finbra*).⁵ The three online publications are characterized by the presentation of the same concept of revenue used in official budget reports, based on revenue collected. In addition to the data from the STN, data from two other sources are needed to calculate the tax burden: Severance Pay Fund (*Fundo de Garantia do Tempo de Serviço*, or FGTS)⁶ and the S System, obtained from the Ministry of Social Security and Social Welfare (*Ministério da Previdência e Assistência Social*, or MPAS).⁷

For the purpose of calculating the tax burden, tax revenue for each tax is considered to be the sum of any mandatory amount collected by the government (taxes, social contributions, economic contributions, fees) for the current period plus amounts collected in the current period relating to prior periods (fines, penalty interest and charges).

The preference for the STN data rather than RFB data can be explained by the origin of the information: RFB measures collection through revenue management reports—their own or those of other federal agencies—and does not resort to balance sheets, as recommended by the methodologies of international organizations.

³ Federal Balance Sheet data can be obtained on the Brazilian Treasury Secretariat's site, grouped by type of revenue: tax revenues (http://www.stn.fazenda.gov.br/contabilidade_governamental/execucao_orcamentaria_do_GF/Receita_Tributaria.xls), revenues from contributions (http://www.stn.fazenda.gov.br/contabilidade_governamental/execucao_orcamentaria_do_GF/Receita_Contribuicao.xls), financial revenues (http://www.stn.fazenda.gov.br/contabilidade_governamental/execucao_orcamentaria_do_GF/Receita_Patrimonial.xls) and other revenues (http://www.stn.fazenda.gov.br/contabilidade_governamental/execucao_orcamentaria_do_GF/Receita_Outras.xls).

⁴ Available at: http://www.stn.fazenda.gov.br/estados_municipios/download/exec_orc_estados.xls.

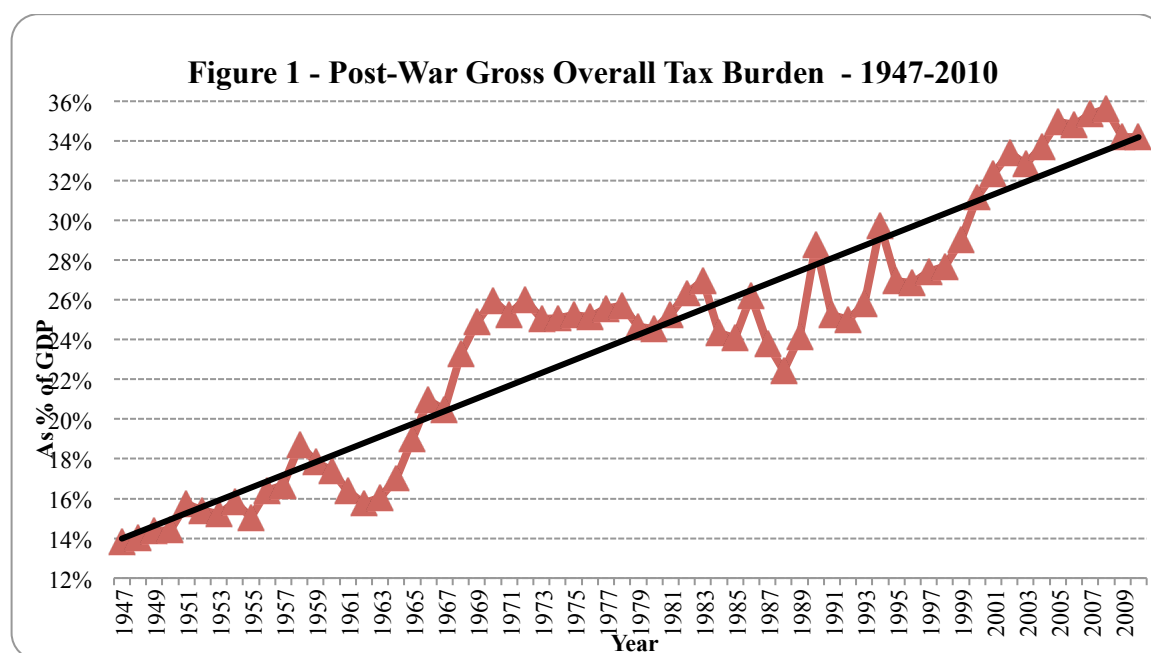
⁵ Available at: http://www.tesouro.fazenda.gov.br/estados_municipios/financas/Finbra2010v1.exe.

⁶ Available at: <http://www1.caixa.gov.br/Download/asp/download.asp>.

⁷ Available at: <http://www.mpas.gov.br/conteudoDinamico.php?id=423>.

1.2 - The Historical Evolution of the Overall Tax Burden

The Brazilian tax system has undergone many alterations throughout the twentieth century and continues to suffer constant changes. The facts to be described in this section do not address these changes directly, but certainly reflect them. The long-term trend in the overall Brazilian tax burden is growth, as can be seen in Figure 1.



Source: Authors' calculations.

Figure 1 shows information for the period since World War Two (from 1947). It was in this period, from the end of the war until the middle of the 1970s, that the world capitalist economy entered the Golden Age of capitalism, whose primary characteristic was a significant increase in government participation in the economy, both through the adoption of Keynesian policies and through the growth of the Welfare State concept. Thus, by expanding the role of the state as a producer and social protector, clearly a larger volume of resources (funding) had to be transferred from the private sector to the state as a way to pay for new government programs. The increase in the overall tax burden, as well as the increase in public debt, was an almost universal characteristic among capitalist countries.

Table 1
Overall Tax Revenue by Tax Base - 2010

	Total Revenues (R\$ Billions)	% of Total Revenues	% GDP	R\$ per capita
Overall	1,288.97	100.00%	34.19%	7,022.30
Merchandises, Services and Goods	579.76	44.98%	15.38%	3,158.53
Production and Sales in General	520.96	40.42%	13.8%	2,838.17
Specific Production and Sales	41.27	3.20%	1.1%	224.83
Public Services	17.54	1.36%	0.5%	95.53
Salaries	334.39	25.94%	8.87%	1,821.77
Employees, Civil Servants, Self-Employed	60.71	4.71%	1.6%	330.75
Employers	261.63	20.30%	6.9%	1,425.36
Other	12.05	0.93%	0.3%	65.65
Income and Capital Gains	240.12	18.63%	6.37%	1,308.18
Families	91.16	7.07%	2.4%	496.66
Companies and Shareholders	148.40	11.51%	3.9%	808.49
Other	0.56	0.04%	0.0%	3.03
Financial Transactions	51.48	3.99%	1.37%	280.48
Assets	45.92	3.56%	1.22%	250.19
International Trade	21.14	1.64%	0.56%	115.15
Other Revenue	16.15	1.25%	0.43%	88.00

Source: Authors' calculations.

Brazil was no different. In 1947, the national tax burden was 13.84 percent of GDP. This result, compared to that in 1978, when the burden reached 25.7 percent of GDP, represents a growth in taxation of almost 100 percent during that period (31 years). The ten-year period between the early 1960s and 1970s is when the Brazilian tax burden accelerated most: in 1962 the burden differed only slightly from that in 1947, at 15.76 percent of GDP. However, in 1972 it reached 26.01 percent of GDP, which represents a relative increase of just over 65 percent during the period (over 10.26 percent of GDP). The growth in the burden in this period coincides, in part, with the Brazilian "economic miracle" (1968/1972)—the period with the greatest economic growth in Brazil's history—which should partly explain the increase in taxation.

Throughout the 1970s, the tax burden remained more or less constant, with few fluctuations. Beginning in the 1980s, coinciding with the global and national economic crisis ("the Lost Decade"), the tax burden became more volatile, but kept its upward trend.

In the 1990s, especially after the implementation of the Real Plan (1994), along with the end of hyperinflation and the return of macroeconomic stability, the tax burden began to resemble the 1960's performance, when growth was steady year after year. In 1999, the last year of the decade, the tax burden approached the milestone of 30 percent of GDP. This trend has continued—to a lesser extent—in the following years, reaching a peak of 35.6 percent of GDP in 2008. Comparing the initial (1947) and final (2010) data, we see an impressive 20.35 percent of GDP increase in Brazil's overall tax burden.

An interesting comparison of the two phases of highest tax burden growth in Brazil (1960s and 1990s) can be seen in Afonso and Meirelles (2006): "... in the past, tax revenue

was highly elastic compared to gross domestic product, i.e., taxation increased when the economy grew, especially when expansion rates were higher. At the turn of the century, the tax burden continued to grow as the economy slowed, and even had low growth rates compared to the post-war period" (Afonso and Meirelles, 2006: 67).

1.3 – Overall Tax Burden in Brazil in 2010

In 2010, the overall gross tax burden reached 34.19 percent of GDP—the fifth highest in the country's history, second only to the tax burden during the 2005–08 period. The tax burden totaled R\$1,289 billion. In per capita terms, this level of taxation represented a burden of R\$7,022.30 for every Brazilian. On average, every Brazilian resident had to work about 125 days a year (365 days) just to pay taxes. Table 1 shows the 2010 tax burden per tax base (source of revenue).

The first aspect of the national tax burden that attracts our attention is its concentration in just a few sources of revenue. The category “Merchandises, Services and Goods,” which represents almost all of Brazilian indirect taxes, accounts for 45 percent of all taxation. This means that approximately 15.38 percent of the national GDP is collected by means of indirect taxes alone. In practice, each resident paid R\$3,158.53 in taxes in 2010, on average, just to consume goods and services.

This is negative for Brazil's socioeconomic environment, as it makes the system unfair and unequal. As the indirect tax is levied, in general, on the value of goods and services, the tax paid is the same for all agents who purchase goods and services. The predominant opinion in the literature on taxation is that, given poor distribution of income and that some agents are less affluent than others, the burden of the tax on goods or services purchased will usually be relatively heavier for some (lower income) agents than for others (with a higher income). This type of tax is what economists call a "regressive tax," precisely because it burdens the poorest most, as a percentage of their income, and the richest least (especially since the former tend to have a higher marginal propensity to consume than the more affluent).⁸

⁸ This dominant opinion on regressive taxation is disputed by some who claim that certain indirect taxes can even be progressive, such as selective taxes (on cars, fuel); A general tax such as the value added tax (VAT) is clearly regressive when it is really levied on the consumer (which may not always be true) and if the poor's propensity to consume is greater than that of the richer (which, again, may not always hold). Additionally,

Taking into account that almost half of the national tax collected is obtained from this type of tax, the Brazilian tax system could also be seen as regressive on some level. The most advanced tax systems are not based predominantly on indirect taxes, but rather on direct taxes, despite a recent growing proportion of indirect taxes in total taxation in those countries, including an increase in rates in many of them (because direct taxes have suffered the effects of the global financial crisis most). There is also the old argument about whether even direct taxes on companies, as in the case of income tax on profits, are eventually passed on to higher prices in the same way as classical indirect taxes. Indeed, the national standardization of accounting recommended by the United Nations makes no distinction between direct and indirect taxes. However, even if one abandons the dichotomy between direct and indirect taxes, a negative peculiarity persists in the Brazilian tax system: the poor quality of domestic taxation on goods and services. This includes the taxation of exports and productive investments; the pro-import bias; enormous complexity; the highest cost of compliance in the world; the unequal incidence on identical taxpayers; the regressive nature already cited; and many other distortions (competitiveness and fairness are topics to be addressed in more depth in Section 7). In this case, the biggest tax reform challenge in Brazil would not be to reduce the amount of indirect taxes (as it would be difficult to reduce the overall tax burden in the short and medium terms), but rather to restructure tax collection so as to cause less side effects on the economy.

The origin of almost 90 percent of the Brazilian tax burden can be seen in the two tax bases listed in the table after “Merchandises, Services and Goods,” While taxation on “Salaries” contributes a little more than 1/4 of the total tax burden (8.87 percent of GDP), tax on “Income and Capital Gains” accounts for 18.6 percent of the total collected, or 6.37 percent of GDP.

The levying of taxes on income reinforces the argument that the Brazilian tax system is regressive. Contributing less than 1/5 of the total, this tax does not represent a large percent of the tax collected for a system that claims to be fair. When added to the other direct tax category (“assets,” at 1.22 percent of GDP), direct taxation accounts for 22.2 percent of the total levied. Once again, the types of taxes that would be fair in terms of distributing wealth have a secondary role in the Brazilian tax system, increasing its distortions. These taxes are usually far more representative in more advanced economies.

throughout a person’s life, the VAT could become progressive because, in old age, the richer tend to consume more than their current income.

The tax bases “financial transactions” (1.37 percent of GDP), “foreign trade” (0.56 percent of GDP) and “other revenues” (0.46 percent of GDP) complete the list of revenue sources by tax base. These three tax bases taken together, which include both indirect and direct taxes, account for less than 7 percent of the total tax burden, and are not very relevant in determining the characteristics of taxation in Brazil.

Another way to look at the tax burden is to group taxes by sphere of government. Or in other words, how much each federal level levies in taxes, before constitutional transfers. Table 2 shows this division.

Table 2
Overall Tax Revenue by Sphere of Government - 2010

	Total Revenues (R\$ Billions)	% of Total Revenues	% GDP	R\$ per capita
Overall	1,288.98	100.00%	34.19%	7,022.32
Federal Government	869.41	67.45%	23.06%	4,736.50
States	341.64	26.50%	9.06%	1,861.23
Municipalities	77.93	6.05%	2.07%	424.58

Source: Authors' calculations.

Note that, despite the decentralization of revenue and of the power to tax promoted by the 1988 Constitution, tax collection in Brazil remains highly concentrated in the Central Government. In 2010 this government tier levied more than 67 percent of the tax revenue, relegating to subnational (state and municipal) governments less than 33 percent of the total. Thus, federal taxation totaled more than 23 percent of GDP in 2010, which meant approximately R\$869.4 billion.

States, even with the country's most important tax—Tax on the Circulation of Goods and the Provision of Communication and Transportation Services (*Imposto sobre Circulação de Mercadorias e Prestação de Serviços de Comunicação e de Transporte*, or ICMS)—collected much less than the Federal Government: just over 9 percent of GDP, or approximately R\$341 billion. Municipalities also had much lower revenues, representing 2.07 percent of GDP (nearly R\$78 billion). The weak fiscal decentralization seen in respect to own revenues is partially reversed when the revenues available to each sphere of government is analyzed. That is, after the constitutional transfers between the Union and subnational governments, one can see a more effective participation of state and especially municipal governments. This subject will be discussed in Chapter 6.

BOX 1 – COMPARISON OF TAX BURDEN ANALYSIS METHODOLOGIES, IN NUMBERS

As presented in the methodology section of this study, the tax burden calculation, even though a simple ratio, may differ significantly from one institution to another depending on the choice of data sources and concepts one wishes to address. The method used here, called the "broad approach," is historically at odds with the official figures, whether released by the RFB or the IBGE. Usually, by considering every mandatory sum collected a tax for the purpose of calculating the tax burden, the "broad approach" results in a higher calculated tax burden than that of other official institutions, as can be seen in Table 3.

The "broad approach" calculation results in a burden higher than that calculated by the IBGE since 1995, the first year for which calculations were done. This pattern only becomes apparent when comparing the "broad approach" with the RFB numbers beginning in 2000. Before that year the two methodologies traded back and forth, with the RFB tax burden greater in 1995, 1998 and 1999, and the "broad approach" calculating a greater tax burden in 1996 and 1997. More important than looking at the tax burden size of the different methodologies is to note the evolution of the tax burden over the years and, consequently, if all the methods reflect its changes. In this sense, there is a good deal of consistency between the calculations of the two official institutions and the "broad approach," considering that the direction of the changes (marked by red and green arrows) is almost always the same. In the comparison with the IBGE, there was a divergence on the direction of the change in the load only in 1996, with the institution indication growth (of 0.38 percent of GDP) and the "broad approach" indicating retraction (of 0.09 percent of GDP). However, in the comparison with the RFB, the divergence occurs in the years 2006, 2008 and 2010, although in the last year, despite the opposing directions in the change, there was very little alteration in tax burden compared to 2009 (+0.01 percent of GDP in the "broad approach" and -0.02 percent of GDP in the RFB's calculation), revealing the consistency of the data. The consistency of the tax burden calculated by the methodology used in this study can also be seen from a breakdown of the 2010 tax burden calculated by the RFB, as shown in Table 4.

Table 3
Overall Tax Burden: Comparison between Methodologies - 1995-2010

Year	Broad Approach		RFB		IBGE	
	% of GDP	Change	% of GDP	Change	% of GDP	Change
1995	26.93	-	27.26	-	26.05	-
1996	26.85	-0.09	26.74	-0.52	26.42	0.38
1997	27.41	0.56	26.92	0.18	26.50	0.08
1998	27.67	0.26	27.76	0.84	27.38	0.88
1999	29.00	1.33	29.02	1.26	28.41	1.03
2000	31.15	2.15	30.34	1.32	29.51	1.10
2001	32.33	1.18	31.23	0.88	30.72	1.21
2002	33.37	1.04	32.36	1.13	31.77	1.05
2003	32.82	-0.54	31.95	-0.41	31.14	-0.64
2004	33.69	0.87	32.65	0.70	-	-
2005	34.95	1.25	33.72	1.07	-	-
2006	34.79	-0.15	34.04	0.32	-	-
2007	35.35	0.56	34.72	0.68	-	-
2008	35.60	0.26	34.41	-0.31	-	-
2009	34.18	-1.42	33.58	-0.83	-	-
2010	34.19	0.01	33.56	-0.02	-	-

Source: Authors, RFB and IBGE.

Table 4
Overall Tax Burden: Comparison between Methodologies - 2010

	Broad Approach	RFB
Overall	34.19%	33.56%
Tax Base		
Merchandises, Services and Goods	15.38%	15.73%
Salaries	8.87%	8.78%
Income and Capital Gains	6.37%	6.18%
Financial Transactions	1.37%	0.72%
Assets	1.22%	1.18%
International Trade	0.56%	0.57%
Other Revenue	0.43%	0.41%
Government Sphere		
Federal Government	23.06%	23.46%
States	9.06%	8.47%
Municipalities	2.07%	1.63%

Source: Authors calculations and RFB.

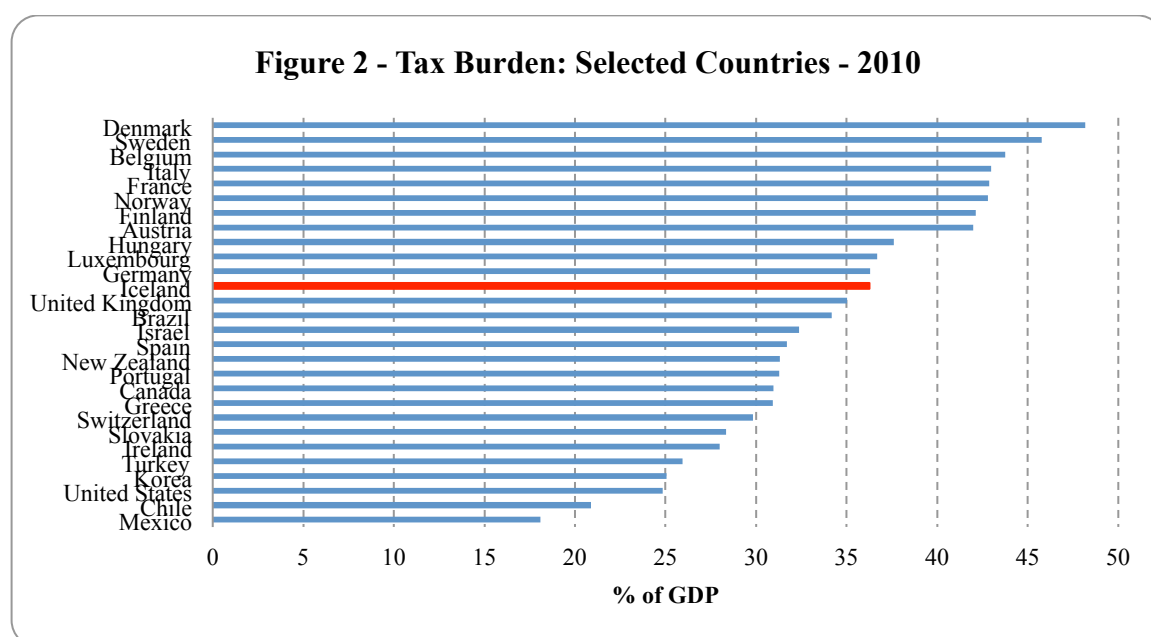
Based on the two manners of computing the tax burden (tax base and sphere of government), one can see considerable similarity in the distributions of the two methodologies. In the RFB's calculation, the tax base "Merchandises, Services and Goods" represents 46.9 percent of the total (15.73 percent of GDP), while in the calculation using the "broad approach," this percentage is approximately 45 percent of the total (15.38 percent of GDP). The consistency of the numbers reveals that the official calculation also shows that there is a large concentration of indirect taxes—even higher than using the "broad approach" —which reinforces the contention that the Brazilian tax system is extremely distorted (unfair and anti-competitive). This supposition is corroborated by comparing the two largest tax bases: 26.1 percent of the RFB's tax burden (8.78 percent of GDP) is from the "Salaries" tax base, while our approach gives this percentage as 25.9 percent of the total (8.87 percent of GDP); only 18.4 percent of all taxes calculated by the RFB (6.18 percent of GDP) come from "Income and Capital Gains," a result similar to the 18.6 percent (6.37 percent of GDP) calculated using our methodology. Comparing the data by sphere of government, official data show a level of tax centralization slightly higher than that calculated using the "broad approach," despite the similarity in figures. While in our methodology the Union collects 67.5 percent of direct revenue (23 percent of GDP) and municipalities collect more than 6 percent of the total (2 percent of GDP), the RFB's figures show that the Union collects 70 percent of the total (23.5 percent of GDP) and the municipalities collect less than 5 percent of all general or consolidated Government revenues (1.6 percent of GDP).

Despite the consistency between the two methods with regard to the distribution among different tax bases and levels of government, some of the primary data used in the two cases diverges in a manner that should be mentioned. The differences in the figures released by the two institutions for income tax and the Manufactured Goods Tax (*Imposto sobre Produtos Industrializados*, or IPI) are the principal discrepancies that attract our attention. We would expect differences between the two published figures given that, in the case of STN data, refunds and tax incentives are subtracted from the tax collected. In the same direction, a recent decision has led to deposits made in relation to judicial proceedings being made into federal accounts, and they are included in RFB calculations, but perhaps cannot be counted as current revenue by the STN. Regardless, it seems that these factors do not explain the large difference: in 2010, for example, the RFB reported collecting R\$18 billion more in income tax than accounted for by STN.

After this discrepancy was noted, a new tax burden calculation was performed using the RFB's figures for income tax and the IPI. If the RFB's data just for income tax and the IPI is used, the 2010 tax burden would grow significantly: from 34.19 percent to 34.73 percent of GDP, an increase of 0.54 percent of GDP, with 0.47 percent due to income tax and the other 0.07 percent due to the IPI.

1.4 - International Comparisons

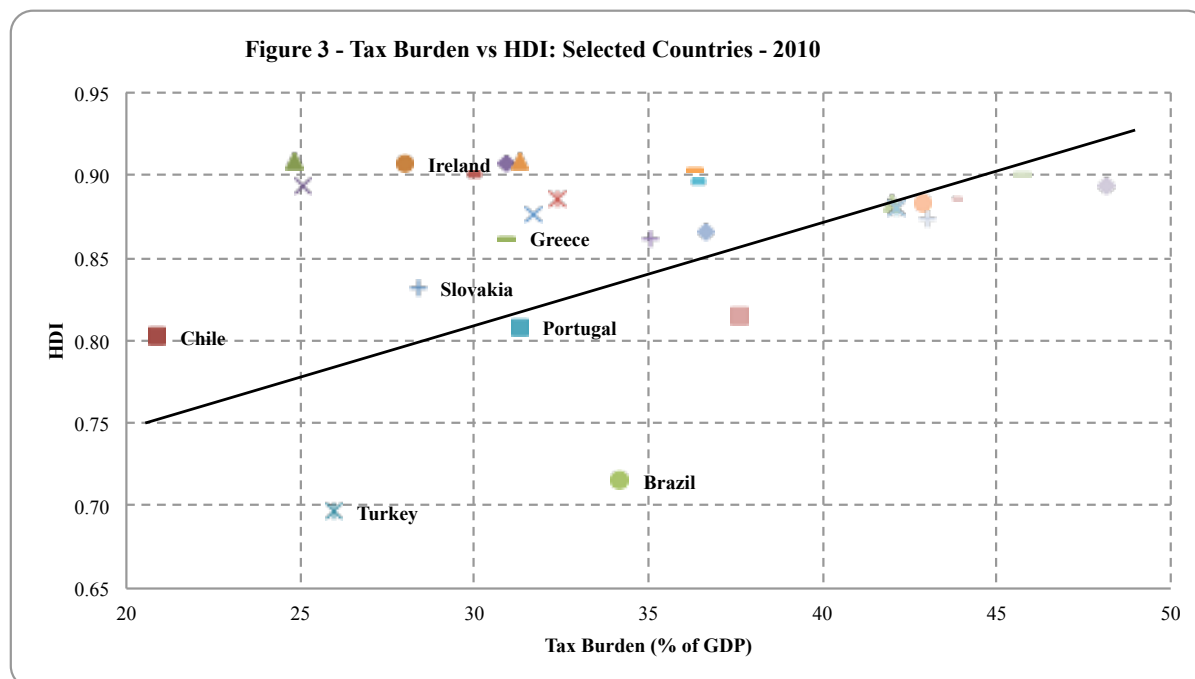
In Brazil, it is commonly asked if the tax burden is appropriate given the country socioeconomic profile. Most public finance experts believe the tax burden is excessive and incompatible with Brazil's level of development. In fact, the Brazilian tax burden is very similar to that of more developed countries, especially those in Western Europe, where government spending on social protection programs is high (within the scope of the welfare state). Figure 2, drawn from OECD data, compares the tax burdens of selected countries in 2010.



Source: OECD.

Note that the Brazilian tax burden in 2010 (34.19 percent of GDP) is very close to that in the UK (35 percent of GDP) and Israel (32.4 percent of GDP). Many other developed countries appear in the chart below Brazil, such as Spain (31.7 percent of GDP), Canada (30.9 percent of GDP), Switzerland (29.8 percent of GDP), Korea (25 percent of GDP) and USA (24.8 percent of GDP). Note that developing countries, in general, have a much lower level of taxation than Brazil. This is the case of Brazil's neighbors: Mexico (18.7 percent of GDP) and Chile (20.9 percent of GDP). Turkey (26 percent of GDP) and Slovakia (28.3 percent of GDP) are other examples of countries with development levels similar to that of Brazil, but with a much lower tax burden. A comparison of tax burden should not be limited

to the group of countries to which Brazil does compare. The level of development versus the tax burden of individual countries can be seen in Figure 3, for comparison.



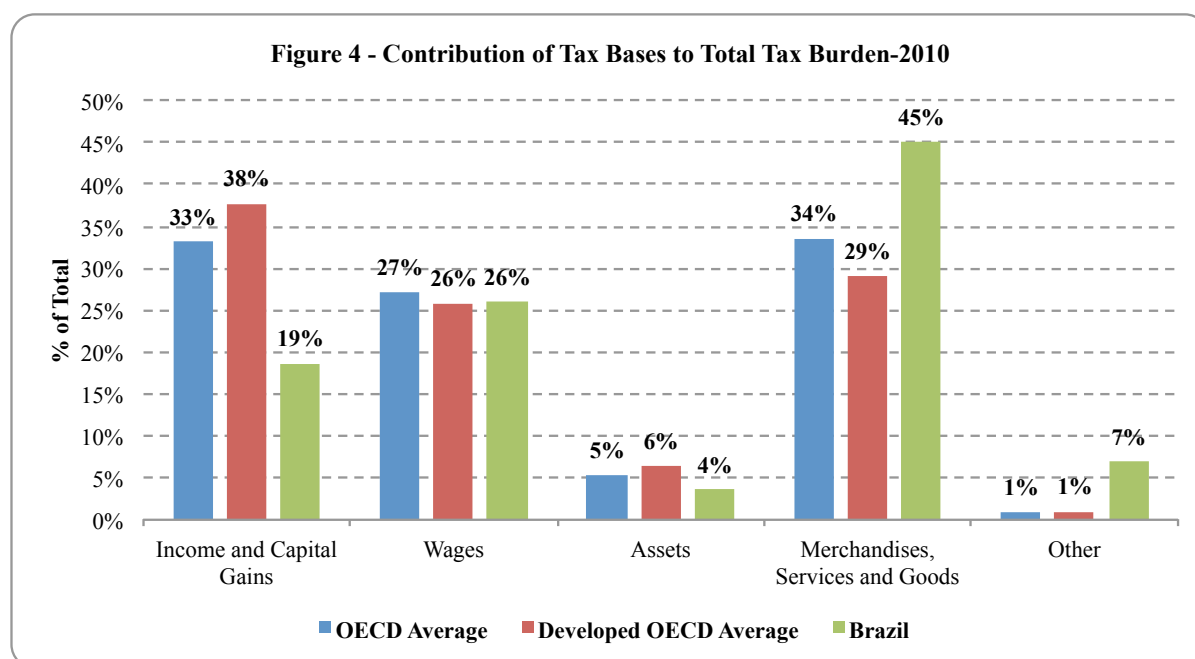
Source: Authors' calculations and UN.

By plotting Human Development Index (HDI), as a proxy for development, against tax burden, one notes that Brazil's position is lower than that of the other countries. In this sample, the only country with a HDI similar to that of Brazil is Turkey, whose tax burden is significantly lower. Chile⁹ is the most notable case, as its tax burden is low, while its HDI is high (the greatest in South America), on the order of 0.805. Another interesting fact is that all the countries in the sample with a tax burden higher than that of Brazil also have a much higher HDI. It is important to stress the limitation of this comparison: the HDI was taken as a proxy for development because there is no other better indicator that measures the level of government spending on activities that actually benefit the population and the economy of the country, such as spending on health, education, social protection, infrastructure, housing, sanitation, etc.

The comparison of tax burden versus development has limitations with regard to the structure of the tax burden. When discussing the 2010 Brazilian tax burden, we mentioned some characteristics common to taxation in more advanced countries, such as a larger share

⁹ It is important to note that the Chilean pension system is mainly operated by the private sector (Amaro, 2000), which greatly reduces the need for tax collection from the public sector in that country.

of direct taxes ("Income and Capital Gains" and "Assets") and smaller share of indirect taxes ("Merchandises, Services and Goods"). Figure 4 provides a comparison of the contribution of each tax base in the composition of the tax burden in Brazil, the OECD countries and the Developed OECD countries.



Source: Authors' calculations and OECD.

For the three "groups" compared, Brazil has a much lower level of taxation on "Income and Capital Gains": 19 percent of the total. The OECD average is 33 percent and the Developed OECD countries average 38 percent—twice as much as in Brazil. This striking feature is key to understanding why taxation is unfair in Brazil, from a distributive perspective, especially when compared with the taxation of countries that have much better income distribution than Brazil. Another element in the direct tax group, which contributes to tax fairness, is the tax base "Assets." In this case, Brazil also taxes this item less than the two other groups of countries: 4 percent of the Brazilian tax burden is composed of this kind of tax, while the OECD average and the average of the developed OECD countries is 5 percent and 6 percent respectively.

At the same time, revenues from "Merchandises, Services and Goods" are very high in Brazil compared to the other two groups of countries. Approximately 45 percent of total national tax revenues came from this tax base, while the OECD average is 34 percent. The average of the Developed OECD countries is even lower (29 percent), reinforcing the better

quality of their taxation systems, in terms of fairness, compared to the Brazil tax system. There is not even evidence that the Brazilian tax system, despite being less fair and progressive, is more neutral than those of the OECD countries because of a larger amount of revenue is coming from indirect taxes. This is because indirect taxes in Brazil are often cumulative, differentiated (by tax regimes and sectors) and highly complex. Thus, the system, which might be economically more efficient, in fact causes large distortions in resource allocation.

The other two tax bases shown in Figure 4 ("Salaries" and "Other") can be summarized as follows. In the first, when the resources come from payroll, the situation is almost identical in Brazil and the two groups, as the share of the total is almost the same in the three cases—around 26 percent of the total. In the case of "Other" taxes, Brazil's is almost 7 percent of the total, whereas they represent barely 1 percent of the total in the other two groups. Brazil's relatively high percentage is composed mainly of taxes on "financial transactions" and "international trade," which could easily be included in the indirect tax group ("Merchandises, Goods and Services"), further emphasizing Brazil's dependence on this type of tax and its deficient tax system.

BOX 2 - BRAZILIAN TAX BURDEN ACCORDING TO THE IMF CLASSIFICATION

The International Monetary Fund (IMF) has its own classification methodology for government statistics (IMF, 2001), such as revenues, expenses, balance of payments, public debt, etc. The completeness of its manual makes it a good tool for analysts and scholars examining specific areas of government operations, including specific information on forms of taxation. Thus, adopting the criteria in this manual allows comparison of tax burden structures between countries. Table 5 shows the overall tax burden in Brazil in 2010, classified according to the precepts contained in the IMF handbook. When adopting the IMF criteria, the composition of the tax burden significantly differs from what is presented in the next chapters. This is especially due to the reclassification of several (social and economic) contributions—that from a legal standpoint, as taxes, differ from traditional taxes in several ways. This is the case for the Social Contribution on Net Income (*Contribuição Social sobre Lucro Líquido*, or CSLL), classified as corporate income tax (code 1.1.1.2), and the Contribution for the Financing of the Social Security (*Contribuição para o Financiamento da Seguridade Social*, or COFINS) and the Social Integration Program Contribution (*Contribuição para o Programa de Integração Social*, or PIS) / Contribution to the Civil Servant's Asset Formation Program (*Contribuição para o Programa de Formação do Patrimônio do Servidor Público*, or PASEP) classified as sales taxes (Code 1.1.4.1.2). Moreover, the tax base classification proposed in this document differs from the classification developed by the IMF. Taxes on financial transactions, for example, do not even appear in the IMF table—indeed, the Financial Operations Tax (*Imposto sobre Operações Financeiras*, or IOF) is classified as a tax on specific services (code 1.1.4.4). Regardless, the aggregated revenue results by revenue source in our classification do not differ very much from those calculated using the IMF classification. The best example of this is taken from indirect taxes (goods and services): while in the IMF classification they represent 46.8 percent of the total tax burden, in this study they are about 45 percent of the total.

Table 5 - Overall Tax Burden in Brazil using IMF classification - 2010

Type of Tax	Revenues (R\$ Billions)	% of Total	% of GDP	R\$ per capita
1.1 - Taxes	976.74	75.78%	25.91%	5,321.27
1.1.1 - Taxes on Income, Profits and Capital Gains	265.00	20.56%	7.03%	1,443.74
1.1.1.1 - On Individuals	17.30	1.34%	0.46%	94.24
1.1.1.2 - On Legal Entities	130.82	10.15%	3.47%	712.68
1.1.1.3 - Other	116.89	9.07%	3.10%	636.81
1.1.2 - Taxes on Payroll and Workforce	22.16	1.72%	0.59%	120.73
1.1.3 - Taxes on Property	45.95	3.56%	1.22%	250.32
1.1.3.1 - Recurring Taxes on Real Estate	16.56	1.29%	0.44%	90.24
1.1.3.2 - Recurring Taxes on Net Wealth	0.00	0.00%	0.00%	0.00
1.1.3.3 - Taxes on Estates, Inheritances and Donations	7.94	0.62%	0.21%	43.25
1.1.3.4 - Taxes on Financial Transactions and Capital	0.02	0.00%	0.00%	0.13
1.1.3.5 - Other Non-Recurring Taxes on Property	0.14	0.01%	0.00%	0.78
1.1.3.6 - Other Recurring Taxes on Property	21.28	1.65%	0.56%	115.92
1.1.4 - Taxes on Goods and Services	603.15	46.79%	16.00%	3,285.93
1.1.4.1 - General Taxes on Goods and Services	517.75	40.17%	13.73%	2,820.72
1.1.4.1.1 - Value Added Taxes	332.74	25.81%	8.83%	1,812.74
1.1.4.1.2 - Sales Taxes	185.02	14.35%	4.91%	1,007.97
1.1.4.1.3 - Other General Taxes on Goods and Services	0.00	0.00%	0.00%	0.00
1.1.4.2 - Excise Taxes	28.51	2.21%	0.76%	155.32
1.1.4.3 - Profits from Tax Monopolies	0.00	0.00%	0.00%	0.00
1.1.4.4 - Taxes on Specific Services	26.58	2.06%	0.70%	144.79
1.1.4.5 - Taxes on the Use of Goods and on Permission to Carry Out Activities	30.31	2.35%	0.80%	165.11
1.1.4.5.1 - Taxes on Vehicles	2.83	0.22%	0.08%	15.42
1.1.4.5.2 - Other Taxes on the Use of Goods and on Permission	27.48	2.13%	0.73%	149.69
1.1.4.6 - Other Taxes on Goods and Services	0.00	0.00%	0.00%	0.00
1.1.5 - Taxes on International Trade and Transactions	21.14	1.64%	0.56%	115.15
1.1.5.1 - Customs and Other Taxes on Imports	21.09	1.64%	0.56%	114.92
1.1.5.2 - Export Taxes	0.04	0.00%	0.00%	0.24
1.1.5.4 - Export and Import Monopoly Profits	0.00	0.00%	0.00%	0.00
1.1.5.4 - Exchange Transaction Profits	0.00	0.00%	0.00%	0.00
1.1.5.5 - Taxes on Exchange Transactions	0.00	0.00%	0.00%	0.00
1.1.5.6 - Other Taxes on International Trade and Transactions	0.00	0.00%	0.00%	0.00
1.1.6 - Other Taxes	19.34	1.50%	0.51%	105.39
1.1.6.1 - Only Legal Entities	0.00	0.00%	0.00%	0.00
1.1.6.2 - Individuals or Unidentifiable	19.34	1.50%	0.51%	105.39
1.2 - Social Contributions	312.24	24.22%	8.28%	1,701.06
1.2.1 - Social Security Contributions	213.30	16.55%	5.66%	1,162.08
1.2.1.1 - Workers	42.30	3.28%	1.12%	230.47
1.2.1.2 - Employers	94.82	7.36%	2.52%	516.58
1.2.1.3 - Sole Proprietors or Unemployed	2.99	0.23%	0.08%	16.29
1.2.1.4 - Not Allocatable	73.19	5.68%	1.94%	398.74
1.2.2 - Other Social Contributions	98.93	7.68%	2.62%	538.98
1.2.2.1 - Workers	15.42	1.20%	0.41%	84.00
1.2.2.2 - Employers	83.51	6.48%	2.22%	454.95
1.2.2.3 - Imputed	0.01	0.00%	0.00%	0.03
1.3 - Donations	0.00	0.00%	0.00%	0.00
1.3.1 - From Foreign Governments	0.00	0.00%	0.00%	0.00
1.3.1.1 - Current	0.00	0.00%	0.00%	0.00
1.3.1.2 - Capital	0.00	0.00%	0.00%	0.00
1.3.2 - From Foreign Organizations	0.00	0.00%	0.00%	0.00
1.3.2.1 - Current	0.00	0.00%	0.00%	0.00
1.3.2.2 - Capital	0.00	0.00%	0.00%	0.00
1.3.3 - From Other Government Units	0.00	0.00%	0.00%	0.00
1.3.3.1 - Current	0.00	0.00%	0.00%	0.00
1.3.3.2 - Capital	0.00	0.00%	0.00%	0.00
1.4 - Other Revenue	0.00	0.00%	0.00%	0.00
1.4.1 - Income from Assets	0.00	0.00%	0.00%	0.00
1.4.1.1 - Interest	0.00	0.00%	0.00%	0.00
1.4.1.2 - Dividends	0.00	0.00%	0.00%	0.00
1.4.1.3 - Withdrawals of Income from Mixed Companies	0.00	0.00%	0.00%	0.00
1.4.1.4 - Income from Assets Attributed to Insurance	0.00	0.00%	0.00%	0.00
1.4.1.5 - Rents	0.00	0.00%	0.00%	0.00
1.4.2 - Sale of Goods and Services	0.00	0.00%	0.00%	0.00
1.4.2.1 - Sales by Commercial Establishments	0.00	0.00%	0.00%	0.00
1.4.2.2 - Administration Fees	0.00	0.00%	0.00%	0.00
1.4.2.3 - Sales by Non-Commercial Establishments	0.00	0.00%	0.00%	0.00
1.4.2.4 - Sale of Imputed Goods and Services	0.00	0.00%	0.00%	0.00
1.4.3 - Fines and Penalties	0.00	0.00%	0.00%	0.00
1.4.4 - Voluntary Transfers other than Donations	0.00	0.00%	0.00%	0.00
1.4.4.1 - Current	0.00	0.00%	0.00%	0.00
1.4.4.2 - Capital	0.00	0.00%	0.00%	0.00
1.4.5 - Unidentified Revenue	0.00	0.00%	0.00%	0.00
Total	1,288.98	100.00%	34.19%	7,022.32

Source: Authors calculations.

2 – MERCHANDISES, GOODS AND SERVICES

This chapter will address the portion of the Brazilian tax burden related to taxation on the circulation and sale of goods and services. The information presented below is key to understanding the national tax system, given its large share of the overall burden.

The levying of tax on merchandises, services and goods amounted, in 2010, to R\$ 579.76 billion, representing 45 percent of all taxes and approximately 15.4 percent of GDP that year. In per capita terms, this represented a burden of R\$ 3,158.53. The detailed data for this tax base is presented in Table 6.

Table 6
Tax Revenue from Merchandises, Services and Goods - 2010

	Revenues (R\$ Billions)	Fines and Interest (R\$ Billions)	Total (R\$ Billions)	% of Total	% of GDP	R\$ per capita
Merchandises, Services and Goods	576.07	3.69	579.76	100.00%	15.38%	3,158.53
Production and Sales in General	517.27	3.69	520.96	89.86%	13.82%	2,838.17
ICMS	264.75	0.00	264.75	45.66%	7.02%	1,442.33
IPI	37.26	0.30	37.55	6.48%	1.00%	204.59
ISS	30.44	0.00	30.44	5.25%	0.81%	165.82
Cofins	138.64	2.60	141.23	24.36%	3.75%	769.44
PIS/PASEP	40.01	0.79	40.79	7.04%	1.08%	222.24
Economic Contributions - Other (Federal)	2.50	0.01	2.50	0.43%	0.07%	13.64
Economic Contributions - Other (States)	0.69	0.00	0.69	0.12%	0.02%	3.74
Economic Contributions - Other (Municipalities)	3.00	0.00	3.00	0.52%	0.08%	16.36
Specific Production and Sales	41.27	0.00	41.27	7.12%	1.09%	224.83
CIDE	7.76	0.00	7.76	1.34%	0.21%	42.27
Stamps	0.21	0.00	0.21	0.04%	0.01%	1.16
DPVAT	2.83	0.00	2.83	0.49%	0.08%	15.42
Oil and Natural Gas Royalties	21.45	0.00	21.45	3.70%	0.57%	116.85
Other Royalties	3.63	0.00	3.63	0.63%	0.10%	19.76
Contributions - Technology, Telecommunications and IT	2.40	0.00	2.40	0.41%	0.06%	13.08
Fees - Telecommunications	2.99	0.00	2.99	0.52%	0.08%	16.29
Public Services	17.53	0.00	17.54	3.02%	0.47%	95.53
Services	12.63	0.00	12.63	2.18%	0.34%	68.82
<i>Services (Federal)</i>	<i>1.91</i>	<i>0.00</i>	<i>1.91</i>	<i>0.33%</i>	<i>0.05%</i>	<i>10.42</i>
<i>Services (States)</i>	<i>8.15</i>	<i>0.00</i>	<i>8.15</i>	<i>1.41%</i>	<i>0.22%</i>	<i>44.40</i>
<i>Services (Municipalities)</i>	<i>2.57</i>	<i>0.00</i>	<i>2.57</i>	<i>0.44%</i>	<i>0.07%</i>	<i>14.00</i>
Police Power	4.90	0.00	4.90	0.85%	0.13%	26.71
<i>Police Power (Federal)</i>	<i>1.02</i>	<i>0.00</i>	<i>1.02</i>	<i>0.18%</i>	<i>0.03%</i>	<i>5.58</i>
<i>Police Power (States)</i>	<i>2.28</i>	<i>0.00</i>	<i>2.28</i>	<i>0.39%</i>	<i>0.06%</i>	<i>12.42</i>
<i>Police Power (Municipalities)</i>	<i>1.60</i>	<i>0.00</i>	<i>1.60</i>	<i>0.28%</i>	<i>0.04%</i>	<i>8.71</i>

Source: Authors calculations.

2.1 - Production and Sales in General

Nearly 90 percent of all revenue based on merchandises, services and goods come from taxes on "production and sales in general." This item includes some of the most important Brazilian taxes: ICMS, COFINS, PIS/ PASEP, IPI and the Municipal Services Tax (*Imposto sobre Serviços*, or ISS). These taxes will be described in detail below.

ICMS

- Levied by: States and Federal District
- Type: Tax
- Background: Established initially as the Tax on the Circulation of Goods (imposto sobre a Circulação de Mercadorias, or ICM) by Constitutional Amendment No. 18 of December

1, 1965 (to the 1946 Constitution), and subsequently converted into ICMS, by Art. 155(II) of the 1988 Constitution. It was regulated by Supplemental Law No. 87 of September 13, 1996 (the "Kandir Law").

- Rate: The rates, established by the States and the Federal District, are summarized in Table 7. Note that there are several exceptions, which generally vary with the essentiality of the good.

Table 7
ICMS Rates by State/Federal District by Origin/Destination

		FCMS Rates by State/Federal District by Origin/Destination																												
		Origin																												
		North							Northeast							Midwest				Southeast				South						
		AC	AM	AP	PA	RO	RR	TO	AL	BA	CE	MA	PB	PE	PI	RN	SE	DF	GO	MT	MS	ES	MG	RJ	SP	PR	RS	SC		
Destination	North	AC	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		AM	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		AP	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7
		PA	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7
		RO	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7
		RR	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7
	TO	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
	Northeast	AL	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		BA	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		CE	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		MA	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		PB	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		PE	12	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	7	7	7	7	7	7	
		PI	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	7	7	7	7	7	7	
		RN	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	7	7	7	7	7	7	
	SE	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	7	7	7	7	7	7		
	Midwest	DF	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	
		GO	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	12	7	7	7	7	7	
		MT	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	12	12	7	7	7	7	7	
		MS	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	7	7	7	7	7	7	
	Southeast	ES	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	7	7	7	7	7	7	
		MG	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	18	12	12	12	12	12	
		RJ	12	12	12	12	12	17	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	18	12	12	12	12	
		SP	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	18	12	12	12	
	South	PR	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	18	12	12	
		RS	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	12	
		SC	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	12	17	

Source: Authors calculations.

Notes: The ICMS rate for interstate sales shown in the table are those applied to transactions between ICMS taxpayers. When the recipient is not a taxpayer, final consumer, the internal rate is applied to the interstate transaction..

- Tax base: Cost of the transaction (cost of good + cost of freight + cost of accessory expenses) to the purchaser.
- Revenue in 2010: R\$264.7 billion, equivalent to 7 percent of GDP, or R\$ 1,442.30 per capita.
- Comments: The principal tax instrument of States and the Federal District (and the main tax in the country in terms of revenue) is characterized by varying rates, determined independently under the laws of each state. In the case of interstate transactions, the amount collected is shared by the producer's state (origin) and consumer's state (destination). Exceptions to this rule are oil (and its derivatives) and electrical power. In these cases, ICMS is collected only by the consumer's state. When the ICMS (ICM at the time) was established in 1967, the rate was uniform throughout the country and set at 15

percent, even for interstate operations and exports. Despite the possibility of changing tax rates through state laws, this was "discouraged" by the Federal Government, reducing the tax war. The best example of this was the creation of the National Council of Financial Policy (*Conselho Nacional de Política Fazendária*, or CONFAZ) in 1975 with the aim of harmonizing standards and procedures inherent to state taxation. The 1988 Constitution, however, granted States the authority to set rates on internal transactions. The Kandir Law (1996), which regulates the ICMS, exempted all export transactions (including primary exports), granted immediate credit for taxes paid upon purchase of capital goods and provided a credit for the tax on inputs not embodied in the good produced ("bens de uso e consume") starting in 1998. However, legislative changes led to the first credit being appropriated during a period of 48 months and the second credit taking effect only in 2020.

COFINS

- Levied by: Federal Government
- Type: Social Contribution
- Background: Created by Decree-Law No. 1,940 of May 25, 1982 as *Finsocial* and converted into COFINS by Supplemental Law No. 70 of December 30, 1991.
- Rate: 7.6 percent (noncumulative) and 3 percent (cumulative).
- Tax base: Turnover.
- Revenue in 2010: R\$141.2 billion, equivalent to 3.7 percent of GDP, or R\$769.40 per capita.
- Comments: COFINS is an important federal social contribution, with two main tax regimes: cumulative, for companies who declare income tax based on presumptive profit, or those or those assessed by the special tax regime for small and micro taxpayers (SIMPLES); and noncumulative, for companies who declare income tax on real profit. There are also several exception schemes for specific sectors.

PIS/PASEP

- Levied by: Federal Government
- Type: Social Contribution

- Background: PIS was created by Supplemental Law No. 7 of September 7, 1970. PASEP was created by Supplemental Law No. 8 of December 3, 1970. The legislation for the contributions was unified by Supplemental Law No. 26 of September 11, 1975.
- Rate: 1.65 percent (noncumulative) and 0.65 percent (cumulative).
- Tax base: Turnover.
- Revenue in 2010: R\$40.8 billion, equivalent to 1.1 percent of GDP, or R\$222.20 per capita.
- Comments: In terms of revenues, the amounts collected through PIS/PASEP are smaller than through COFINS. However, it is similar to the latter in several ways: tax base, the existence of two principal tax regimes and the existence of various exceptions.

BOX 3 - COFINS and PIS/PASEP: RECENT REFORMS

The creation of the social contributions COFINS (1982) and PIS/PASEP (1970) can be considered a resumption of cumulative taxation in Brazil after the successful tax reform of 1967, which definitively implemented the value added tax (VAT) in Brazil. The increasing share of these two revenue sources, especially in the 1990s, began to draw attention to them and the need for changes in the legislation governing them. In 2002 and 2003, the Federal Government was able to approve these changes in the PIS/PASEP and COFINS laws, respectively. The basic objective was to reduce the cumulative nature of these taxes, thus reducing the distortions caused by the lack of neutral taxation; in other words, to transform these contributions into legitimate VATs. However, the results were not satisfactory from the standpoint of economic efficiency. Both contributions remained based on turnover, and two basic contribution schemes were created: a noncumulative one and another, which continued to be cumulative. The first is only for companies who choose or are required to pay corporate income tax on real profits. In this case, the rates were increased to 7.6 percent for COFINS and 1.65 percent for PIS/PASEP. The second is only for companies who choose to pay corporate income tax on presumptive profits and companies entitled to pay taxes under the SIMPLES regime. The rates for contributions under this scheme remained the same: 3 percent for COFINS and 0.65 percent for PIS/PASEP. According to Afonso and Araújo (2004), the main criticisms of the reform were: cumulative contributions remained; legislation more complex; excessive increase in the rate in the noncumulative regime, and low Government concern about resolving tax distortions (or high Government interest in maintaining the amount collected).

IPI

- Levied by: Federal Government
- Type: Tax

- Background: Established by Constitutional Amendment No. 18 of December 1, 1965 (to the 1946 Constitution).
- Rate: Variable according to the IPI table, published annually.
- Tax base: For domestic transactions, the value of the product as it leaves the industrial facilities, and in the case of importation, the value used as the customs duties base, plus the customs duties paid or to be paid by the importer.
- Revenue in 2010: R\$37.6 billion, equivalent to 1 percent of GDP, or R\$204.60 per capita.
- Comments: This tax is levied on selected products (according to their essentiality) and is not cumulative, as established in the 1988 Constitution.

BOX 4 — THE IPI AS AN INSTRUMENT OF FISCAL POLICY

The U.S. subprime crisis, beginning in early 2007 and peaking in September 2008 (Lehman Brother's bankruptcy), led to an economic recession in much of the world. Brazil was no different. The effects of this crisis were felt by the Brazilian economy since the start, reducing the flow of international trade and creating abrupt alterations in the exchange rate. The Brazilian government adopted countercyclical measures to address the problems arising from the crisis through both monetary and fiscal policy. In the latter case, the IPI was one of the instruments the government used. Reductions in tax rates and even tax exemptions were established in sectors such as automotive, appliances, furniture and construction. The purpose of the measures is to support domestic demand (consumption by families), sustaining GDP growth. Despite this and other measures, in 2009 the Brazilian GDP decreased slightly (-0.3 percent), indicating that domestic policies were not sufficient to counteract the impact of the crisis in Brazil.

ISS

- Levied by: Municipalities and the Federal District
- Type: Tax
- Background: Established by Constitutional Amendment No. 18 of December 1, 1965 (to the 1946 Constitution). Provided for in the 1988 Constitution, it is currently regulated by Supplemental Law No. 116 of July 31, 2003.
- Rate: Established by the Municipalities and the Federal District, in the range 2 to 5 percent.
- Tax base: Price of the service.
- Revenue in 2010: R\$30.4 billion, equivalent to 0.8 percent of GDP, or R\$165.80 per capita.

- Comments: This tax ensures larger sums are collected by municipalities, especially those with more robust economies. Just to give an indication of its importance, in 2010 ISS represented more than a quarter of the revenue of the city of São Paulo. A controversial aspect of the ISS is its conflict of jurisdiction with the ICMS. Until Supplemental Law No. 116 of August 1, 2003 the interpretation of which tax to collect on services was unclear, since the ICMS is also levied on some services, giving rise to double taxation. However, since the enactment of this law, a list of activities to which either ICMS or ISS applies has made interpretation less ambiguous. Additionally, in all cases where the activity is not on the list, ISS is levied. Another striking feature of ISS is its cumulative nature. According to Medeiros Neto (2001), the ISS is cumulative when, for example, one company provides services to another service provider. Since companies may not deduct the ISS paid in the next step, as is possible with the ICMS, the ISS is a cumulative tax. This problem has been pointed out by experts in public finance for a long time, and they have even submitted proposals for replacing the tax. Ferreira (2001) and Ministry of Finance (*Ministério da Fazenda*) (2007) are just two examples that propose replacing the ISS with a Retail Sales Tax.

BOX 5 – THE ISS TAX WAR

The ICMS is always present when the tax wars discussion arise in Brazil. In fact, it is the subject of the biggest national tax dispute in Brazil, which will be a prominent theme in Chapter 7. However, the ISS should be mentioned when addressing the issue at the local (municipal) level, especially in metropolitan areas. Various economically underprivileged municipalities have profited from the ISS tax waiver (reduction in the rate or tax base) to attract companies in the service sector; this tends to occur more often in large urban centers (Soares, 2011). The idea is to have these companies establish their offices in their cities, to stimulate development of the local economy. However, what occurs in practice is that companies install small offices in the smaller cities, but undertake virtually no activities there. They actually carry out their activities in the larger city, where the tax (and oversight) is normally much higher. The company that pays less tax, is less supervised, and operates in a more dynamic area wins. Both cities lose: the smaller where the company is officially located and the larger where the company operates. In the first case, it is because the city neither collects taxes nor spurs local development; and the second because it fails to collect tax on operations taking place in the area under its jurisdiction.

2.2 — Specific Production and Sales and Public Services

In 2010, the taxes levied on "specific production and sales" and on "public services" represented approximately 10 percent of all taxes collected on merchandises, services and

goods. The Contribution for Intervention in the Economic Domain (Contribuição de Intervenção no Domínio Econômico, or CIDE) and royalties from oil and natural gas, which are described later, are the principal sources of revenue in this classification.

CIDE

- Levied by: Federal Government
- Type: Economic Contribution
- Background: Established by Law No. 10,336 of December 19, 2001.
- Rates:
 - a) gasoline and its components, including those which, due to their characteristics, may alternatively be used for the formulation of diesel, R\$501.10 per m³;
 - b) diesel and its components that, due to their characteristics, are exclusively used for the formulation of diesel, R\$157.80 per m³;
 - c) jet fuel, R\$21.40 per m³;
 - d) kerosene, R\$25.90 per m³;
 - e) fuel oils, R\$11.40 per metric ton;
 - f) liquefied petroleum gas (LPG), including that derived from natural gas and naphtha, R\$104.60 per metric ton; and
 - g) ethanol fuel, R\$22.54 per m³.
- Tax base: Quantity of fuel sold.
- Revenue in 2010: R\$7.8 billion, equivalent to 0.2 percent of GDP, or R\$42.30 per capita.
- Comments: The revenues from this contribution, after being distributed to states and municipalities (29 percent), are earmarked for environmental programs to reduce pollution caused by fuel, subsidies for the purchase of fuel and transportation infrastructure. These allocations were regulated by Law No. 10,636 of December 30, 2002.

Royalties from oil and natural gas

- Levied by: Federal Government
- Type: Economic Contribution
- Background: There is a long history of financial royalties from oil exploration activities. Law No. 2004 of 1953, which created Petrobras, established a payment of 5 percent of

the value of the product extracted to the states and municipalities where exploration occurred. Subsequently, Law No. 7453/1985 established a provision for payment of compensation to states and municipalities near wells and the geo-economic area for exploration on the continental shelf. The topic was addressed in article 20 of the 1988 Constitution, and regulated by Law No. 7,990 of 1989. This law maintained the idea of distributing financial compensation to the territories close to the sites of exploration activity and set the rate at 5 percent of production value. Later, Law No. 9,478 of August 6, 1997 (the "Oil Law") increased the rate to 10 percent (5 percent distributed according to the criteria of Law 7,990/1989 and the remainder in accordance with Art. 49 of the Oil Law). That law also provided for the possibility of reducing the rate to 5 percent if the Brazilian Oil Agency (ANP) decided to do so.

- Rate: 10 percent, and may be reduced to 5 percent in special cases. Extraction fields with large profits or high production levels are taxed more, up to 40 percent.
- Tax base: Value of oil and gas produced.
- Revenue in 2010: R\$21.4 billion, equivalent to 0.6 percent of GDP, or R\$116.90 per capita.
- Comments: This source of revenues was of little importance to the Brazilian government until the mid-1990s, when the Brazilian market opened (the end of the Petrobras monopoly) and there was a significant increase in the long-term cost per barrel on the international market, despite short-term fluctuations. In 2010, the amount collected as oil royalties was enough to set it apart as a major economic contribution in Brazil, at a level similar to that of the Vehicle Tax (*Imposto sobre Propriedade de Veículos Automotores*, or IPVA), the second largest state tax. Its evolution, especially in the 2000s, has attracted so much attention from politicians that the system of divvying up revenue, unchanged since 1989, is currently being heavily criticized in Brazil. This federative issue will be discussed further in Chapter 7.

Fees for Services and Police Power

- Levied by: Federal Government, States and Municipalities
- Type: Fee
- Background: The historical evolution of fees in Brazil is varied, given their large numbers in the country. According to Varsano (1996), fee collection was already established by

the Brazilian Constitution of 1891, both by the Federal Government (stamps and postal charges) and by state governments (stamps).

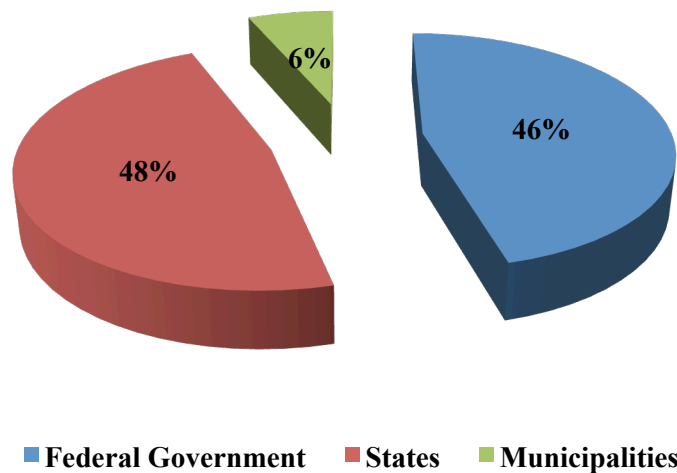
- Rates: Determined by the establishing law.
- Tax base: Determined by the establishing law. The base cannot be identical to a base used for taxes and the amount charged depends on the service provided.
- Revenue in 2010: R\$17.5 billion, equivalent to 0.47 percent of GDP, or R\$95.50 per capita.
- Comments: There are two different types of fees, classified as police power and services. There is a subtle difference between this type of tax and social contributions. While social contributions are generic, and are for the collective good, the fee is more specific and its purpose is to satisfy an individual need. In practice, this is a tax paid in consideration for a public service, funded by the State and made available to anyone who pays the fee. Examples of well-known fees in Brazil are: the Garbage Collection Fee (Municipalities), the Fire Fighting Fee (States) and the Vehicle Tax (States). The list of fees charged in Brazil is extensive,¹⁰ especially at the Federal level. The most important are the Civil Aviation Inspection Fee, the Health Monitoring Inspection Fee, the Electrical Power Granting and Inspection Fee, and Business Registration Fees. One interesting thing to note about Brazilian fees is the loss of their essential character: to finance the provision of public services. In some cases, such as fees related to telecommunications and electricity, the purpose has been lost and the primary objective, in practice, is purely fiscal (maximizing revenue).

2.3 – Taxation by Sphere of Government

In addition to describing the taxes covered in this chapter, it is important to note the distribution of tax revenues by level of government. Almost all of the tax revenues from merchandises, services and goods are under the authority of the Federal Government and the states, as can be seen in Figure 5.

¹⁰ The Appendix provides a detailed list of Brazilian taxes, including the main fees.

Figure 5 - Tax revenue from Merchandises, Services and Goods by Government Sphere - 2010



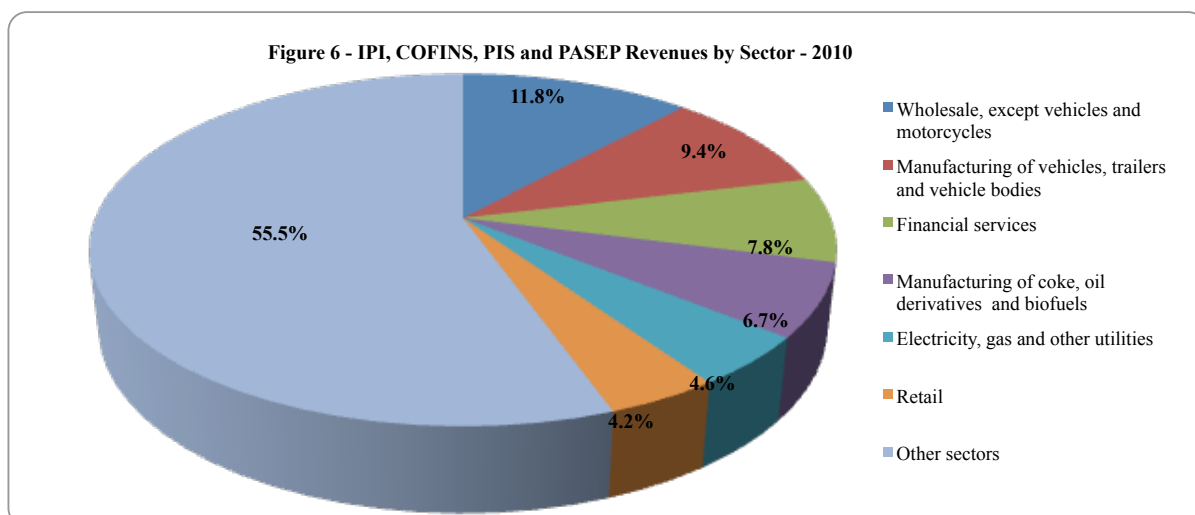
Source: Authors' calculations.

With only a 6 percent share of taxes levied on this tax base (through the ISS), municipalities collected R\$37.6 billion (1 percent of GDP) in 2010. States collected the most, 48 percent of the total or R\$275.9 billion (7.32 percent of GDP). Of state tax collected for this tax base, 96 percent is through the ICMS. And finally, the Federal Government collected R\$266.3 billion (7.06 percent of GDP), which represented 46 percent of the total levied on merchandises, services and goods.

2.4 – Taxation by Sector

An important view of tax collection data in Brazil is the breakdown by sectors. With information based on the RFB's Angela System (Revenue Management Analysis), one can obtain data on taxes collected for each economic sector. This data, however, is limited to the principal federal taxes. In the case of taxes on merchandises, services and goods, only the IPI, COFINS, PIS and PASEP were included.

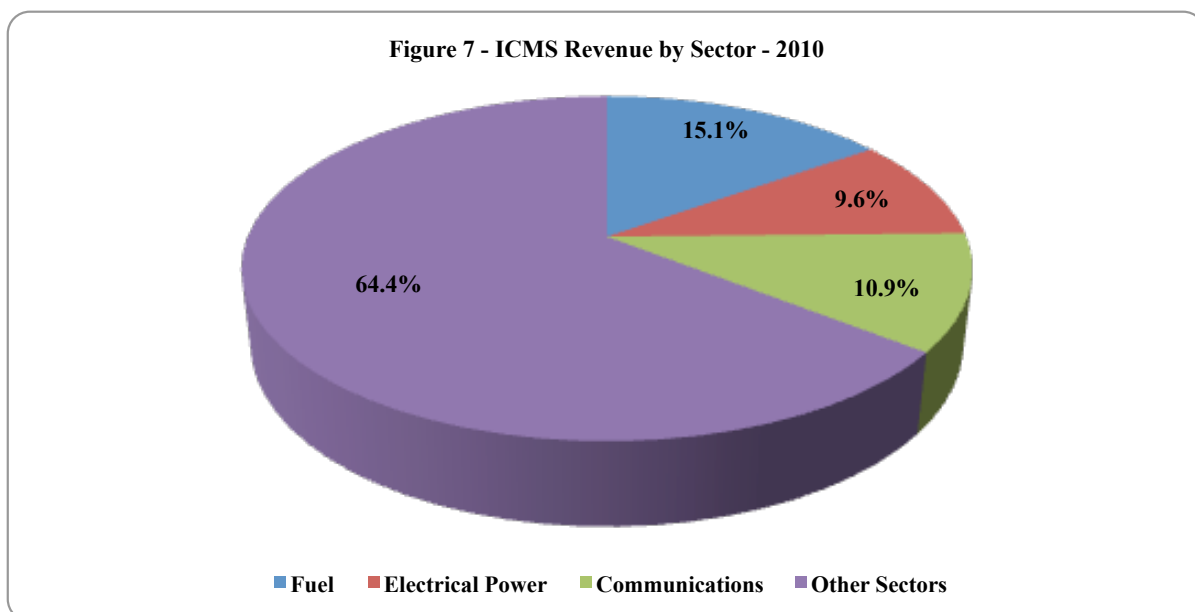
What we see in this type of analysis is that the principal tax revenues come from a limited number of sectors. In 2010, just the first six sectors of the sample were responsible for almost 45 percent of all revenues from the four aforementioned taxes. Revenues by sector are shown in Figure 6.



Source: Authors' calculations.

Naturally, as expected, the sectors with the highest percentages are also the most dynamic. Typical service sector activities, such as wholesale trade (1st) and retail trade (6th), accounted for approximately R\$31.6 billion in tax revenues, or 16 percent of the total collected through the four indirect taxes. The energy sector (oil and electricity, in 4th and 5th places, respectively) also deserves mention for having brought in just over R\$22.4 billion (11.3 percent of total). Vehicle manufacturing (2nd) and financial services (3rd) complete the list of six key sectors. Revenues from these sectors were R\$18.6 billion and R\$15.4 billion, respectively.

As the source of this data is solely federal taxes, the ICMS—the country's principal tax—was excluded. However, the CONFAZ publishes a sector breakdown for the ICMS. It is, however, limited since it is restricted to just three sectors: fuel, electricity and communications. ICMS revenues for these three sectors are shown in Figure 7.



Source: Authors' calculations.

Despite the broad categories, note that the three sectors selected are responsible for a large share of ICMS collected. The fuel sector alone, which includes oil, fuels and lubricants, contributed nearly R\$41 billion in 2010, accounting for just over 15 percent of all ICMS revenue for that tax year. The 20.5 percent of ICMS collected from the electricity and communications sectors amounted to approximately R\$55.4 billion in 2010, R\$25.9 billion from the former and R\$29.5 billion from the latter. The three sectors accounted for 35.6 percent of all ICMS collected.

3 - PAYROLL

Chapter 3 sets out to describe payroll taxes and their importance as part of the tax burden. The relevance of the information below is quite high, since this tax base represents large revenues and greatly affects business costs.

The levying of tax on payroll amounted, in 2010, to R\$334.4 billion, representing 25.9 percent of all taxes and approximately 8.9 percent of GDP that year. In per capita terms, this represented a burden of R\$1,821.80. The detailed data for this tax base is presented in Table 8.

Table 8
Tax Revenue from Wages - 2010

	Revenues (R\$ Billions)	Fines and Interest (R\$ Billions)	Total (R\$ Billions)	% of Total	% of GDP	RS per capita
Wages	331.49	2.90	334.39	100.00%	8.87%	1,821.77
Employees, Civil Servants, Self-Employed	60.71	0.00	60.71	18.16%	1.61%	330.75
General Social Security	45.29	0.00	45.29	13.54%	1.20%	246.76
<i>Employees</i>	42.30	0.00	42.30	12.65%	1.12%	230.47
<i>Self-Employed</i>	2.99	0.00	2.99	0.89%	0.08%	16.29
Civil Servants' Social Security	15.42	0.00	15.42	4.61%	0.41%	84.00
<i>Federal Civil Servants' Social Security</i>	4.85	0.00	4.85	1.45%	0.13%	26.44
<i>State Civil Servants' Social Security</i>	7.94	0.00	7.94	2.38%	0.21%	43.28
<i>Municipal Civil Servants' Social Security</i>	2.62	0.00	2.62	0.78%	0.07%	14.29
Employers	261.63	0.00	261.63	78.24%	6.94%	1,425.36
General Social Security	94.82	0.00	94.82	28.36%	2.52%	516.58
<i>Employers</i>	94.82	0.00	94.82	28.36%	2.52%	516.58
Civil Servants' Social Security	19.24	0.00	19.24	5.75%	0.51%	104.81
<i>Employers</i>	19.24	0.00	19.24	5.75%	0.51%	104.81
Education Contribution	11.05	0.00	11.05	3.30%	0.29%	60.20
Union Contributions	0.56	0.00	0.56	0.17%	0.01%	3.03
S System	10.56	0.00	10.56	3.16%	0.28%	57.51
FGTS	64.27	0.00	64.27	19.22%	1.70%	350.14
Social Security (Other)	61.14	0.00	61.14	18.28%	1.62%	333.10
Other	9.15	2.90	12.05	3.60%	0.32%	65.65
Social Security - Late and Installment payments	9.15	2.90	12.05	3.60%	0.32%	65.65

Source: Authors' calculations.

3.1 - Employees, Civil Servants, the Self-Employed

The 18.2 percent of national revenue from "payroll" comes from taxes on "employees, civil servants and self-employed." Workers, who are responsible for the payment of these contributions, can be classified into two groups: those that contribute to the general social security system, such as private sector taxpayers, and those who contribute to the government social security system, namely the civil servants. The two forms of revenue are described in more detail below.

General System

- Levied by: Federal Government
- Type: Social Contribution
- Background: The Social Security General System (*Regime Geral de Previdência Social*, or RGPS) is regulated by Laws 8,212 and 8,213 of July 24, 1991 and Decree 3,048 of

May 6, 1999. The creation of the first social security system in Brazil dates back to 1923, with the Eloi Chaves Law (Legislative Decree No. 4,682 of January 14, 1923). This law provided for the creation of retirement benefits and pensions for railway employees. The social security schemes in Brazil were unified and harmonized by the Social Security Law (Law No. 3,807 of August 26, 1960), which can be considered a milestone in the national social security system (Homci, 2009).

- Rates: Variable, depending on the case.

- *Employee, independent workers and domestic help:*

Table 9 - INSS Contribution rates for Employees, Domestic Help and Independent Workers - 2012

Base Wage (R\$)	Rate (%)
up to R\$ 1,174.86	8.00
from R\$ 1,174.87 to R\$ 1,958.10	9.00
from R\$ 1,958.11 to R\$ 3,916.20	11.00

Source: MPAS.

- *Self-employed:*

- 11 percent for the self-employed who provides services to a company, including a work cooperative; and
- 20 percent for the self-employed who provides services to an individual; to another self-employed; to a social welfare organization, exempt from paying the employer's portion; to diplomatic missions or foreign consulates.

- *Optional Insured:*

- 20 percent of the declared salary, subject to minimum and maximum base salaries; and
- 11 percent for individuals contributing based on the minimum wage.
- Tax base: Salary upon which the contribution is based.
- Revenue in 2010: R\$45.3 billion, equivalent to 1.2 percent of GDP, or R\$246.80 per capita.
- Comments: The social security system in Brazil comprises two systems: the RGPS for workers in general, particularly those with formal employment contracts, and the Government Social Security Systems (*Regime Próprio de Previdência Social*, or RPPS), restricted to government employees at each level. The RGPS is a sharing scheme, in which the contributions of active workers pay the benefits of the inactive, including individuals who contribute to the Brazilian Social Security Institute (*Instituto Nacional de*

Seguridade Social, or INSS). Social Security contributions to the INSS are compulsory for all employees and employers except those governed by the RPPSs. The RGPS accounted for 80 percent of Social Security contributions in 2010, while the RPPSs accounted for the remaining 20 percent.

Government Social Security System

- Levied by: Federal, State and Municipal Governments
- Type: Social Contribution
- Background: In the last decade of the twentieth century, legislation such as Law No. 9,717/98 and Administrative Act No. 4,992/99 were enacted for the purpose of establishing standards for the creation and maintenance of special Social Security schemes by states and municipalities.
- Rates: The contribution rates of active State, Federal District and Municipal employees to their specific social security schemes cannot be lower than those of federal government employees. The same rates applied to the salaries of the respective government employees are applied to the contributions based on the earnings of inactive employees and on pensions. Table 10 contains a list of social security contribution rates for state and federal employees.

Table 10 – Rates for Federal and State Government Social Security Schemes

Government unit	Rates				Legislation
	Employer	Active	Inactive	Retired	
FEDERAL	22%	11%	11%	11%	Rates set in Law No. 10,887 of June 18, 2004.
NORTH					
Rondônia	11.5%	11%	11%	11%	Rates provided for in Law No. 524 of September 28, 2009.
Acre	11%	11%	11%	11%	Supplemental Law No. 154 of December 8, 2005 maintains the 11% rate for the employer and changes the employee rates from 8% to 11%.
Amazonas	22%	11%	11%	11%	Article 1 of Supplemental Law No. 43 of May 20, 2005 changed Supplemental Law No. 30 of December 27, 2001, setting the rates for active and inactive employees, retirees and the employer.
Roraima	14%	11%	11%	11%	Rates were set in Supplemental Law No. 79, of October 18, 2004, changing Supplemental Law No. 30/1999 and Supplemental Law No. 54/2001.
Pará	18%	11%	11%	11%	Supplemental Law No. 49, of January 24, 2005 set rates for retirees and changed the rate for active employees from 10% to 11%. State contributions were defined by Supplemental Law No. 51, of January 25, 2006.
Amapá	12%	11%	11%	11%	Law No. 915 of August 18, 2005 changes the employer rate from 5% to 12 and the employee rate from 8% to 11%.
Tocantins	12%	11%	11%	11%	Law No. 1,614 of October 6, 2005 maintained the employee rate at 11%.
NORTHEAST					
Maranhão	15%	11%	11%	11%	Law No. 73 of February 4, 2004 set rates for inactive employees and retirees, and changed the rates for the employer and active employees. Supplemental Law No. 82 of May 30, 2005 changed the employer rate from 16% to 15%.
Piauí	22%	11% up to R\$1,200; 12% on amounts surpassing this.	12%	12%	Graduated rates for active employees are described in Law no. 40 of June 14, 2004. Single employer rate of 22% set in Supplemental Law No. 40/2004. Supplemental Law No. 43 of December 20, 2004 establishes rates for inactive employees and retirees.
Ceará	22%	11%	11%	11%	Rates for active and inactive employees and retirees defined in Law No. 13,578 of January 21, 2005. The same law states that the government contribution is twice that of active employees.
Rio Grande do Norte	22%	11%	11%	11%	Active employees now contribute 11%, since Law No. 8,633 of February 3, 2005. The rate for inactive employees and retirees is now 11%.
Paraíba	22%	11%	11%	11%	Rates set in Law No. 7,517 of October 30, 2003. Law No. 8,185 of May 10, 2007 changed the employer rate from 18% to 22%.
Pernambuco	27%	13.5%	13.5%	13.5%	Law No. 147, published December 4, 2009, sets the State's contribution rate at 27%. The law took effect 90 days after publication.
Alagoas	11%	11%	11%	11%	Law No. 6,288 of March 28, 2002 set the employer's rate. Law No. 6,585 of March 29, 2005 set contribution rates for active and inactive employees and retirees.
Sergipe	20%	13%	13%	13%	Supplemental Law No. 113/2005 set the rates for active and inactive employees and retirees at 13%. Supplemental Law No. 118/2006 modified Supplemental Law No. 113/2005, increasing the employer's rate from 13% to 20%.
Bahia	24%	12%	12%	12%	Contributions of active employees were set in Law no. 7,249 of January 7, 1998, and those of the State by Law No. 9,444, of April 26, 2005, which altered Law No. 7,249/1998. Law No. 9,003 of January 31, 2004 set contributions for inactive employees and retirees.
SOUTHEAST					
Minas Gerais	11%	11%	11%	11%	Supplemental Law No. 77 of January 13, 2004 defined the contributions for active and inactive employees and retirees, and Law No. 79 of July 30, 2004 set the State's contribution.
Espírito Santo	22%	11%	11%	11%	Contribution rates set by Law No. 282 of April 22, 2004.
Rio de Janeiro	22%	11%	11%	11%	Employer's rate increased by Law No. 4,765/2006. Rates for active and inactive employees and retirees defined in Law No. 4,275 of February 6, 2004.
São Paulo	22%	11%	11%	11%	Rates of active and inactive employees and retirees defined by Supplemental Law No. 1,012 of July 5, 2007. Employer's rate set by Supplemental Law No. 1,010 of May 12, 1978.
SOUTH					
Paraná	10% up to R\$1,200; 14% on amounts surpassing this.	10% up to R\$1,200; 14% on amounts surpassing this.	–	–	Rate for active employees and the employer set by Law No. 12,398 of December 30, 1998. There is no current law defining the rate for inactive employees and retirees.
Santa Catarina	11%	11%	11%	11%	Rates for active and inactive employees and retirees set by Supplemental Law No. 266 of February 4, 2004; Rate for the State set by Supplemental Law No. 412 of June 26, 2008
Rio Grande do Sul	22%	11%	11%	11%	Rates set in Supplementary Law No. 12,065 of March 29, 2004.
MIDWEST					
Mato Grosso	22%	11%	11%	11%	Rates of active and inactive employees and retirees defined by Supplemental Law No. 202 of December 28, 2004. Supplemental Law No. 254 of October 2, 2006 changed the employer rate to 22%.
Mato Grosso do Sul	22%	11%	11%	11%	Rates for active and inactive employees and retirees set in Law No. 3,150 of December 22, 2005.
Goiás	22%	11%	11%	11%	Rates for active employees set in Supplemental Law No. 29 of April 12, 2000; rates for inactive employees and retirees set by Supplemental Law No. 46 of January 19, 2004; employer rate defined by Law No. 13,903 of September 19, 2001.
Federal District	22%	11%	11%	11%	Section 59, sole paragraph of Supplemental Law No. 769/2008 states that contribution rates shall be adjusted annually and should be stated in the Budget Guidelines Law.

SOURCE: MPS/SPS/Government Social Security Schemes Department - DRPSP/CGNAL(CADPREV).

Note:

- Tax base: Salary upon which the contribution is based.
- Revenue in 2010: R\$15.4 billion, equivalent to 0.4 percent of GDP, or R\$84.00 per capita.
- Comments: The RPPSs are established and administered by each federal entity—states, municipalities and the union—and cover public servants with work contracts. Each Government entity may create its own Social Security scheme, or adhere to the RGPS. However, as soon as a specific scheme is established, government employees in that entity may no longer participate in the RGPS. Brazil is divided into 26 states plus the Federal District, and 5,565 municipalities, a total of 5,593 entities, including the Federal government. As of 2009, all the states and the Federal District had a specific social security scheme for their employees. In the case of municipalities, 1,874 had a specific social security scheme, 335 had a scheme that was being phased out, and 3,354 adhered to the RGPS.

3.2 - Employers

A large share of taxes on payroll comes from corporations and individual employers: approximately 78.2 percent of total revenues come from taxes levied on “employers.” In addition to the division between private (RGPS) and government (RPPS) Social Security schemes, revenue from employers also includes other taxes. The main ones are the Severance Pay Fund (*Fundo de Garantia do Tempo de Serviço*, or FGTS), the Education Contribution, and the S System contributions. All of these revenue sources are explained in detail below.

RGPS

- Levied by: Federal Government
 - Type: Social Contribution
 - Background: See the General System in Section 3.1.
 - Tax rates and tax base: Variable, depending on the case.
- *Employers:*
- 20 percent of total monthly remuneration to enrolled employees and temporary workers who provide services;

- An additional 1 percent (low risk), 2 percent (medium risk) or 3 percent (high risk), on the same base, according to the risks of disability due to the type of work performed;
- 15 percent on the gross amount of the invoice, bill or receipt for services, for services rendered to the employer by members of labor cooperatives; and
- Varying rates, based on the company's activity, for other entities and funds (third parties), levied on the total remuneration paid, payable or credited, for any reason, during the month, to enrolled employees and temporary workers who provide services.

- *Domestic Employer:*

- 12 percent of the salary of the household employee.
- Revenue in 2010: R\$94.8 billion, equivalent to 2.5 percent of GDP, or R\$516.60 per capita.
- Comments: See the General System in Section 3.1.

BOX 6 – THE COST OF PAYROLL TAXES

Business owners in Brazil roundly criticize the national socioeconomic situation, blaming it for the lack of industrial competitiveness. This is called the "Brazil cost." A major component of the "Brazil cost" is taxation—and taxation on payroll plays an important role in reducing the competitiveness of Brazilian companies. The main claim in this regard is that corporate taxation on wages is excessive and greatly increases the cost of hiring labor. This causes problems, such as increasing the cost of production of goods and services, reduction in formal employment, increased outsourcing, and big losses for the manufacturing industry (especially labor-intensive work) in world markets. Studies show that the total tax burden as a proportion of the cost of labor is considerably higher in Brazil than the average of other countries. In comparison to developing countries, the gap is even greater. They claim that a decrease in payroll taxes could reduce business costs, lowering prices and increasing investment capacity in the medium term, not only through the increased financial capacity of established companies, but also by attracting new factories.

FGTS

- Levied by: Federal Government
- Type: Social Contribution
- Background: Created by Law No. 5,107 of September 13, 1966, currently governed by Law No. 8,036 of May 11, 1990.
- Rate: 8 percent.

- Tax base: Employee's salary.
- Revenue in 2010: R\$64.3 billion, equivalent to 1.7 percent of GDP, or R\$350.10 per capita.
- Comments: The FGTS was created in the 1960s to protect workers fired without just cause. It was intended to be a form of "forced savings" that would benefit the employee in the event of termination and/or retirement. Employers are responsible for the monthly transfer of 8 percent of each worker's salary to an account linked to that worker's individual employment contract. Currently, among other uses, the employee may withdraw resources from the FGTS account to purchase a home while the Government may use the funds to finance public housing, sanitation and urban infrastructure programs.

BOX 7 –FGTS: CRITICISM OF A SOCIAL TOOL

The FGTS, created as a mechanism for compulsory savings but eventually contributing to increase worker security and fund Government programs, has been criticized both in terms of its resources and uses. The first of these criticisms is related to the subject addressed above in Box 6 (The Cost of Payroll Taxes) and relates to the excess of payroll taxes on workers from businesses' point of view. On the other hand, there are arguments that the creation of the FGTS contributed to making the labor market more flexible, with increased turnover of employees when the barrier to dismissing employees was removed. A third aspect relates to low-income workers: a high turnover of these workers, coupled with low wages, leads to very low FGTS compensation (often less than unemployment benefits) and contributes little to their financial security when unemployed. The fourth aspect concerns the fund's yield, which is considered very low. Given that the FGTS is a form of savings, one would expect that the amounts deposited in the fund would earn interest similar to that of a traditional savings account. However, this is not what happens. In fact, the interest is low enough to be regularly surpassed by inflation, resulting in real losses to workers. Finally, the use of FGTS resources to finance infrastructure programs, such as housing and sanitation, is very dependent on economic cycles and could become volatile. When unemployment is low, and more workers are formally employed, the fund naturally has more resources available for this kind of financing. However, if the scenario changes and the unemployment rate grows (or fewer workers are formally employed), fund resources may diminish, affecting financing activities.

Education Contribution

- Levied by: Federal Government
- Type: Social Contribution

- Background: Created by Ordinary Law No. 4,440 of October 27, 1964, and currently governed by Law No. 9,424 of December 24, 1996.
- Rate: 2.5 percent
- Tax base: Total value of remuneration paid or credited by companies, for any reason, to employees covered, subject to legal exceptions.
- Revenue in 2010: R\$11 billion, equivalent to 0.3 percent of GDP, or R\$60.20 per capita.
- Comments: The education contribution is a social contribution, established in 1964, intended to finance programs, projects and actions for basic public education. It is levied, audited and collected by the Federal government. Companies in general and public and private entities that have adopted the RGPS must contribute.

S System

- Levied by: Federal Government
- Type: Social Contribution
- Background: The organizations participating in the S System were created starting in the 1940s. Only the institutions SEBRAE, SENAR, SEST and SENAT were created more recently, in conjunction with the 1988 Constitution. The exact dates of the establishment of these organizations, and their respective laws, are listed in Table 11.
- Rate: Variable, depending on the category of contribution. Table 11 presents a summary.

Table 11 - S System Component Contributions

Entity	Purpose	Rates and tax basis
INCRA (Law No. 2,613, of September 23, 1955)	Rural social services and field technique training programs.	Basic contribution: 2.5% paid by companies in the sectors listed in s. 2 of Decree Law No. 1,146/70, including sugarcane cooperatives, dairy producers, and coffee and cereal companies.
SENAI (Law No. 4,048 of January 22, 1942)	Organization and administration of industrial training schools, extended to transport and communications.	1.0% on the total remuneration paid by the companies in the sector to their employees.
SESI (Law No. 9,403 of June 25, 1946)	Organization and administration of industrial training schools, extended to transport and communications.	1.5% on the total remuneration paid by the companies in the sector to their employees and to independent workers who provide services during the month.
SENAC (Law No. 8,621, of January 10, 1946)	Organization and administration of commercial training schools.	1.5% on the total remuneration paid by the companies in the sector to their employees and to independent workers who provide services during the month.
SESC (Law No. 9,853, of August 13, 1946)	Programs that contribute to the social wellbeing of employees of the companies in this sector and their families.	1.0% on the total remuneration paid by commercial companies to their employees and to independent workers who provide services during the month.
DPC (Law No. 5,461, of June 25, 1968)	Professional marine training.	2.5% on the total remuneration paid by maritime companies to their employees and independent workers.
SEBRAE (Law No. 8,029, of April 12, 1990)	Support for development of small and microenterprises.	Basic rate: 0.3% of the total remuneration paid by SESI/SENAI and SESC/SENAC sector companies to their employees.
Air Transport Fund (Decree Law No. 1,305 of January 8, 1974)	Professional aeronautical training, for airline personnel and civil specialists.	Basic rate: 2.5% on the total remuneration paid by the companies in the air transport sector to their employees and to independent workers who provide services during the month.
SENAR (Law No. 8,315, of December 23, 1991)	Organization, administration and training for rural professionals and promotion of the social welfare of rural workers.	Basic rate: 2.5% on the total remuneration paid to all employees by companies in the agricultural-industrial sector and rural unions, rural federations and other rural associations.
SEST (Law No. 8,706, of September 14, 1993)	Management, development and implementation of programs for the social welfare of workers in highway transport and independent transport professionals, in the fields of food, health, culture, and work safety.	1.5% calculated on the amount of remuneration paid to employees (in the case of road transport companies) or 1.5% calculated on the social security salary base for independent road transport workers.
SENAT (Law No. 8,706, of September 14, 1993)	Management, development and implementation of programs for the social welfare of workers in highway transport and independent transport professionals, in the fields of food, health, culture, and work safety.	1.0% calculated on the amount of remuneration paid to employees (in the case of road transport companies) or 1.0% calculated on the social security salary base for independent road transport workers.

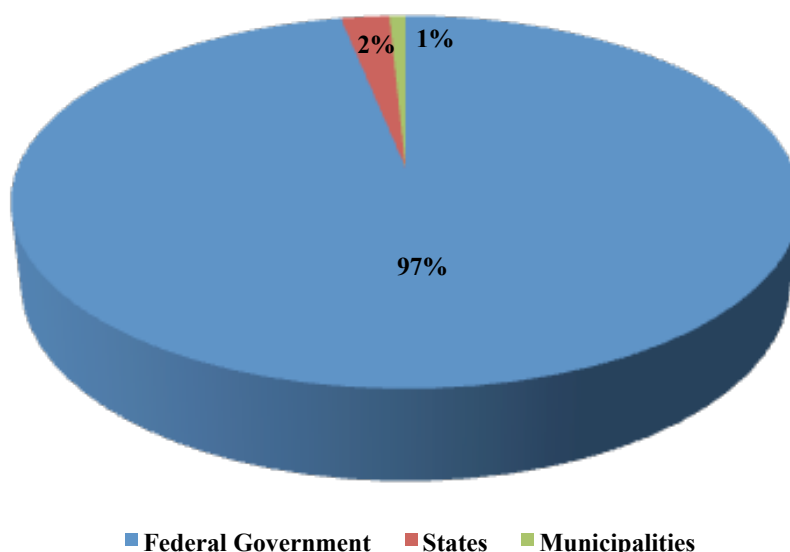
Source: MPAS/Social Security Taxation – Explanatory text

- Tax base: Payroll.
- Revenue in 2010: R\$10.6 billion, equivalent to 0.3 percent of GDP, or R\$57.5 per capita.
- Comments: The S System is composed of eleven contributions that are transferred to the entities, most of which are private, as established under law. In general, contributions are used to finance activities whose objectives are professional development and improving the well being of workers. S System contributions are oriented towards the interests of specific professional and economic categories, and are considered quasi-fiscal. Although the S system contributions are levied and collected by a federal agency, the INSS, the revenues obtained are fully passed on to entities not directly administered by the Government.

3.3 - Taxation by Sphere of Government

When looking at payroll taxes from the sphere of Government viewpoint, we see, as expected, a high concentration of Federal government taxes. Figure 8 clearly shows the centralization of almost 97 percent of total revenues from this source.

Figure 8 - Payroll Tax Revenue by Government Sphere - 2010

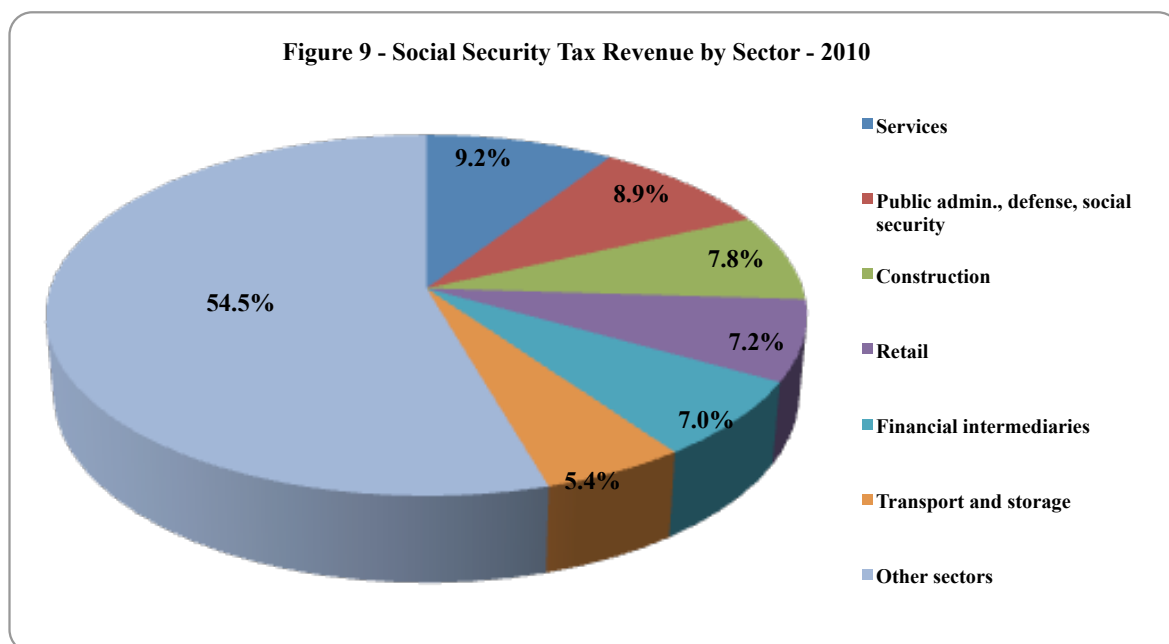


Source: Authors' calculations.

The fact that the Union has authority over virtually all of the taxes cited throughout this chapter results in subnational governments having a share on the order of just 3.2 percent of the total (2.4 percent for states and 0.8 percent for municipalities). The states and municipalities tax payroll only in the case of special social security schemes for civil servants. To increase revenue in these cases, more civil servants must be hired and/or new social security schemes must be created in municipalities that do not have their own schemes. In either case, this would mean more personnel expenses for state and local governments, which is not always possible, either due to lack of need, or due to budget constraints (accentuated by the Fiscal Responsibility Law).

3.4 – Taxation by Sector

In the presentation of sector data in Chapter 2, the RFB (Angela System) was used as a primary data source. In the analysis in this chapter, the MPAS's Statistical Social Security Bulletin is the main data source, since the Angela system does not provide sector data for payroll taxes. Figure 9 shows the distribution of social security revenues collected for key sectors.



Source: Authors' calculations.

Note that the first six sectors are services. This is to be expected, since they hire mostly labor and are therefore the primary payers of payroll taxes. The slightly more than 45 percent of the total (about R\$91.3 billion) collected by companies as Social Security contributions are evenly distributed among the six principal sectors. The first, services provided mainly to enterprises, collected almost R\$18.6 billion in 2010. The public sector (public administration) was second, at R\$17.8 billion. Construction, a sector that typically hires many employees, contributes approximately R\$15.7 billion to Social Security. Retail, financial intermediaries and transport and storage fill out the top six, collecting, respectively, R\$ 14.5 billion, R\$14 billion and R\$10.7 billion.

4 – INCOME AND CAPITAL GAINS

This chapter describes the taxes on income and capital gains, showing their importance within overall taxation. The information provided in this chapter is important as it presents the principal instrument of direct taxation in Brazil, namely income tax. Although this source of revenue is not as relevant in Brazil as in countries with a more developed tax system, understanding this group of taxes is important for grasping the problem of (lack of) tax equity, which will be addressed in more detail in chapter 7.

Taxation of income and capital gains amounted, in 2010, to R\$235.8 billion, representing 18,6 percent of all taxes and approximately 6.4 percent of GDP that year. In per capita terms, this represented a burden of R\$1,308.20. The detailed data for this tax base is presented in Table 12.

	Revenues (RS Billions)	Fines and interest (RS Billions)	Total (RS Billions)	% of Total	% of GDP	RS per capita
Income and Capital Gains	235.81	4.31	240.12	100.00%	6.37%	1,308.18
Families	90.04	1.12	91.16	37.97%	2.42%	496.66
Individual income tax	16.17	1.12	17.30	7.20%	0.46%	94.24
Income tax	70.72	0.00	70.72	29.45%	1.88%	385.27
<i>Withheld at source (states)</i>	15.88	0.00	15.88	6.61%	0.42%	86.53
<i>Withheld at source (municipalities)</i>	5.37	0.00	5.37	2.24%	0.14%	29.26
<i>Withheld at source (union) - Work</i>	49.47	0.00	49.47	20.60%	1.31%	269.49
Lotteries, games and casinos	3.15	0.00	3.15	1.31%	0.08%	17.15
Companies and shareholders	145.22	3.18	148.40	61.80%	3.94%	808.49
Corporate income tax	82.43	2.01	84.44	35.17%	2.24%	460.04
Social contribution on net income (CSLL)	45.20	1.17	46.37	19.31%	1.23%	252.62
PIN and PROTERRA	0.00	0.00	0.00	0.00%	0.00%	0.02
Withheld at source (federal) - remittances abroad	11.54	0.00	11.54	4.80%	0.31%	62.84
Withheld at source (federal) - other earnings	6.05	0.00	6.05	2.52%	0.16%	32.96
Other	0.56	0.00	0.56	0.23%	0.01%	3.03

Source: Authors' calculations.

4.1 – Families

Of all revenues derived from income and capital gains in Brazil, about 38 percent come from "families." Basically, this revenue comes from the income of individuals derived from a formal work contract, whether in the private (market) or the public sector. The personal income tax (Imposto de Renda da Pessoa Física, or IRPF) is also levied on income obtained from sources other than a formal work contract. In addition to the IRPF, there is also a specific tax on gains obtained through "lotteries, games and casinos." The IRPF and the Income Withholding Tax (Imposto de Renda Retido na Fonte, or IRRF) will be described in more detail below.

IRRF – Labor Income

- Levied by: Federal Government, States and Municipalities
- Type: Tax

- Background: Taxation of income in Brazil dates back to the nineteenth century, with the enactment of Law No. 317 of October 21, 1843. It was a tax on salaries received from the Government, and was prematurely discontinued due to great dissatisfaction. With a restricted tax base, as in that period few people had income in Brazil—an imperialist, slave-based elitist society—income tax was the subject of debates for decades and was not adopted until much later. This tax was only instituted by Law No. 4,625 of December 31, 1922. Previously, taxes on wages or income in general had been charged, but with different names and regulations very different from those in use today. Currently, after several alterations, including institutional changes to increase the efficiency of tax collection management and auditing, the income tax is regulated by Decree No. 3,000 of March 26, 1999 (<http://www.receita.fazenda.gov.br/Memoria/irpf/history/historia.asp>).
- Rates: Variable, depending on the income level. Table 13 presents a summary.

Table 13 - Individual Income Tax Monthly Table - 2013 (calendar year 2012)

Monthly tax base (R\$)	Rate (%)	Amount to deduct (R\$)
up to R\$1,637.11	-	-
from R\$1,637.11 to R\$ 2,453.50	7.50	122.78
from R\$ 2,453.51 to R\$ 3,271.38	15.00	306.80
from R\$ 3,271.39 to R\$ 4,087.65	22.50	552.15
Over R\$ 4,087.65	27.50	756.53

Source: RFB

- Tax base: Gross monthly income less legal deductions, consisting of: amounts paid in cash for alimony, including interim periodic support; R\$164.56 per dependent; contributions to Social Security schemes, whether of the Federal Government, states, the Federal District or municipalities; contributions to a supplementary social security entity in Brazil or to a Individual Retirement Fund (Fundo de Aposentadoria Programada Individual, or FAPI).
- Revenue in 2010: For the Federal government, R\$49.5 billion, which is 1.3 percent of GDP or R\$269.50 per capita; for States, R\$15.9 billion, equivalent to 0.4 percent of GDP, or R\$86.50 per capita; and for Municipalities, R\$5.4 billion, equivalent to 0.1 percent of GDP, or R\$29.30 per capita.
- Comments: IRRF – labor income is a specific way of collecting the IRPF. The difference between this and the IRPF is periodicity and who collects the tax. The IRRF – labor income is collected directly by the institution (company, government agency, public administration, etc.) responsible for paying the worker, and the amount is discounted

monthly from the employee paycheck. This is an important modality of tax collection, which is responsible for 74 percent of the total IRRF revenue.

IRPF

- Levied by: Federal Government
- Type: Tax
- Background: See the section on IRRF – Labor Income.
- Rates: Variable, depending on the income level. Table 14 presents a summary.

Table 14 - Individual Income Tax Annual Table - 2013 (calendar year 2012)

Annual tax base (R\$)	Rate (%)	Amount to deduct (R\$)
up to R\$ 19,645.32	-	-
from 19,645.33 to R\$ 29,442.00	7.50	1,473.40
from R\$ 29,442.01 to R\$ 39,256.56	15.00	3,681.55
from R\$ 39,256.57 to R\$ 49,051.80	22.50	6,625.79
Over R\$ 49,051.80	27.50	9,078.38

Source: RFB.

- Tax base: Annual gross income less legal deductions, consisting of: amounts paid in cash for alimony, including interim periodic support; R\$1,974.72 per dependent; contributions to social security schemes, whether of the Federal government, states, the Federal District or municipalities; contributions to a supplementary Social Security entity in Brazil or to a FAPI; educational and medical expenses; contributions to funds controlled by the Municipal, State and National Councils for the Rights of Children and Adolescents; contributions effectively made in favor of cultural projects, approved under the regulations of the National Cultural Support Program (PRONAC); investments made to promote audiovisual activities; tax withheld or paid, including complementary payments corresponding to income included in the calculation basis; tax paid abroad in accordance with the provisions of Art. 103.
- Revenue in 2010: R\$17.3 billion, equivalent to 0.5 percent of GDP, or R\$94.20 per capita.

Comments: This tax is collected annually, both from workers who did not pay monthly during the calendar year and as an adjustment in the amount income tax withheld at source monthly.

According to RFB data (<http://www.receita.fazenda.gov.br/Publico/estudotributarios/estatisticas/GrandesNumerosDI RPF2005.pdf>), in 2005 (the last data available) approximately 19.56 million people filed an

electronic annual income tax returns, and another 378,000 filed paper tax returns, which have since been discontinued. Of this total, only 7.11 million owed income tax (12.45 million owed nothing). About 3.22 million people used the simplified return form, while 6.34 million people used the full return form. For 2012, RFB was expecting about 25 million individual income tax returns

BOX 8 – INDIVIDUAL INCOME TAX DISTORTIONS

Despite the progressive character of individual income tax, insufficient (or no) readjustment of the tax table in recent years is including more and more low-income workers in the taxable income range and creating a greater burden for middle-income workers. According to 2011 calculations by the National Union of Brazilian Revenue Office Auditors (Sindicato Nacional dos Auditores-Fiscais da Receita Federal do Brasil, or SINDIFISCO), RFB failed to incorporate an increase of 63.5 percent to the bounds of the income brackets. This percentage results from the difference between the 172.2 percent inflation measured by the Broad Consumer Price Index (Índice de Preços ao Consumidor Amplo, or IPCA) from January 1996 to November 2011 and the 66.5 percent adjustment in the income bracket bounds in the same period. In 2010 and 2011, despite an inflation rate of 6.5 percent, the bounds were adjusted only 4.5 percent. The gap increases when prior periods are considered. The tax rate table was not updated from 1996 to 2001. In 2002, it was adjusted 17.5 percent. In 2005, it was adjusted 10 percent, then another 8 percent in 2006. From 2007 to 2011, the rate was adjusted 4.5 percent per year. Since the adjustment always lags, after an adjustment a taxpayer exempt in one year often jumps to the next higher tax category the following year, and pays tax only because his salary was corrected for inflation. For this reason, more workers end up paying individual income tax.

4.2 — Companies and Shareholders

Most of the tax collected (61.8 percent of the total) on income and capital gains comes from "companies and shareholders." The most important taxes in this category are the Corporate Income Tax (Imposto de Renda da Pessoa Jurídica, or IRPJ) and the CSLL, which are very similar as they have the same base and similar collection rules. The rules applied depend on the way the company chooses to calculate its profits. The company's option—real profits, presumed profits or arbitrated profit—must be the same for both the IRPJ and the CSLL. A company may not, for example, pay IRPJ under the real profits option but pay CSLL under the presumed profits option. According to an analysis of the last consolidated IRPJ report, published by RFB: "Companies with annual revenues of less than R\$48 million (about US\$ 22 million) may opt for the presumed profit regime, in which they only need to declare sales and apply a tax rate to them, with a different rate for different economic activities, reflecting a profit margin determined by legislation (ranging from 1.6 percent to 32 percent on gross sales). A similar scheme is applied to micro and small companies, which may choose a

simplified regime (known as the SIMPLES), and also comprises other federal taxes (including replacing the employer social security contribution on payroll), and also results in payment of a percentage of sales, based on the sector. The collecting agency separates the portion representing each tax originally due to official accounting purposes" (Afonso and Barroso, 2007: 13).

IRPJ

- Levied by: Federal Government
- Type: Tax
- Background: See the section on IRRF – Labor Income.
- Rates:
 - 15 percent;
 - in the case of legal entities that choose to pay income tax on real, presumed or arbitrated profits, 10 percent on the portion of the monthly estimated tax base over R\$ 20,000.00.
- Tax base: Real or presumed profits calculated by legal entities, including those under the SIMPLES.
- Revenue in 2010: R\$84.4 billion, equivalent to 2.2 percent of GDP, or R\$460.00 per capita.
- Comments: The RFB's most recent consolidated information, for 2004, indicates that 2,840,970 companies filed tax returns with tax due and 151,071 filed returns without tax due. 178,723 companies (5.97 percent of a total of 2,992,041) declared IRPJ under the real profit regime. Companies declaring under the presumed profit regime accounted for 22.84 percent of the total (683,520 companies). More than half of companies used the SIMPLES regime: 1,978,727 (66.13 percent of the total). Companies that are not taxed are divided into two categories: immune (social or educational services, workers' unions, etc.) and exempt (civil, cultural, philanthropic, union, recreational, scientific or other association). Of these companies, 38,521 and 112,490, respectively, filed returns. Despite the smaller number of companies under the real profit regime, it is this group that provides the greatest share of the IRPJ revenues: approximately 85 percent of all aggregated taxable revenues come from them. The remaining 15 percent is divided among presumed profits (9 percent of the total) and the SIMPLES (6 percent of the total).

BOX 9 – THE GROWTH OF THE SIMPLES

Initially called the "Federal SIMPLES" and established by Law No. 9,317 of December 5, 1996, the National SIMPLES was consolidated by Supplemental Law No. 123 of December 14, 2006 (Art.89), which replaced the previous law. The SIMPLES was created to facilitate or simplify taxation of micro and small businesses.¹¹ Its main features are: it is optional; it replaces the IRPJ, CSLL, PIS/PASEP, COFINS, IPI, ICMS, ISS and the employers contribution to the Social Security; all taxes are calculated and collected through a single collection document; an electronic system is available to calculate the monthly amount due; and there is a single, simplified declaration for socioeconomic and tax information.

The SIMPLES is noteworthy because of the increase in the number of companies under it: while in 2004 (the last set of data consolidated by the RFB) 1,978,727 companies were under this regime, as of May 29, 2011, in accordance with National Microenterprise Tax Management Committee data, this number reached 5 million, or a growth of almost 153 percent in seven years (an average growth of 14.16 percent per year). This result means that 83.7 percent of micro and small enterprises (5,972,474) were under the regime on that date. This overwhelming growth clearly indicates the importance of the program for small business with respect to tax planning.

With taxation as complex as in the Brazilian system, a small company would not be able to afford the type of complex accounting infrastructure large companies have just to comply with tax obligations. In this respect, the Simple regime was established to significantly reduce this cost of complexity.

CSLL

- Levied by: Federal Government
- Type: Social Contribution
- Background: Created by Law No. 7,689 of December 15, 1988.
- Rates: 9 percent, except for special cases cited in legislation.
- Tax base: See the tax base for the IRPJ.
- Revenue in 2010: R\$46.4 billion, equivalent to 1.2 percent of GDP, or R\$252.60 per capita.

¹¹ In Brazil, as of January 2012, a microenterprise can be any of various categories of companies (*sociedade empresária*, *sociedade simples*, limited liability company with a single shareholder, or sole proprietor) with annual gross sales of R\$ 360,000 or less. a small enterprise can be any of the same categories of companies with annual gross sales surpassing R\$ 360,000 but less than or equal to R\$ 3,600,000. Note that the classification (or concept) microenterprise and small enterprise can vary significantly between countries. "Despite these variations, in general governments have a clear idea of the kind of company they want to encourage, depending on the characteristics of each country's economy. In OECD countries, for example, the number of employees is the most widely used indicator, defining small and medium-sized enterprises (SMEs) as those having fewer than 500 employees. However, some countries, including those in the European Union, define the cutoff at 250 employees" (Viol and Rodrigues, 2000: 8).

- Comments: Similar to COFINS and PIS/PASEP, CSLL was created to finance Social Security. A striking feature of the contribution are the frequent changes in the law since its creation, especially with respect to tax rates and the tax base throughout the 1990s in order to increase revenues. Changes in the percentage applied to gross revenues of companies under the presumed profit regime increased the CSLL calculation base significantly (Araujo, 2005).

IRRF – Remittances Abroad

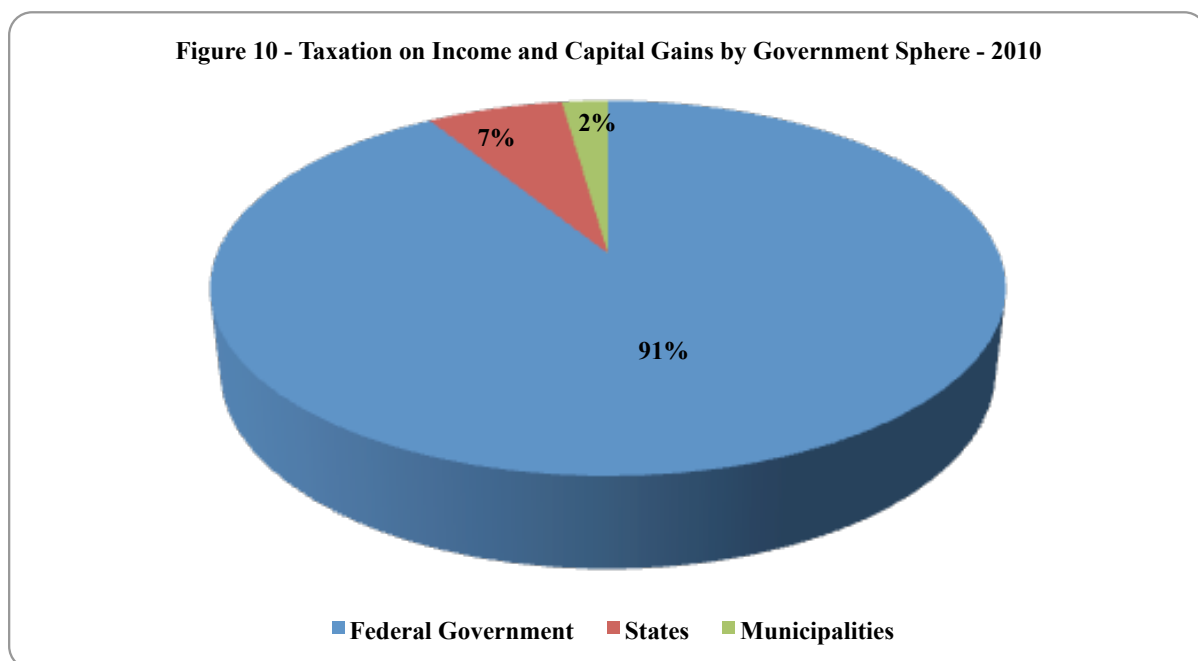
- Levied by: Federal Government
- Background: See the section on IRRF – Labor Income.
- Rates:
 - 25 percent, in the case of labor income, with or without a formal contract, retirement benefits, pensions due to death or disability, and earnings from services rendered by non-residents, and
 - 15 percent in the case of other income.
- Tax base: earnings paid, credited, delivered or remitted abroad as profits, dividends, interest and amortization, royalties, technical, scientific or administrative consulting and similar.
- Revenue in 2010: R\$11.5 billion, equivalent to 0.3 percent of GDP, or R\$62.80 per capita.

IRRF – Other Earnings

- Levied by: Federal Government
- Background: See the section on IRRF – Labor Income.
- Rates and tax base:
 - Prizes and raffles in general: 30 percent of the value of cash prizes and 20 percent of the value of prizes in the form of goods and services, obtained through lotteries, sporting competitions (horse racing) and other competitions;
 - Advertising Services: 1.5 percent of the value of earnings obtained for providing advertising and publicity services, and
 - Remuneration of services: 1.5 percent of the value of remuneration received due to professional services rendered.
- Revenue in 2010: R\$6 billion, equivalent to 0.2 percent of GDP, or R\$33.00 per capita.

4.3 - Taxation by Sphere of Government

Similar to taxation on payroll, taxation on "income and capital gains" is mostly collected by the Federal government, though to a lesser extent. Despite all "income and gains" taxes being legislated by the Federal government, income tax withheld at source also occurs at the state and municipal level, which is the only reason why this type of taxation is not exclusively to the Union. Figure 10 shows the division of this tax base by sphere.



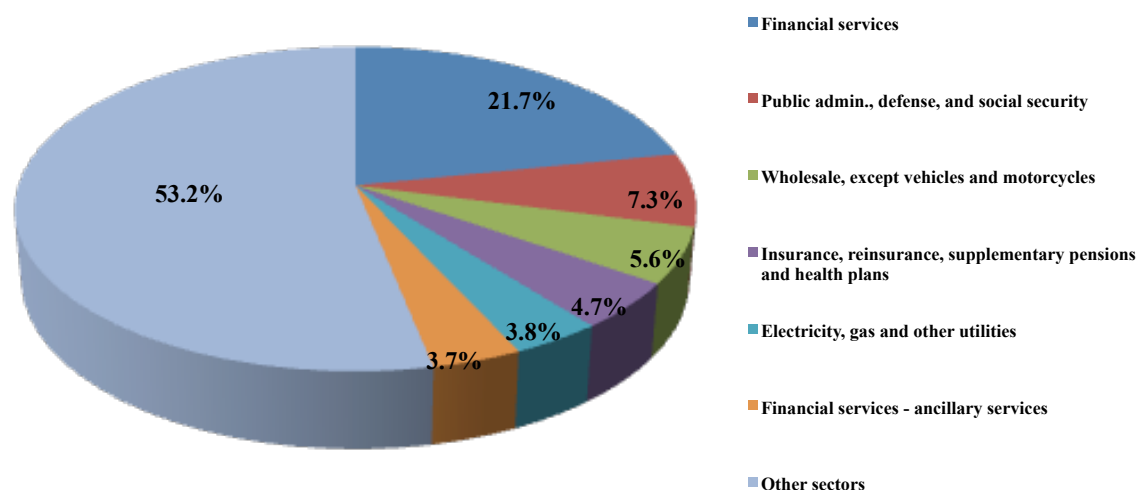
Source: Authors' calculations.

The federal government collects just over 91 percent of all taxes on income, whereas subnational governments (6.6 percent state and 2.2 percent municipal) collect the remainder.

4.4 – Taxation by Sector

As with the principal indirect federal taxes (IPI, COFINS, PIS/PASEP), the Angela system also provides sector data for the main direct federal taxes: income tax and CSLL. The revenues collected in the six most important sectors are shown in Figure 11.

Figure 11 - Income Tax and CSLL Revenues by Sector - 2010



The most important sectors in this case are notably different from the main sectors involved in indirect taxation. For income tax and CSLL, the relevant sector is financial services, which is coherent with the successive profit records obtained by the biggest Brazilian banks. Almost 22 percent of all income tax and CSLL revenues come from this sector, which in 2010 totaled just over R\$48.5 billion. If related sectors — such as insurance (4th) and activities related to financial services (6th) — are added, the figure rises to approximately R\$67.4 billion (more than 30 percent of all revenues collected for the two taxes). As in the case of indirect taxes, wholesale (3rd) and electricity (5th) also appear among the top sectors for income taxes: R\$12.4 billion for the former and R\$8.4 billion for the latter. The main difference is the public administration sector, which is the second largest contributor to direct taxes, collecting approximately R\$16.4 billion in 2010 (7.3 percent of the total).

5 - OTHER TAX BASES

Now that we have described the three principal tax bases in the Brazilian tax system, this chapter will describe the remaining sources of revenue, which can be summarized as "financial transactions," "property," and "international trade." There is also a fourth source that will not be covered in detail as it is just revenues from fines and fees on late payment of various taxes, especially state and municipal taxes. Although the three tax bases to be discussed are not significant in terms of amount collected (9.2 percent of the total revenue in 2010, resulting in R\$118.5 billion, or 3.14 percent of GDP), some taxes included in these groups are important as a government economic policy instrument and even as a specific source of funds for states (Vehicle Tax (*Imposto sobre Propriedade de Veículos Automotores*, or IPVA)) and municipalities (Urban Real Estate Tax (*Imposto Predial e Territorial Urbano*, or IPTU)).

5.1. Financial Transactions

In 2010, taxes on financial transactions brought in about R\$51.5 billion, or 1.37 percent of GDP (here we have included IRRF revenue derived from taxation of capital gains, as it is not included in tax paid based on the progressive table on the annual declaration). Although the Provisional Contribution on Financial Transactions (*Contribuição Provisória sobre Movimentação Financeira*, or CPMF) is included in Table 15, only the Tax on Financial Operations (*Imposto sobre Operações Financeiras*, or IOF) and the IRRF – Capital Gains were sources of revenue in 2010, with each tax responsible for approximately 50 percent of the revenues collected. Even though the CPMF is no longer levied in Brazil, it is important to mention it not only because its residual fines and interest fees are still levied but also due to the fact that it was the subject of an important debate in Brazil recently.

Table 15
Tax Revenues from Financial Transactions - 2010

	Revenues (R\$ billions)	Fines and interest (R\$ billions)	Total (R\$ billions)	% of total	% of GDP	R\$ per capita
Financial transactions	51.37	0.12	51.48	100.00%	1.37%	280.48
CPMF	-0.05	0.07	0.02	0.05%	0.00%	0.13
Tax on financial operations	26.53	0.05	26.58	51.62%	0.70%	144.79
IRRF - Capital (Federal)	24.88	0.00	24.88	48.33%	0.66%	135.56

Source: Authors' calculations.

IOF

- Levied by: Federal Government
- Type: Tax

- Background: Created by Law No. 5,143 of October 20, 1966. Currently, Decree No. 2,219 of May 2, 1997 governs this issue, and also regulates the tax on transactions involving gold, financial assets and exchange instruments (Law No. 7,766 of May 11, 1989), exchange and security transactions (both governed by Law No. 8,894 of 21.06.1994).
- Rates:
 - *On Credit Transactions:* 0.0082 percent per day for individuals; 0.0041 percent per day for corporations, and an additional 0.38 percent regardless of the term and the contractor.
 - *On Exchange Transactions:* 0.38 percent; except for settlement of foreign exchange transactions related to foreign loans with a minimum average maturity of up to 1,800 days (6 percent) and foreign exchange transactions due to credit card purchases abroad (6.38 percent).
 - *On Insurance Transactions:* 0 percent (zero) on reinsurance transactions; on compulsory insurance linked to home mortgage financing through an agent of the Housing Finance System; on export credit and international freight insurance; on aviation insurance and civil liability insurance paid by air carriers; and on transactions in which premiums are used to pay the costs of life insurance plans with coverage for survivors; 0.38 percent on transactions related to life insurance and similar plans, personal accident and work insurance, including compulsory insurance for personal injuries caused by land-based motor vehicles and seafaring vessels, or their cargo, to people transported or to other people; 2.38 percent on insurance transactions for private health care; and 7.38 percent on other operations.
 - *On Transactions Related to Bonds or Securities:* 0.5 percent per day when withdrawing investment fund shares before the maturity date for credit of earnings; 1.5 percent when stocks on a Brazilian stock exchange split; 1.5 percent per day on investments made by foreign investors in Emerging Market Mutual Investment Funds or in Real Estate Investment Funds; 1 percent per day on the withdrawal, split or repricing of bond or security transactions; 0 percent on the withdrawal, split or repricing of bond or security transactions after 30 days.
 - *On Transactions Involving Gold, Financial assets and exchange instruments:* 1 percent.

- Tax base: Value of the following transactions: credit transactions performed by financial institutions; exchange transactions; insurance operations performed by insurers; transactions related to bonds or securities; and transactions involving gold or financial assets.
- Revenue in 2010: R\$26.6 billion, equivalent to 0.7 percent of GDP, or R\$144.80 per capita.
- Comments: The source of just over half the tax collected on financial transactions in Brazil, the IOF began to take the lead beginning in 2008. Before that year, the easier and less expensive CPMF was used to produce the amounts the federal government deemed necessary. With the demise of the CPMF in December 31, 2007, the IOF began to be used to compensate the revenue loss, and was altered in various ways, especially its rate. In fact, this can be seen by analyzing the figures: in 2007 the IOF raised about R\$7.8 billion, which represented 0.29 percent of GDP that year, while in the year immediately following that (2008) the amount collected rose significantly to R\$20.2 billion, equivalent to 0.67 percent of GDP that year. The real increase surpassed 100 percent.

BOX 10 - IOF AND EXCHANGE TRANSACTION CONTROL

One of the factors that has most contributed to the loss of Brazilian industrial competitiveness is the exchange rate. With the relative fiscal stability of the Brazilian public sector and the capital inflows provided by richer countries (especially United States and the Euro zone), Brazil became an interesting destination for international investments, and has attracted increasing amounts of money. Due to these massive inflows, the Brazilian real has appreciated with respect to other international currencies, especially the dollar—a fact to which Brazilians have become accustomed in recent years.

Some mechanisms have been used by the government to contain the appreciation of the Brazilian real, such as Brazilian Central Bank intervention in the exchange market, which has resulted in the institution's constantly increasing international reserves. From a tax perspective, the Government has been using the IOF to fight the "exchange war" since last year. The first alterations were made on March 28, 2011 (Decree No. 7,456): the IOF rate on foreign use of credit cards rose from 2.38 percent to 6.38 percent; and international credit transactions with terms of up to 1 year had a rate of 6 percent, while transactions for longer terms remained exempt. On April 6, 2011 (Decree no. 7,457), the second change was enacted: international credit transactions with terms of up to 2 years would have a rate of 6 percent, with transactions with longer terms exempt. On February 29, 2012 (Decree no. 7,683), the third change occurred: international credit transactions with terms of up to 3 years would have a rate of 6 percent, with transactions with longer terms exempt. On March 9, 2012 (Decree no. 7,698), the fourth change was enacted: international credit transactions with terms of up to 5 years would have a rate of 6 percent, with transactions with longer terms exempt.

Finally, on March 15, 2012, the fifth change in less than one year was enacted: the IOF applied to exporter exchange rate hedge transactions with derivative contracts was reduced to zero.

Even though these measures strive to reduce external goods consumption, discourage short-term speculative capital from abroad and decrease exporter costs, all of the changes were to control the exchange rate and increase competitiveness. The effects are still not being seen as strongly as the Government hoped, given the constant change in the tax and the increased flow of Brazilian tourists abroad.

IRRF - Capital Gains

- Levied by: Federal Government
- Type: Tax
- Background: Decree No. 3,000 of March 26, 1999.
- Rates:
 - *Long-term funds and fixed rate investments in general*: 22.5 percent for investments maturing in up to 180 days; 20.0 percent for investments maturing in 181 to 360 days; 17.5 percent for investments maturing in 361 to 720 days; and 15.0 percent for investments maturing in more than 720 days.
 - *Short-term funds*: 22.5 percent for investments maturing in up to 180 days; and 20.0 percent for investments maturing in more than 180 days.
 - *Stock funds*: 15 percent;
 - *Variable-rate investments*: 0.005 percent
- Tax base: capital gains (gain calculated as the positive difference between the sale value, net of IOF, and the amount invested);
- Revenue in 2010: R\$24.9 billion, equivalent to 0.66 percent of GDP, or R\$135.60 per capita;
- Comments: Despite being classified as part of the "financial transactions" tax base, the income tax withheld at source on capital gains is a specific part of income tax, applying to gains on financial investments, and for this reason is a direct tax (despite what its tax base would suggest).

BOX 11 – THE END OF THE “CHECK TAX”

One of the most controversial taxes in Brazil in recent times was certainly the CPMF, also called the "check tax" because it covered any financial transaction in the banking system. This tax was initially created as the IPMF (Provisional Tax on Financial Transactions) in 1993, through Supplemental Law No. 77 of July 13, 1993 and had a rate of 0.25 percent. During an economic transition (the creation of the Real Plan and the end of hyperinflation), this tax was created to increase revenue quickly, on an emergency basis, without a link to specific expenditures, and with an end date: December 31, 1994.

But it returned in the form of a social contribution in 1996 (Law No. 9,311 of October 24, 1996), as a temporary measure. The main argument for its re-creation was to finance public health. That is, the revenue earned through the contribution—with a rate of 0.20 percent—would be fully invested in the National Health Fund. Before the contribution expired, the CPMF was extended for another two years by Law No. 9,539 of December 12, 1997. With Constitutional Amendment No. 21 of March 18, 1999, the Government extended the contribution for three more years, this time with a rate of 0.38 percent in the first year and 0.30 percent in the two subsequent years. Additionally, the increase in revenues due to the difference in rates was to be used to finance Social Security. In 2002, through Constitutional Amendment No. 37 of June 12, 2002, the CPMF was extended until the end of 2004, with a rate of 0.38 percent for 2002 and 2003, and 0.08 percent in 2004. The revenues for those periods were to be distributed as follows: in 2002–2003, the National Health Fund would receive 0.2 percent, social security would receive 0.1 percent, and the Fund for Combating and Eliminating Poverty would receive the remaining 0.08 percent; in 2004, the Fund for Combating and Eliminating Poverty would receive the full 0.08 percent. Constitutional Amendment No. 42 of December 19, 2003 reversed the rate reduction for 2004, maintaining it at 0.38 percent, and extended the CPMF once again, until the end of 2007. The proposal to renew the contribution was rejected in December 2007, and the CPMF was finally discontinued at the end of that year. This subject was very controversial at the time and continues to be today.

Despite the fact that a provisional tax lingered for more than 10 years with successive extensions, tax experts and politicians presented various arguments defending the end or the continuation of the "check tax." The arguments against extending the CPMF were its cumulative nature, the increase in business and individual costs, and the lack of effective earmarking for the revenues due to the existence of a transitory constitutional provision that allows the use of part of the social contribution revenue to fund general government activities, known as de-earmarking of federal revenues (*desvinculação de recursos da União*, or DRU).. The low cost of the tax, its simplicity and its use as a mechanism to avoid tax avoidance were the arguments that defended the extension of the CPMF. Even after its demise, there were attempts to recreate it with another name (Social Contribution for Health - CSS), but in most respects similar to the former CPMF.

5.2 – Assets

With states and municipalities responsible for almost 100 percent of taxation on assets, this type of tax brought in approximately R\$ 45.9 billion in revenues in 2010, or 1.22 percent of GDP.

Table 16
Tax Revenues from Properties - 2010

Property	Revenues (R\$ billions)	Fines and interest (R\$ billions)	Total (R\$ billions)	% of total	% of GDP	R\$ per capita
Property	45.88	0.05	45.92	100.00%	1.22%	250.19
IPTU	16.04	0.00	16.04	34.93%	0.43%	87.40
ITR	0.48	0.05	0.52	1.14%	0.01%	2.84
ITBI	5.43	0.00	5.43	11.83%	0.14%	29.59
ITCD	2.51	0.00	2.51	5.46%	0.07%	13.66
Betterment contributions (municipal)	0.14	0.00	0.14	0.31%	0.00%	0.78
Betterment contributions (state)	0.00	0.00	0.00	0.00%	0.00%	0.00
IPVA	21.28	0.00	21.28	46.33%	0.56%	115.92

Source: Authors' calculations.

IPVA

- Levied by: States and Federal District
- Type: Tax
- Background: Established by Constitutional Amendment No. 27 of November 28, 1965 (to the 1967 Constitution).
- Rates: Vary from total exemption to 4 percent, depending on the state and type of vehicle.
- Tax base: Market value of the vehicle.
- Revenue in 2010: R\$21.3 billion, equivalent to 0.6 percent of GDP, or R\$115.90 per capita.
- Comments: Currently, the IPTU is the primary tax on assets or property in Brazil. Like all direct taxes, it is based on the ability to pay principle with the owners of more expensive vehicles paying more. Before the creation of the IPVA, there was a similar tax, called the Single Highways Fee, which was collected annually by the Federal government upon vehicle licensing. Its revenues were used to carry out highway conservation work (Bernardes and Melo, 2008). With the creation of the IPVA, the states and Federal District were empowered to establish and levy the tax. These governments have full autonomy to legislate with respect to the tax, as no supplemental Federal legislation was established to define parameters for the subnational units. Different state legal norms gave rise to a type of "tax war": vehicle owners living in one state commonly register their cars in another state in order to pay a lower rate or even to avoid annual vehicle licensing. It is not surprising to see many cars with license plates from states with lower rates, such as Espírito Santo, Santa Catarina and Paraná, in states with high IPTU rates

(São Paulo, Rio de Janeiro, and Minas Gerais). This effect can also be classified as a distortion, since in these cases the state that receives the tax does not need to provide public services. The states affected by this practice have tried to prevent it, but the process is costly and legally difficult.

IPTU

- Levied by: Municipalities and the Federal District
- Type: Tax
- Background: It originated in 1808, with the name "Urban Tenth," and was collected by the Crown until 1834, when it came under the authority of the provinces. Municipalities have had the authority to levy it since 1891, when the first Brazilian Republican Constitution was enacted (Bones, 2005), Municipalities establish the tax within the limits proposed by the National Tax Code (Fornerolli, undated)
- Rates: Set by each municipality, limited to a maximum of 15 percent (Law No. 10,257 of July 10, 2001).
- Tax base: Market value of the property.
- Revenue in 2010: R\$16 billion, equivalent to 0.4 percent of GDP, or R\$87.40 per capita.
- Comments: Municipal governments have full autonomy to levy this tax, since the current Constitution places no restrictions on the IPTU rates. However, the rate is not the main problem with the tax, but rather the fiscal value of property, which is its base. According to Carvalho Jr. (2006), there is a substantial regressive component in the implementation of the tax caused by a regressive evaluation of the market value of property. This means that local governments allow a greater discrepancy between the market value and the fiscal value of more expensive properties than for less expensive properties, burdening relatively poorer households. Tristão (2003) also indicates the possibility of political manipulation by interest groups, especially in small municipalities, as a way to reduce taxes levied on local property. Constitutional amendment No. 29 of September 13, 2000 permits progressive rates for the IPTU, which would, in principle, solve the regressive tax problem.

BOX 12 — IPTU vs IPVA

One characteristic of Brazilian taxation, which is not new, is the fact that more IPVA is collected than IPTU. This alone is enough to awaken the curiosity of someone hearing about this fact for the first time. However, what stands out most is that the difference in amount collected is increasing. For instance, using data from three separate years (1990, 2000 and 2010), each one representing a different decade, in 1990 the IPTU brought in 0.18 percent of GDP, while the IPVA brought in 0.09 percent of GDP. Or in other words, in 1990 twice as much IPTU was collected than IPVA. In 2000, the IPTU represented 0.47 percent of GDP, whereas the IPVA was 0.45 percent of GDP. Note that, at the start of the 2000s, the two taxes were almost identical in terms of amount levied. And now, in 2010, the IPTU brought in approximately 0.43 percent of GDP, and the IPVA 0.56 percent of GDP, surpassing the IPTU by 0.13 percent of GDP. The explanation for this evident trend depends on two basic factors: the strong growth of the fleet of cars and the difficulty in estimating the tax base for the IPTU. The evidence is clear on the first factor: according to DENATRAN data, in 2010 there were 64.8 million vehicles (of all types); in 1998 (the first year available in DENATRAN data), there were 24.4 million cars. This represents a growth of 165.6 percent in 12 years (or an average growth of 8.5 percent per year). On the second factor, one must take into account the difficulty of most municipalities in precisely evaluating the market value of real estate, due either to lack of property inspectors or to lack of trustworthy data from the real estate market. Additionally, a change in the fiscal value of property would require the approval of the City Council, which could be difficult for political reasons. In the end, the tax base of the IPTU is readjusted based only on inflation, despite increases in the real value of the properties. This problem does not occur with the IPVA, since there are references and publications that follow the automotive market, such as the FIPE Table. Thus, the states do not incur the cost of doing research on the value of the tax base, which is always up-to-date.

Real Estate Transmission Tax (*Imposto sobre Transmissão Intervivos*, or ITBI)

- Levied by: Municipalities and the Federal District
- Type: Tax
- Background: The first version of the tax on property transmission in Brazil dates to 1809, but it was included in the Constitution only in 1891, when states were given the authority to levy it. Additionally, the Constitution of 1891 established the two separate taxes, one on real estate sales, the ITBI, and the other on transmissions through gifts or at death, the Tax on Inheritance and Gift (*Imposto sobre Transmissão Causa Mortis e Doação*, or ITCD). After a sequence of fusions and separations of the two taxes in the following constitutions, the 1988 Constitution established the prevailing rule: the states and Federal District may levy the ITCD and the municipalities may levy the ITBI (Conti, 1998).
- Rates: Variable, depending on the municipality.
- Tax base: Market value of the property transferred.
- Revenue in 2010: R\$5.4 billion, equivalent to 0.1 percent of GDP, or R\$29.60 per capita.

ITCD

- Levied by: States and Federal District
- Type: Tax
- Background: See the section on the ITBI.
- Rates: Variable, depending on the state.
- Tax base: Market value of the property or rights transferred.
- Revenue in 2010: R\$2.5 billion, equivalent to 0.1 percent of GDP, or R\$13.70 per capita.

Rural Real Estate Tax (*Imposto Territorial Rural*, or ITR)

- Levied by: Federal Government
- Type: Tax
- Background: Taxation on rural property has existed in Brazil since 1879. It was eliminated for a short time, then was re-established in the 1891 Constitution, but integrated with the tax on urban property. Therefore it was one tax on all properties with a rate of 5 percent. After various changes throughout the twentieth century, the 1988 Constitution ratified the levying of the tax. However, it was regulated through supplementary legislation in 1994 (altered in 1996), when the rates increased significantly. Currently, the ITR is governed by Law No. 9,393 of December 19, 1996.
- Rates: Calculated according to the total area of rural property and its Degree of Use (GU), according to Table 17:

Table 17 - Rural Real Estate Tax Rates

Total area of property (hectares)	Degree of use (%)				
	Over 80	From 65 to 80	From 50 to 65	From 30 to 50	Up to 30
Up to 50	0.03	0.20	0.40	0.70	1.00
From 50 to 200	0.07	0.40	0.80	1.40	2.00
From 200 to 500	0.10	0.60	1.30	2.30	3.30
From 500 to 1,000	0.15	0.85	1.90	3.30	4.70
From 1,000 to 5,000	0.30	1.60	3.40	6.00	8.60
Over 5,000	0.45	3.00	6.40	12.00	20.00

Source: Finance Ministry.

- Tax base: Market value of the "naked" land (without any improvements).
- Revenue in 2010: R\$0.5 billion, equivalent to 0.014 percent of GDP, or R\$2.80 per capita.
- Comments: Previously levied by states and municipalities (1961), is came under the authority of the Federal government in 1964 in order to eliminate administrative

problems. The National Institute for Colonization and Agrarian Reform (Instituto Nacional de Colonização e Reforma Agrária, or INCRA), responsible for collecting the tax at the time, could not overcome political problems, due to the great influence of large land owners, and administrative problems, due to the country size and the difficulty in defining productivity indicators for agricultural activities (Meneghetti Neto, 1992). Even today, the objective of the tax is to promote a redistribution of land, aligned with the Brazilian agrarian reform agenda, by discouraging owning land as an investment. However, the lack of effective administrative measures in terms of broader inspections, registration and control of agrarian tax debts has prevented these objectives from being reached (Petti, 1998).

5.3 – International Trade

In 2010, taxes levied on "international trade" amounted to 0.56 percent of GDP, or approximately R\$21.1 billion (R\$ 115.2 per capita).

Table 18
Tax Revenues from International Trade - 2010

	Revenues (R\$ Billions)	Fines and Interest (R\$ Billions)	Total (R\$ Billions)	% of Total	% of GDP	R\$ per capita
International Trade	21.08	0.06	21.14	100.00%	0.56%	115.15
Import Tax	21.04	0.06	21.09	99.79%	0.56%	114.92
Export Tax	0.04	0.00	0.04	0.21%	0.00%	0.24

Source: Authors' calculations.

Import Tax (Imposto de Importação, or II)

- Levied by: Federal Government
- Type: Tax
- Background: A tax on imports was initially established by the 1891 Constitution, under the name Tax on Imports from Foreign Origins and authority to levy the tax was given only to the Federal Government, with the possibility of (only) collection by states in specific cases, with subsequent transfer of the revenue to the National Treasury. The basic structure of the tax, still levied by the Central Government, has remained the same since then, and was ratified by the 1988 Constitution.
- Rates: Established in the Common External Tariff¹² (*Tarifa Externa Comum*, or TEC) table and the Manufactured Product Tax Table (*Tabela do Imposto sobre Produtos Industrializados*, or TIPI)¹³ tables.

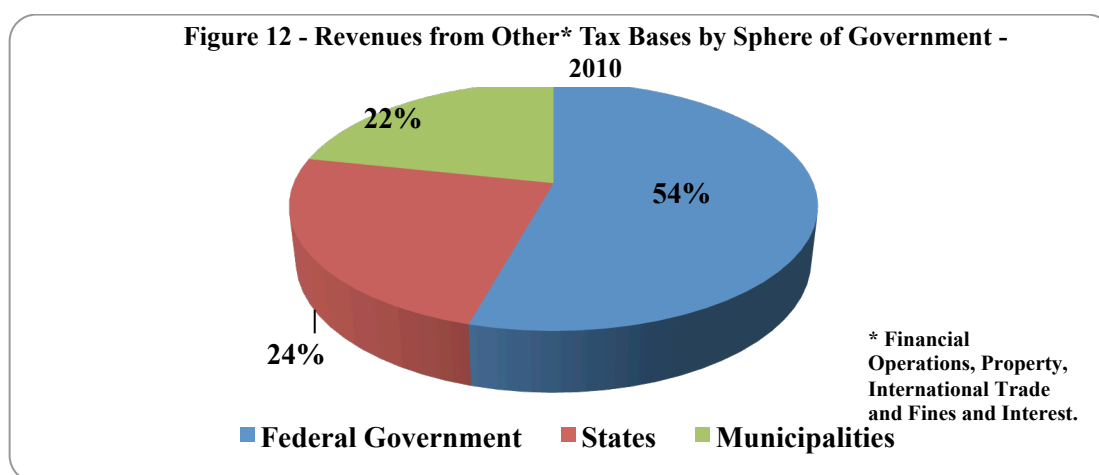
¹² Available at: <http://www.receita.fazenda.gov.br/Aduana/TabelaTec/Introducao.htm>.

¹³ Available at: <http://www.receita.fazenda.gov.br/aliquotas/downloadarqtipi.htm>.

- Tax base: Value of imported good.
- Revenue in 2010: R\$21.1 billion, equivalent to 0.56 percent of GDP.
- Comments: The II, responsible for practically all revenues on foreign trade, currently has a secondary role as a source of revenue and is used more as a trade policy instrument or for regulation purposes. However, this was not always the case. From the end of the nineteenth century to the 1930s, this tax was a very important for raising tax revenues: "Since the economy was principally agricultural and extremely open, the principal source of public revenues during the Empire was foreign trade, especially the import tax, which corresponded to up to 2/3 of public revenues in some years" (Varsano, 1996: 2). It has been adapted to fit Brazil's participation in Southern Cone Common Market (Mercado Comum do Cone Sul, or MERCOSUL), with an tariffs (rates) harmonized with those of the other three signatory (Uruguay, Argentina and Paraguay) of the Treaty of Asunción (<http://www.mercosul.gov.br/tratados-e-protocolos/tratado-de-assuncao-1>) of March 26, 1991.

5.4 - Taxation by Sphere of Government

Considering the three tax bases described in this chapter ("financial transactions," "property" and "international trade") together with "Other Revenues" (Table 28, contained in the Appendix), note that there is a reasonable distribution of revenue among the three spheres of government, the Central Government collecting just over half the total. The more equitable distribution of tax authority seen in this chapter facilitates understanding how collection is shared among the spheres. Figure 12 shows the federative division of the revenues from the three tax bases and "other revenues."



Source: Authors' calculations.

Of the four categories, the Federal Government has the sole authority to levy two of them: "financial transactions" and "foreign trade." Just these two categories account for almost all of the Federal Government's revenues in this analysis, corresponding to 54 percent of the total (R\$73.2 billion, or 1.94 percent of GDP). The two remaining categories ("property" and "other revenues") are taxed by subnational governments—with the exception of the ITR, Federal Fines and Late Fees. Thus, the states and municipalities have a 24 percent (R\$ 32.4 billion) and a 22 percent (R\$ 29.2 billion) share of the total, respectively.

6 - INTERGOVERNMENTAL TRANSFERS AND AVAILABLE REVENUE

Brazil is an enormous country, politically divided into 26 states, which are subdivided into 5,564 municipalities, and the Federal District. It is heterogeneous in many aspects, such as: cultural, economic, demographic density, natural resources, etc. For public policy issues, the states can be grouped into five regions with similar socioeconomic characteristics: the poorer North and the Northeast, the richer South and Southeast, and the Midwest. For these reasons, the public administration of a federation like Brazil must have strong mechanisms for auditing, verification and accountability and an appropriate, adaptable transfer system.

Specifically, the intergovernmental transfers and their implications for the revenues of the different levels of government are the focus of this chapter, which is structured as following: the first section presents the principles on which the Brazilian transfer system is based, that is, on which specific criteria and peculiarities of the country the creation of the transfers was based on. That will be followed by a short analysis of the distribution of revenue among the spheres of government from the point of view of available revenue (after transfers); the last section will detail each of the transfers currently taking place.

6.1 – Introduction to Intergovernmental Transfers in Brazil

The greater the capillarity of public services, the greater the demand for subnational autonomy: in other words, local governments need greater freedom to develop and carry out policies, since their greater proximity to taxpayers increases the efficiency and focus of local public policies. At the same time, the ability of the people to monitor and demand actions of the government is greater in the case of local government, increasing the accountability of the federative system. On the other hand, the fiscal responsibility of national governments could be compromised, since the Central Government's power to manage public accounting is reduced.

The transfer system and the rules of the federative system must be planned so that there is a balance of responsibilities in this respect, as the subnational governments must render accounts both to the people and to the Central Government. The federative question and its rules will be discussed in greater depth in chapter 7, which is on issues in Brazilian taxation.

The income inequality among states is a reality that requires fund transfer mechanisms for regional redistribution of income, transferring tax revenues from more developed to less developed regions. The idea is to ensure that states or municipalities with different tax bases make equivalent efforts to finance public services. Or in other words, a subnational government with lower revenue generation capabilities should receive funds proportional to its needs, so that it does not need to apply higher tax rates to offer public services of the same level of quality as governments in the opposite situation.

In order to avoid excess tax resources transfers to areas with restricted tax bases, the redistribution should take another aspect into consideration: the ratio of the cost of the set of public goods and services demanded by the people and the local government ability to finance them. In general, the larger the population, the greater the need for public services such as transport; road infrastructure and traffic management; larger and more-advanced hospitals, more schools; security forces; etc. This fact, known as the fiscal gap, tends to reduce the transfer needs to less populous areas to the benefit of other (more developed areas) as would occur based on revenue generation criteria, though the methods can be used simultaneously. It is not important if the area collects less tax than the average municipality or state, but rather if it collects enough to provide public services, improve quality of life and promote income equality for its residents.

One problem in the federative system is the lack of subnational governments' ability to provide certain goods or services whose benefits are not directly measurable or which they cannot claim credit for. This is the case of education, which provides benefits for all of society, but cannot be taken into account by local governments because of the possible migration of the better-educated residents and, consequently, the loss of the "earnings." The Brazilian transfer scheme was developed following these principles and parameters, and is described in detail in the remainder of this chapter.

BOX 13 – CLASSIFICATION OF TRANSFERS BY THEIR NATURE (CONDITIONAL OR NOT)

The idea of the conditional nature of transfers is related to the earmarking of revenues. When they are unconditional, revenues transferred are not earmarked for a specific use, and the recipient can use them as it sees fit; when unconditional, the use is restricted by the transferor. Matching funds, which must be spent by state or municipal governments out of their own resources, are additional and proportional to the resources received through transfers for a specific purpose. The transfers may be classified further as block grants (without matching funds), matching grants (with matching funds) or equalizing. The classifications by conditional nature can be broken down further:

- a) *Unconditional redistributive transfers*: This type of transfer follows criteria whose objective is equitable sharing of resources, generally through indexes that consider population, per capita income, access to basic services, etc. without taking into account the region in which the income originated. Its purpose is the regional redistribution and reduction in the fiscal gap. Examples: State Revenue Sharing Fund (*Fundo de participação dos Estados*, or FPE) and Municipal Revenue Sharing Fund (*Fundo de Participação dos Municípios*, or FPM).
- b) *Unconditional restitutive transfers*: These transfers give back tax revenues to the subnational government which collected them. Their purpose is to increase the efficiency of the tax system. The centralization of tax collection tends to reduce the costs of collection both for taxpayers and the government, as auditing and registration of taxpayers is easier and the effect of cumulative taxes is reduced. Examples: Municipal Value Added Tax
- c) *Voluntary conditional transfers*: These transfers are due to discretionary federal government policies. Examples: Agreements and accords.
- d) *Mandatory conditional transfers*: The rules on the sums to be transferred to subnational governments are defined in the Constitution and governed by law. Their purpose is to encourage the provision of public services such as health and education by subnational governments. Examples: Education—the Fund for Maintenance and Development of Elementary Education and Promotion of Teachers (*Fund for Maintenance and Development of Fundamental Education and Enhancement of Teaching*, or FUNDEF) and the Fund for Maintenance and Development of Elementary Education and Promotion of Education Professionals (*Fundo de Manutenção e Desenvolvimento da Educação Básica e de Valorização dos Profissionais da Educação*, or FUNDEB)—and health (the National Health System).
- e) *Transfers to the Productive Private Sector*: Funds are transferred to development agencies or financial institutions, rather than subnational governments. Their objective is to promote a regional redistribution of income. Examples: Constitutional Fund for Financing in the Northeast (FNE), Constitutional Fund for Financing in the North (FNO) and Constitutional Fund for Financing in the Midwest (FCO).
- f) *Direct transfers to individuals*: These are funds transferred directly to individuals, as indicated, without subnational governments acting as intermediaries. Their objective is regional and individual redistribution of income. Examples: the family allowance program.

6.2 – Available Revenue: The Tax Burden from Another Point of View

In chapter 1, the Brazilian tax burden was described in a traditional manner: direct taxation, by tax base (origin of revenue), and by sphere of government. In other words, besides describing the tax burden by type of tax, we also mentioned how much each level of Government collected directly through the taxes that they are empowered to collect.

However, as it was explained at the beginning of this chapter, the Brazilian federative system is characterized by flows of monies between government spheres, which consequently affect their budgets. We are calling the sums received by each sphere of government through direct collection and intergovernmental transfers "available revenue." Table 19 shows this alternative view, outlining not only the share of each government sphere (Federal government, states and municipalities), but also the transfers responsible for the shares.

Table 19
Available Revenues by Sphere of Government - 2010

	Total (R\$ Billions)	% of GDP	% of Total	R\$ per capita
Available Revenue	1,288.98	34.19	100.00	6,940.70
Federal Government	729.81	19.36	56.62	3,929.77
States	323.36	8.58	25.09	1,741.18
Municipalities	235.81	6.25	18.29	1,269.75
Constitutional transfers				
Federal Government to States	73.78	1.96	5.72	397.26
FPE	39.02	1.04	3.03	210.13
FPEX	2.95	0.08	0.23	15.88
IOF Gold	0.00	0.00	0.00	0.01
ICMS Insurance	1.17	0.03	0.09	6.32
FUNDEB	11.28	0.30	0.87	60.73
Education Contribution	7.37	0.20	0.57	39.66
FEX 1/	1.46	0.04	0.11	7.88
CIDE	1.34	0.04	0.10	7.21
Financial Aid to States	0.80	0.02	0.06	4.31
Royalties and Participations	8.38	0.22	0.65	45.15
Federal Government to Municipalities	65.82	1.75	5.11	354.42
FPM	43.07	1.14	3.34	231.91
ITR	0.36	0.01	0.03	1.95
IOF Gold	0.00	0.00	0.00	0.02
ICMS Insurance	0.39	0.01	0.03	2.08
FUNDEB	15.26	0.40	1.18	82.17
FEX 1/	0.49	0.01	0.04	2.63
CIDE	0.44	0.01	0.03	2.36
Financial Aid to Municipalities	0.52	0.01	0.04	2.78
Royalties and Participations	5.30	0.14	0.41	28.53
States to Municipalities	92.05	2.44	7.14	495.68
ICMS	51.92	1.38	4.03	279.55
IPVA	10.64	0.28	0.83	57.29
FPEX	0.74	0.02	0.06	3.97
FUNDEB	28.76	0.76	2.23	154.87

Source: Authors' calculations.

1) Fund to promote exports (until 2004, it was considered part of the Kandir Law).

The calculation of the "loss" or "gain" in revenues by a government sphere can be performed by comparing own revenue, provided in chapter 1, with available revenue, shown in Table 19 above. The federal government, for example, collected R\$869.4 billion (23.06 percent of GDP) in own taxes in 2010, but its available revenue was R\$729.8 billion (19.36 percent of GDP). Or in other words, the Federal Government transferred about R\$139.6 billion (3.71 percent of GDP) to subnational governments.

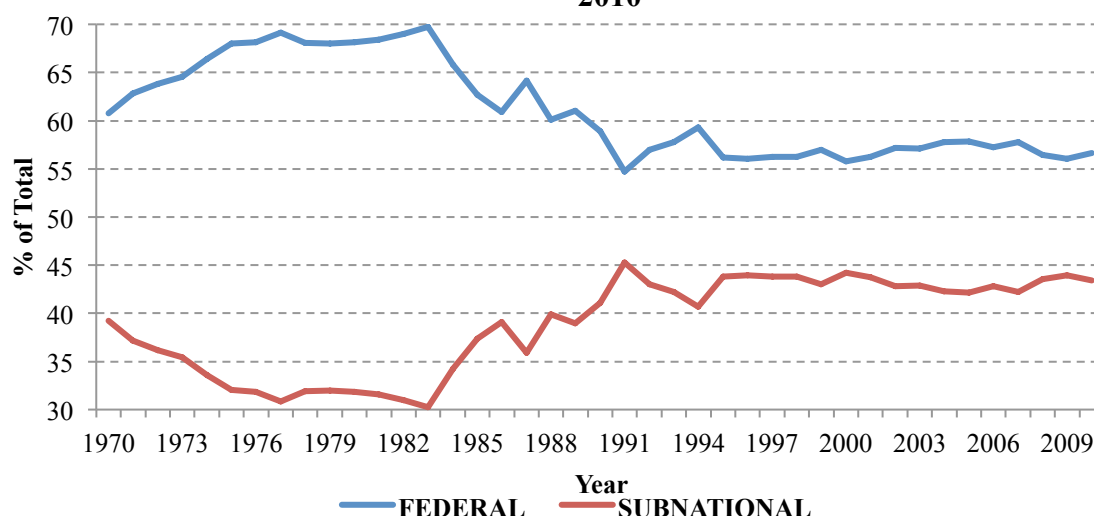
States, which collected R\$341.6 billion or 9.06 percent of GDP in 2010, kept R\$323.4 billion (8.58 percent of GDP) after transfers. This means that, in net terms (received less transferred), this government sphere transferred R\$18.2 billion (0.48 percent of GDP), making it a net transferor. The municipalities, in contrast, are the only sphere of Government that receives more funds than they transfer. They collected R\$77.9 billion (2.07 percent of GDP), and had available revenues of R\$235.8 billion (6.25 percent of GDP). The difference between these two numbers (almost R\$158 billion) represents the net funds received by municipalities. That means that approximately 67 percent of revenues available to municipalities do not come from taxes that they collected, but rather come from the Federal Government and the states.

The transfer of monies between government levels varies, as shown in Table 19, and comes from several sources for different purposes. The principal sources, in terms of volume of funds, are the ICMS, the Municipal Revenue Sharing Fund and the State Revenue Sharing Fund. The next section describes the transfers shown in Table 19 in more detail.

BOX 14 - EVOLUTION OF AVAILABLE REVENUE AND FISCAL DECENTRALIZATION IN BRAZIL

One of the principles that guided the drafting of the 1988 Brazilian Constitution was federalism. From that moment on, more rights and duties have been conferred to subnational governments. In several policy areas, the state and local governments have been given more responsibilities, such as primary and secondary education, public safety and urban planning. To ensure these tasks were carried out, fiscal decentralization—or fiscal federalism—was a fundamental mechanism. Empowered to legislate on taxation and constantly receiving funds from the central government, the states and municipalities have been given more autonomy to manage their resources and budgets than previously. In practice, the process of decentralization began even before the Constitution of 1988, with the political reopening initiated in the early 1980s. Figure 13 shows the history of tax revenue sharing by the federal government and subnational governments since 1970.

Figure 13 - Available Revenues by Sphere of Government - 1970–2010



Note that an important transition clearly took place in the 1980s. The process started in 1983–1984, when the Federal Government's share of available revenue fell from almost 70 percent of the total to 66 percent. From then on, states and municipalities obtained increasingly more resources, peaking in 1991 when they received just over 45 percent of revenues after transfers. The institutional changes promoted since the early 1980s were responsible for this change. In 1983, through Constitutional Amendment No. 23, the percentage of federal transfers through the State Revenue Sharing Fund and the Municipal Revenue Sharing Fund increased from 10 percent to 14 percent and from 10 percent to 16 percent, respectively. Subsequently, on November 28, 1985, through Constitutional Amendment No. 27, the percentage for subnational governments via State and Municipal Revenue Sharing Funds rose again, in addition to the allocation of part of the Single Highways Tax (TRU) to these governments.

According to Souza (1997), public perception that states and—especially—municipalities were becoming impoverished, which could lead to serious social unrest, facilitated the decentralization of the 1980s. The height of the process was the 1988 Constitution, which, according to Falleti (2006): “...deepened the process of political and fiscal decentralization. Politically, the municipalities were recognized as integral members of the Federation. [...] Fiscally, both states and the municipalities secured higher levels of automatic federal transfers” (Falleti, 2006: 76). From 1991 to 1994, the decentralization process reversed slightly. At the beginning of the macroeconomic stability consolidation in Brazil, in 1995, it returned to a level similar to that of 1991, and except for small variations in specific years, has remained the same since. In 2010, the subnational governments' share was approximately 43.4 percent of the total. In general, “contrary to what is usually defended as 'common sense,' the process of fiscal decentralization preceded stabilization and began during an extremely adverse macroeconomic context of hyperinflation, low growth rates, heightened tensions and increased social demands. But the fact is that today we have a highly decentralized system, in which subnational units enjoy considerable autonomy, while the country's agenda is committed to the maintenance and guarantee of stability” (Afonso, Ramundo and Araújo, 1998: 8).

6.3 – Intergovernmental Transfers

Transfer of the ICMS or the ICMS quotas

- Classification: Unconditional non-matching transfers which distribution criterion is 3/4 restitutive and 1/4 redistributive.
- Background: From 1967, when it was established, to 1972, when new rules were set, the ICMS quotas were practically restitutive. Decree Law No. 1,216/72 modified the criterion for the transfers: instead of restitution to the place where the tax was collected, the quotas became proportional to the value added in each municipality, computed from taxpayer's information. In other words, instead of using revenue to compute the quotas, which was unfair with municipalities producing exempt goods (including exports), the value added by establishments located in the municipality was used. The restitutive transfers benefited municipalities with large tax bases, especially industrial ones. In 1980 (Constitutional Amendment No. 17/80), the distribution became hybrid in character: the use of the value added concept was limited to 75 percent of the resources to distribute and the remaining 25 percent could be distributed according to criteria established in a state law. The 1988 Constitution kept the distribution criterion, but increased the share of the ICMS allocated to municipalities from 20 percent to 25 percent.
- Source of revenue: 25 percent of the ICMS collected by the states.
- Destination of revenues (sharing scheme): 75 percent of revenues return to the municipality in accordance with the value added concept and 25 percent is distributed according to criteria established in state law. The most common criteria used in state laws have been number of inhabitants of the municipalities, their surface area, and a flat coefficient.
- Transfers in 2010: R\$51.92 billion, equivalent to 1.38 percent of GDP, or R\$279.75 per capita.

FPM

- Classification: Unconditional non-matching redistributive transfers.
- Background: The FPM was created during a centralizing political regime that, despite not having vetoed its existence, strongly restricted its source of funds. Still in existence today, it was reaffirmed by the 1988 Federal Constitution and is regulated by Decree Law No. 1,881/1981.
- Source of revenue: 23.5 percent of Federal Government revenues from income tax and IPI.

- Destination of revenues (sharing scheme): 10 percent of the funds are earmarked for state capitals; 86.4 percent to rural municipalities, and 3.6 percent to non-capital cities.
 - *Capitals*: two criteria are taken into account—the percentage of the population in that capital compared to the total population in all capitals and the state per capita income, so that capitals in richer states receive relatively less compared to poorer capitals.
 - *Rural municipalities*: The criteria for sharing resources is to use the population factor, calculated using a table of regressive coefficients in relation to the size of the population. It establishes a higher, but decreasing, weight for the most populous cities to offset the higher tax capacity of large population centers. A factor floor and ceiling were also set; below or above a certain number of inhabitants, the percentage of funds received is constant.
 - *Non-capital cities*: The same criteria used for capitals is applied to municipalities with a population factor equal to or greater than 3.8.
- Transfers in 2010: R\$43.07 billion, equivalent to 1.14 percent of GDP, or R\$231.91 per capita.

FPE

- Classification: Unconditional non-matching redistributive transfers.
- Background: The first constitutional treatment of redistributive transfers in Brazil dates back to 1967, when the FPE was created. The provision established that the fund would distribute 10 percent¹⁴ of net revenues from income tax and IPI to all states in accordance with each state's area,¹⁵ population and income. In 1976, the Special Reserve for Northern and Northeastern States (REENE) was created, which allocated up to 20 percent of the fund to the states in those regions, but without changing the distribution criteria. The remaining 80 percent was distributed to all states, including those in the North and Northeast. The FPE was ratified by the 1988 Constitution, but the portion of income tax and IPI collected by the Federal Government and distributed to states increased to 21.5 percent. Supplemental Law No. 62 of 1989 established the distribution criteria still valid today.

¹⁴ The fund was drawn from as little as 5 percent of income tax and federal value added tax collected in the most centralizing years of the military dictatorship, but it grew gradually to its current levels.

¹⁵ 5 percent of revenues were distributed using this criterion.

- Source of revenue: 21.5 percent of net revenues from the IPI and income tax.
- Destination of revenues (sharing scheme): Fixed coefficients as shown in Table 20.

Table 20
State Revenue Sharing Fund (FPE) - Apportionment among states

State	Region	% of FPE	State	Region	% of FPE
Bahia	NE	9.3962	Amapá	N	3.4120
Ceará	NE	7.3369	Paraná	S	2.8832
Maranhão	NE	7.2182	Goiás	MW	2.8431
Pernambuco	NE	6.9002	Rondônia	N	2.8156
Pará	N	6.1120	Amazonas	N	2.7904
Paraíba	NE	4.7889	Roraima	N	2.4807
Minas Gerais	SE	4.4545	Rio Grande do Sul	S	2.3548
Tocantins	N	4.3400	Mato Grosso	MW	2.3079
Piauí	NE	4.3214	Rio de Janeiro	SE	1.5277
Rio Grande do Norte	NE	4.1779	Espírito Santo	SE	1.5000
Alagoas	NE	4.1601	Mato Grosso do Sul	MW	1.3320
Sergipe	NE	4.1553	Santa Catarina	S	1.2798
Acre	N	3.4210	São Paulo	SE	1.0000
			Federal District	MW	0.6902
TOTAL N, NE, MW = 85%					
TOTAL S, SE = 15%					

Source: Mendes, Miranda and Cosio (2008).

- Transfers in 2010: R\$39.02 billion, equivalent to 1.04 percent of GDP, or R\$210.13 per capita.

FUNDEB

- Classification: Equalizing matching conditional transfers.
- Background: FUNDEB is a broadened version of its predecessor, FUNDEF, established in 1998, which finances not only elementary education, but also all basic education in Brazil. The alteration was established via Constitutional Amendment No. 53/2006, which changed the percentage of funds states and municipalities must allocate to basic education—both their own funds and those received through transfers—from 15 percent to 20 percent. The Federal Government must supplement fund resources to ensure equal financing of education by subnational governments.
- Source of revenue: States and municipalities transfer 20 percent of their own revenues plus revenues from transfers, and the Federal Government supplements the financing.
- Destination of revenues (sharing scheme): Based on minimum per capita amounts per child enrolled, with different values for different school levels, urban or rural regions, or special types of education (such as aboriginal or afro-Brazilian cultures) and youth and adult education.

- Transfers in 2010: R\$11.28 billion for states and R\$15.26 billion for municipalities, equivalent to 0.3 percent and 0.4 percent of GDP, respectively.

Government Revenues from Natural Resource Exploitation

- Classification: Partially restitutive, non-matching, conditional mandatory transfers.
- Background: Initially, in 1953 (Law No. 20,004), the tax collected was intended exclusively for the state from whose land the resource was extracted; in addition, it was mandatory for the state to distribute 20 percent to its municipalities. Starting in 1969, when offshore oil exploitation began, tax on these exploitations were collected exclusively by the Federal Government. These rules applied until 1985 (Law No. 7,453), when revenues from offshore exploitation were shared: 20 percent to the Federal Government, 60 percent to states and municipalities facing the wells, and 20 percent to all other subnational governments. These rates were changed to 20 percent, 70 percent and 10 percent, respectively, in Law No. 7,990 of 1989, and have remained the same since then. Special participations (collected from higher-volume, high-profit wells), governed by Law No. 9,478/97, are distributed as follows: 50 percent to the Federal Government, 40 percent to states and 10 percent to municipalities (Afonso and Gobetti, 2008).
- Source of revenue: Royalties, special participations and financial compensation from oil exploitation activities; governed by national law and audited by regulatory agencies (and not the RFB).
- Destination of revenues (sharing scheme): The rule on sharing of resources is linked to the type of resource exploited and is specified by the law regulating the mandatory payment of the government share on production (for example, in the case of oil and gas, the source of most revenues, distribution is defined in accordance with the rate applied). The schemes for sharing revenues from "oil and natural gas," "electrical power" and "mineral resources" are shown in Tables 21 and 22.

Table 21
Criteria for Distributing Royalties and Special Participations from Oil and Natural Gas Exploitation

Federal Entity Category	Royalties on 5% of production		Royalties on the rate exceeding 5%		Special Participation
	Exploitation on land, in lakes, rivers and on islands in lakes or rivers	Exploitation on the continental shelf	Exploitation on land, in lakes, rivers and on islands in lakes or rivers	Exploitation on the continental shelf	
State where produced, or bordering	52.5%	22.5%	52.5%	22.5%	40.0%
Municipality where produced, or bordering	20.0%	30.0%	15.0%	22.5%	10.0%
Municipalities where offshore or land facilities for loading or unloading crude oil and/or natural gas are located	10.0%	10.0%	-	-	-
Municipalities affected by loading or unloading operations	-	-	7.5%	7.5%	-
Special fund for distribution to all states and municipalities	-	10.0%	-	7.5%	-
Municipalities in the state where produced, or bordering (as per ICMS criteria)	17.5%	17.5%	-	-	-
Federal Government	-	20.0%	25.0%	40.0%	50.0%
Total share of states and municipalities	100.0%	80.0%	75.0%	60.0%	50.0%
Total share of municipalities	47.5%	57.5%	22.5%	37.5%	10.0%

Source: Mendes, Miranda and Cosio (2008).

Table 22
Criteria for Distributing Financial Compensation Related to the Production of Electrical Power, Royalties from the Itaipu Plant and Exploitation of Mineral Resources

Federal Entity Category	Water resources	Itaipu royalties	Mineral resources
States directly affected	40.0%	38.25%	23.0%
Municipalities directly affected	40.0%	38.25%	65.0%
States affected by upstream reservoirs	-	6.75%	-
Municipalities affected by upstream reservoirs	-	6.75%	-
Federal Government	20.0%	10.00%	12.0%
Total share of states and municipalities	80.0%	90.00%	88.0%
Total share of municipalities	40.0%	45.00%	65.0%

Source: Mendes, Miranda and Cosio (2008).

- Transfers in 2010: R\$8.38 billion for states and R\$5.3 billion for municipalities, equivalent to 0.22 percent and 0.14 percent of GDP, respectively.

Compensation for Loss of Revenues from Exports

- Classification: Voluntary, unconditional non-matching restitutive transfer,.
- Background: The exemption of exports of commodities and semi-manufactured goods from the ICMS, established in Supplemental Law No. 86/1996 (the Kandir law), provided guaranteed compensation to states through transfers, based on criteria specified in the same law. Believing they were insufficiently compensated, the state governments pressed for better the conditions. Constitutional Amendment No. 42/2003 established the mandatory nature of the compensation, but left for future supplementary legislation the

definition of criteria, terms and conditions for transfer of resources. As the supplementary law has not yet been approved, the Kandir law criteria continue in effect, including those that established, starting in 2003, that the Federal Government's transfers to states are be subject to budgetary allocation, allowing the Federal Government to reduce the amounts to be transferred. Currently, compensation is paid through two mechanisms, one being related to the export of manufactured products and the other associated with the export of commodities and semi-manufactured goods (transfers based on the so called IPI-exports and the Exporting State Revenue Sharing Fund (*Fundo de Participação dos Estados Exportadores*, or FPEX), respectively).

- Source of revenue: 10 percent of the IPI revenue in the case of the IPI-exports and budgetary allocation in the case of the FPEX.
- Destination of revenues (sharing scheme): The funds are transferred to the states in accordance with the quantity of each state's exports. 25 percent of revenues received by the states must be distributed to their municipalities using the same criteria used for distributing the ICMS quotas.
- Transfers in 2010: R\$2.95 billion from IPI-exports and R\$1.17 billion from FPEX from the Federal Government to the states, and R\$0.74 billion from FPEX from States to Municipalities; equivalent to 0.08 percent, 0.03 percent and 0.02 percent of GDP, respectively.

CIDE – oil

- Classification: Mandatory non-matching transfer for conditional use (tied to investments in transport infrastructure).
- Background: A 25 percent transfer of the CIDE was established by Constitutional Amendment No. 42/2003, with 18.75 percent to the states and 6.25 percent to municipalities. Law No. 10,866/2004 regulated the distribution of the tax and Constitutional Amendment No. 44/2004 increased the percentage distributed from 25 percent to the current 29 percent.
- Source of revenue: The federal government must transfer 29 percent of the revenue from CIDE, with 21.75 percent passed to the states and Federal District and 7.25 percent to municipalities.
- Destination of revenues (sharing scheme): The criteria for distributing funds to the states is the following: 40 percent proportional to the federal and state highway network in the state

or Federal District; 30 percent proportional to fuel consumption; 20 percent proportional to the population; and 10 percent distributed linearly.

- Transfers in 2010: R\$1.34 billion to states and R\$0.44 billion to municipalities, equivalent to 0.04 percent and 0.01 percent of GDP, or R\$7.21 and R\$2.36 per capita, respectively.

Other Unconditional Transfers

- Classification: Unconditional non-matching restitutive transfer.
- Source of revenue: 50 percent of the IPVA collected by the states; 50 percent of ITR) collected by the Federal Government; and 100 percent of the IOF on gold collected by the Federal Government.
- Destination of revenues (sharing scheme):

Table 23
Criteria for Distribution of the IPVA, ITR and IOF Gold

	IPVA	ITR	IOF Gold
States – origin of tax base	-	-	30%
Municipalities – origin of tax base	50%	50%	70%

Source: Authors' calculations.

- Transfers in 2010: R\$10.64 billion from the IPVA, R\$0.36 billion from the ITR and R\$3 million from the IOF on gold to municipalities, equivalent to 0.29 percent of GDP. States received R\$1.3 million from the IOF on gold, approximately 0 percent of GDP.

7 – IMPORTANT BRAZILIAN TAX ISSUES

Throughout the previous six chapter of this report, peculiarities, characteristics, problems and solutions related to the Brazilian tax system were cited. Generally speaking, what we see is a scenario with many more defects than positive aspects. In addition to the level of the tax burden in Brazil—which, by itself, would be a questionable characteristic—taxation is organized in a perverse manner. The way the tax system is today along with several aspects of both own revenue collection and tax sharing can easily be challenged from several viewpoints: federalism, economic efficiency, equity, tax justice, simplicity, adaptability and dynamism.

The objective of this last chapter is to present the main taxation issues debated in Brazil. In the first section we present the relationship between taxes and the competitiveness of national companies in domestic and export markets. In the second section, based on observations of the social aspects of taxation, the focus will shift to the impacts of Brazilian taxes on household income distribution. In the third and final part we will discuss a contemporary political debate, namely conflicts throughout the federation: the tax war and the disputes for FPE resources and for royalties and financial compensation from oil and natural gas exploitation.

7.1 - A Tax System that Reduces Competitiveness

When discussing the relationship between taxes and industrial competitiveness or between taxes and economic efficiency, one should focus primarily on the distinct characteristics inherent in indirect taxes, levied on the production, circulation and consumption of goods and services. Indirect taxation in Brazil has at least two characteristics relevant to determining the competitiveness of national firms in domestic and foreign markets. They are: taxpayers' difficulty or impossibility in using tax credits for the ICMS, COFINS and PIS ; and the cumulative taxation of these three taxes and the ISS ().

7.1.1 – The Tax Credit Problem

Modern tax systems seek to use the most neutral indirect taxes possible in order to preserve the ability of firms to compete. By following the principle of neutrality, which advocates minimal interference in the allocation of tax resources, these systems are exercising their principal purpose without significantly affecting the competitiveness of the companies taxed. Neutral taxes are usually of value added taxes (VAT), which, as the name indicates, focus on

the value added at each stage of production. The Brazilian taxes that reduce competitiveness, in principle, are VATs. "In principle" because they were created (or reformed) to behave like a traditional VAT, although this is not what occurs in practice.

VAT is calculated in Brazil using the tax credit method, which "requires the company apply the rate to total sales and then from this result deduct the tax paid (credit), recorded on purchase tax receipts" (Bordin, 2002: 19). It is precisely this method, widely used by other countries, which creates one of the main problems for companies. If they cannot use their tax credits perfectly, the tax is no longer neutral. This difficulty is created by both the state governments, in the case of the ICMS, and the Federal Government, in the case of PIS/COFINS.

The problem of excess VAT credits is particularly detrimental for exporting companies. Given that companies are exempt from the tax when selling products overseas, the tax credit generated by the purchase of inputs might not be used (or be underutilized) if it exceeds the liabilities they incur due to sales to the domestic market. The degree of underutilization of credits will depend on the percentage of exports in company sales. If a company makes many sales abroad and few to the domestic market, it is very likely that it will accumulate these credits and cannot use them. The percentage of foreign sales large enough to cause an accumulation of credits is much smaller than one might think: "... companies that export more than 35 percent of production accumulate ICMS tax credits. That is, the amount of ICMS paid on the purchase of inputs is greater than the amount to be collected on sales to the domestic market" (FIESP, 2009: 6).

A situation like this would be easily solved by the refund of the excess credits in cash or through the sale of these tax credits to companies that owe tax, as in other countries. There is not much room for this type of measure in Brazil. The law that regulates the ICMS (the Kandir Law) attempted to create a tax aligned with good taxation practices by recognizing the transferability of credits to third parties. However, Supplemental Law No. 102/2000 reversed this process by specifying that these transfers could only occur under rules established by each state.

In general, this is not in the states' interest, as it can have fiscal implications such as loss of revenue and noncompliance with the Fiscal Responsibility Law. State governments usually claim they do not create compensatory measures because of credit transfer fraud and operational difficulties in paying the credits in kind. These allegations cannot always be

assumed to be true. The state government could easily manage the transfer of tax credits as an intermediary and adopt a standard procedure for the transaction. The alleged difficulty in paying in kind is not justifiable, since the Federal Government does this with income tax reimbursements. More recently, some state and local governments began to credit banking accounts of taxpayers using electronic tax invoices, which clearly demonstrates that there is no difficulty with direct compensation.

The problem of excess tax credits is more complex when interstate transactions are involved. When a company in one state purchases inputs from another state to produce export goods, it will accumulate tax credits in the state where it is located. This means that this state should refund the credit for tax collected by another state. Or in other words, refund an amount not received (IEDI, 2006). If each state undertook to repay credits in cash, this would result in a transfer of income from one state to another—a situation that local politicians could reject.

This is the case with the ICMS, but a similar problem exists for the PIS and COFINS. In this case, the slowness in tax credit refunds seems to be the principal reason for companies' loss of competitiveness (CNI, 2008). The accumulation of tax credits at the Federal level does occur, as the RFB recognized in mid-2011 when it published IPI, PIS and COFINS credit figures. Table 24 below shows these numbers.

Table 24
Tax Credits Accumulated by the Federal Government

Tax Credit	R\$ Billions		
	Credit (Total)	Debit (Total)	Balance
Total	62.4	37.4	25.0
PIS/COFINS	40.3	21.1	19.8
IPI	22.1	16.3	5.8

Source: RFB (2011).

It is quite likely that the export potential of Brazilian companies is affected by the accumulation of tax credits. First, the fact that governments retain resources belonging to companies for too long increases their opportunity cost—money that could be invested, for example. Thus, the cost of the final product increases, reducing competitiveness on the international market. Second, firms may prefer to sell more of their production to the domestic market, in order to be able to compensate their tax credits. The immediate

consequence is a reduction in exports, causing a decrease in the currency flow and current account imbalance.

In the specific case of PIS and COFINS, a reduction in bureaucracy would seem to be the principal solution. For the ICMS, however, the regulation of tax credit trading and/or the refund of these credits in cash would be the first important steps. In situations where there are interstate transactions, the best solution would be the adoption of the destination principle, in which the tax is collected by the state importing the good. As there is strong political resistance to a ICMS reform of this type, Rezende (2007) proposes the establishment of mechanisms for using credits without generating federative conflicts of interest: "Reconciliation of the interests of the states involved depends on [...] the assumption that the full use of tax credits resulting from export transactions can benefit both. [...] As an increase in exports is needed to obtain higher economic growth rates in Brazil, the states would also benefit from the increase in the tax revenues resulting from greater economic dynamism and from the increase in federal taxes subsequently transferred to states" (Rezende, 2007: 5).

7.1.2 – Cumulative Taxes

A tax is cumulative when "it is applied to two or more stages of the sale of goods, without the possibility of credit in a later step for tax paid in the previous step" (Medeiros Neto, 2001: 3). For a tax system to be neutral, as described in the previous section, there must be no cumulative taxes. Given that all tax systems have some cumulativeness, however small (Varsano et al, 2001), the previous statement can be rephrased: "For a tax system to approach neutrality, cumulative tax effects must be small." Sadly, this is not the case for the Brazilian situation.

Drawing a parallel with the tax credits issue described in the previous section, when a government does not allow the use of a VAT credit or when there are delays or a good deal of bureaucracy to obtain a refund, such as in the case of the ICMS, the tax can be classified as a cumulative tax. The VAT can also be classified in this way, at least during the period in which the taxpayer cannot receive or use accumulated credits—and, in Brazil, this is a chronic problem not only for the ICMS, but also for COFINS, PIS and IPI.

However, the problem is more widespread and worrisome given that many other taxes in Brazil are cumulative. What determines whether a tax will be cumulative or not is the how the company pays taxes. In Brazil, for purposes of IRPJ, companies can be classified under three basic regimes: real profits, presumed profits and the SIMPLES. In the latter two

regimes, which comprise most small companies, PIS and COFINS are cumulative. According to Silva (2005), even the CSLL and the IRPJ collected in these regimes have a cumulative effect. There is also the ISS, which is a cumulative tax if the company's activity is on the municipality's list, regardless of the regime under which the company pays taxes.

The significant presence of cumulative taxation, in addition to the distortion in the resource allocation, creates several problems for the economy. According to Varsano (2001), the detrimental effects of cumulativeness on the economy go beyond this. It promotes the vertical integration of companies, since outsourcing services would be more expensive due to the cumulative effect than providing the service in-house; harms investments, as capital goods, which normally result from long production chains, are strongly burdened by cumulative taxes; and distorts domestic competitiveness, to the extent that when the same products can be prepared by more than one manufacturing technique, some are burdened more by cumulative taxes; and it distorts foreign competitiveness, since imported products and/or competitors on the foreign market do not suffer from the same problem" (Varsano, 2001, cited in Castro, 2010: 26).

Attempts to reduce the cumulative effect were adopted in 2002 and 2003, through PIS and COFINS reforms (Box 3). However, the results were not satisfactory as the tax burden of the two taxes has increased significantly. The fact that the tax remained cumulative for many companies (specially the small ones) was perhaps the principal failure of the reform: "It is always important to remember that COFINS and PIS were not transformed into VATs. The new scheme is only applied to companies under the real profits regime [...] and even then with exceptions. There is a basic error in the philosophy that resulted in the recent changes: it was assumed that different economic sectors do not interrelate; as if the block formed by the large companies were an autonomous entity embedded in the economy, having no, or very few, interaction with companies outside the block" (Afonso and Araújo, 2004: 2–3). Additionally, several specific taxation schemes were created, significantly increasing the complexity of these contributions (FIRJAN, 2004).¹⁶

Most people believe that reforming taxation will improve competitiveness. However, according to some analysts, the few reforms in Brazil have had contrary effects. Castro (2010), using a methodology based on an input-output matrix, concludes that the 2002–2003

¹⁶ The Brazilian tax system is considered one of the world's most complex and requires much taxpayer time and money just to comply with tax obligations. According to PWC (2008), Brazil is the world champion of compliance, that is, the country where companies spend the most hours per year to comply with tax rules (about 2,600 hours/year).

PIS and COFINS reforms had negative impacts in terms of prices and industrial production, and created distortions in the relative prices of industrial goods. Therefore, the prior situation remained the same or even worsened.

A very recent change (the decrease in the tax burden on payroll) is also increasing cumulativeness in the tax system, despite the official discourse and reasonable consensus among analysts and taxpayers, all against cumulative taxes, although few complained: the employer's tax base in about a dozen economic sectors (including textile, footwear, software, call centers and hotels) changed from payroll to gross revenues (with a rate varying from 1 percent to 2 percent). In addition to not exempting companies from a tax—since the tax was not eliminated, only the tax base was changed (although less tax might be collected, depending on the calibration of the new rate)—, the new tax on gross revenues will replace one distortion with another, cumulativeness, which will be more important to the extent that it affects intermediate and capital goods industries, as there will be no way to eliminate the tax in later transactions.

7.2 - Equity and Fiscal Justice

Despite the recent slight improvement in income distribution indicators and in the percentage of households below the poverty line, social indicators in Brazil can still be considered very low, especially compared to other countries. Fiscal policy—understood here as taxation and social spending (both universal and targeted)—can be seen as one of the principal factors influencing the maintenance or even worsening of this distorted picture.

Disregarding the Government social spending policy (which is not the subject of this study), in Brazil, families with lower income levels are proportionally more "penalized" (burdened) by taxes than richer families. In other words, the Brazilian tax model is regressive, and this is why societal income distribution is worsening.

The first aspect that stands out, and has already been touched upon in Chapter 1, is the amount of money collected through indirect taxes in the country, which represents almost half of the total tax burden. In theory, tax systems that promote income redistribution via indirect taxes could succeed, if they focused this type of tax on goods consumed by higher income classes and exempted basic necessities. An alternative, with the objective of attaining greater tax justice, was proposed by Kaldor (1955), namely the levying of a (direct) tax on personal consumption (and not on the goods consumed). According to Kaldor, "this tax would bring together the advantages of economic neutrality, social justice and the direct

relationship between the taxpayer and the tax authority, supplementing the progressive role of income tax in the tax structure" (Quadros, 1994: 8).

However, indirect taxation does not work that way. Usually, indirect taxes are levied on most goods and services, whether basic or superfluous. The indirect tax embedded in the price is the same for any person who wishes to acquire the good or service. What could appear fair, given that everyone pays the same amount in tax when purchasing the same product, hides inequality in taxation. The problem resides in the fact that the purchasers of this product may have different income levels. Thus, the amount of tax represents a different percentage of each purchaser's income, which is contrary to the theoretical principle of ability to pay. In other words, there is no differential treatment for different individuals, as recommended by the concept of vertical equity (Stiglitz, 1999). It follows then that the person with the lowest income will pay a higher percentage of his income in tax on the product, and vice versa. Thus, a tax system that is strongly based on indirect taxes is regressive and harms income distribution.

This finding is not only theoretical. Zockun et al. (2007) argues emphatically that the regressivity of indirect taxation in Brazil is sufficient to overcome the progressivity of direct taxation, affecting the poorest mostly. Table 25 shows the distribution of the tax burden by income range.

Table 25
Direct and Indirect Tax Burden on Total Family Income in 1996 and 2004

Monthly Family Income	Direct and Indirect Tax Burden on Total Family Income in 1996 and 2004						Increase in Tax Burden (% points)
	% of Family Income				Total Tax Burden		
	Direct Taxation		Indirect Taxation				
	1996	2004	1996	2004	1996	2004	
up to 2x Min.wage	1.7	3.1	26.5	45.8	28.2	48.8	20.6
2x to 3x	2.6	3.5	20.0	34.5	22.6	38.0	15.4
3x to 5x	3.1	3.7	16.3	30.2	19.4	33.9	14.5
5x to 6x	4.0	4.1	14.0	27.9	18.0	32.0	14.0
6x to 8x	4.2	5.2	13.8	26.5	18.0	31.7	13.7
8x to 10x	4.1	5.9	12.0	25.7	16.1	31.7	15.6
10x to 15x	4.6	6.8	10.5	23.7	15.1	30.5	15.4
15x to 20x	5.5	6.9	9.4	21.6	14.9	28.4	13.5
20x to 30x	5.7	8.6	9.1	20.1	14.8	28.7	13.9
over 30x	10.6	9.9	7.3	16.4	17.9	26.3	8.4

Source: Zockun et al (2007).

Four aspects of Table 25 should be stressed: the regressive nature of the total tax burden, the increase in regressivity of indirect taxation, the lack of strong progressivity in direct taxation and the worsening of progressivity in direct taxation from 1996 to 2004. With respect to this last feature, note that the difference in payment of direct tax between the

lowest income range (up to two minimum wages) and the last (more than 30 times the minimum wage) fell substantially between 1996 and 2004: in the earlier year, while the poorest families spent 1.7 percent of their incomes on direct taxes, the richest spent 10.6 percent of their income — a difference of 9.9 percent; in the more recent year, these percentages were 3.1 percent and 9.9 percent, respectively, a difference of 6.8 percent. Note that, while families earning up to two minimum wages had increased direct taxes, households bringing in more than 30 minimum wages paid less in direct taxes. The distribution, which was already only slightly progressive in 1996, significantly worsened in 2004, contrary to good tax practices for obtaining tax equity.

The trend in direct taxation adds to the already patent regressivity in indirect taxation. Even worse, the regressivity of indirect taxes grew from 1996 to 2004: in the earlier year the difference in tax burden between the two extreme income ranges was 19.2 percent (26.5 percent less 7.3 percent), but in 2004 it had increased to 29.4 percent (45.8 percent less 16.4 percent). In short, Brazil does not just have a regressive tax system; it has accentuated the distortion in recent years.

The low level of effectiveness of direct taxation in Brazil to change income distribution is notable, not only due to the low effective tax rates paid by rich families, but also due to the low share of this type of tax in the overall tax burden. "First, the low degree of progressivity in direct taxation in the country is evident, since households in the poorest decile spend 3.7 percent of their income on taxes, while the richest ten percent of the households pay 12.0 percent. And the worst is that, while the poorest ten percent of households have an income of just R\$23.80 per person, the richest ten percent have an income of R\$2,126.53 per person. The progressivity of direct taxation is considered low because the Kakwani progressivity index is 0.1229, lower than that of six developed countries in which the direct tax burden on available income is about 33 percent, while in Brazil it is only 10 percent. In other four countries with lower progressivity, direct taxes are a much greater percentage of income, around 45 percent, and these countries also have less inequality in individual income distribution" (Silveira, 2008: 97).

Paes and Bugarin (2006) explore the same idea, showing that while taxation on income is (slightly) progressive, the same cannot be said with respect to taxes on consumption. Aside from the concept of tax on general consumption, some specific products have regressive taxation, while others have progressive taxation: "Among the most regressive taxes are those on basic groceries, domestic fuel (natural gas), electricity, clothing and

tobacco. The more progressive taxes are on automotive fuel, transportation, education, recreation and alcoholic beverages" (Siqueira, Nogueira and Souza, 2010: 31).

With a different approach, focusing on the tax burden relative to functional income distribution—not personal income, as analyzed above—the Institute for Applied Economic Research (IPEA) (2009) reveals that the burden on employees (24.4 percent of income) is considerably greater than the burden on employers or self-employed (13.6 percent of income). Considering that employers/self-employed have greater purchasing power than employees, we can reach a conclusion similar to the previous one: the Brazilian tax burden is regressive.

In response to the argument that families in lower income strata under-report income in socioeconomic surveys, Siqueira, Nogueira and Souza (2010) have proposed a new calculation for indirect tax burden by income class, based on level of consumption rather than income level, as is usually done. Thus, the authors come to a different conclusion, that indirect taxation in Brazil is not as regressive as previous research suggests. "Note that the two major components of the tax burden on the poorest are the taxes on domestic fuel and basic groceries, which are also the most regressive. However, the strong progressive nature of taxes on transportation and automotive fuel, which weigh heavily on the wealthy, has a compensating effect. In the end, the system becomes approximately proportional "(Siqueira, Nogueira and Souza, 2010: 26). Although this result shows that the indicator needs to be discussed further, if the same approach to the income of the poorest were applied to the richest, the results would most likely again indicate regressivity. That is, since the poorest families omit part of their income in surveys, the richest families probably do the same, for security reasons and/or misunderstanding. If just this were taken into account, the regressivity of the tax burden shown in prior studies would prove not to be overestimated, as the authors propose.

In a more recent study, Rezende, Afonso and Silveira (2011) again found that the weight of (highly regressive) indirect taxes is not offset by the progressivity of direct taxes, resulting in an overall regressive tax burden. In contrast, Siqueira, Nogueira and Souza (2012) show some degree of progressivity in (direct and indirect) taxation, despite acknowledging that the redistributive role of the system is negligible. As the tax system is currently designed, there are a few alterations that can be made to it in order to reduce or mitigate Brazil's distributional problems. Highly regressive indirect taxes, together with the progressive inefficiency of direct taxes, results in a weak tool for income redistribution in

Brazil (Immervoll, 2006). Improvements on direct taxation would require a reform that, at least, reviewed the potential of deductions in individual income tax (perhaps more important than increasing rates), reduced the distance between taxation on earnings from capital gains and from work, and increased taxation on company income, especially those related to personal nature. It can be said that the more ambitious the agenda, the greater the political resistance.

It is important to remember that taxation of income tends to be proportional or slightly progressive throughout the world. In Brazil and Latin America, the redistributive potential is even smaller, due to the ease of evading taxes on capital gains and even on some activities, such as agriculture and services. Despite the criticism of the national system, Brazil is not the only country in this situation. However, equity remains a missing issue on the national agenda of debates on taxation.

7.3 - Federative Disorders

The concept of "tax competition" brings to light the process by which two or more territories with administrative autonomy compete for investments or to maximize taxation (Ribeiro, 2010). In a broad sense, it comes from the idea of promoting local development through creating greater economic dynamism through alterations in tax legislation. This "competition" could be between two nations or even between two territories (states, provinces and municipalities) in a single country, if it is a federation.

With the intention of addressing the most problematic issues in the current Brazilian tax structure, which includes not only collection, but also distribution of funds, we changed the term to "fiscal competition." Given that the idea of a "fiscal war" is used to describe a conflict in a federation (Varsano, 1997), two fiscal wars are taking place in Brazil now: the best known, the ICMS fiscal war, involves a waiver of tax collection; and the most recent, a fiscal war over oil royalties, involves sharing of taxes collected.

In addition to the fiscal wars, another debate with respect to the federative question is currently in vogue in Brazil: the criteria for distributing the FPE. Many believe that the criteria used today are outdated and need to be changed to adapt the fund to the country's new socio-economic reality.

7.3.1 –ICMS: The "Traditional" Fiscal War

Fiscal competition usually arises in federative systems in which there is decentralization both in the provision of public services and in taxation. The autonomy granted to the Federative governments creates a non-cooperative environment in which competition arises over territorial benefits, even if this results in losses for the other competing governments. In the case of a single nation, this might not result, in practice, in an evident benefit for the country as a whole.

The literature on the subject discusses three categories of fiscal competition: competition in the supply of public goods and services; for resources to finance public goods; and for productive investments, in order to increase local production, employment and income (Varsano et al, 2002).

In Brazil, there has been a fiscal dispute between states to attract investments since the 1920s (Nascimento, 2009), and the issue, under the name "fiscal war," has been the object of constant debates and tax system reform proposals. This does not mean that other types of competition are irrelevant or nonexistent in Brazil, but rather have been little discussed in relation to competition for productive investments.

To describe the Brazilian fiscal war, we organized this section to, first, recount the principal aspects of the history of non-cooperative practices within the scope of the ICMS since its creation; and, second, search for the determinants and effects of the fiscal war, identifying the stakeholders and their gains or losses. We end with an explanation of the solutions proposed by some academics in the area and the attempts of the Federal Government to prevent the practices in question.

The ICMS, initially created as ICM in 1965, is used to attract investments by states in the context of the fiscal war.¹⁷ A prior tax, the Tax on Sales and Consignments (*Imposto sobre Vendas e Consignações*, or IVC) was used for the same purpose in the competition for investments which led, contemporaneous with the creation of the ICM, to the first regulations to prevent federative conflicts: Law No. 5,172/1966 (Brazilian Revenue Code) and Supplemental Law No. 34/1967. Basically, the legislation sought to encourage regional

¹⁷ The set of instruments used by states is quite broad and was more thoroughly addressed in the work of Alves (2001). The tax instruments, however, were always the most prominent. An ICMS waiver can occur in three ways: reduction in the tax (reduction in the rate or in the tax base, or exemption); increase in tax credits; and reduction in the tax due, directly (discount in the amount due) or indirectly (increase in time for payment without restatement or interest).

cooperation and consensual standardization of rates and incentive policies among its members. Such measures, however, only turned the contest into an "interregional tax war" (Alves, 2001).

In the 1970s, new measures were adopted by the Government to control disputes between states, which culminated in the creation of the CONFAZ. "Beginning in 1970 the Federal Government began holding meetings of State Secretaries of Finance to try to avoid competitive granting of subsidies. The restrictive legislation was reaffirmed later in Supplemental Law No. 24/75, which clarified the principle that every type of exemption must result from a decision formalized in agreements entered into by states (Art. 1), in a meeting in which the majority of states participated (Art. 2.1) and by unanimous decision of the states represented (Art. 2.2), with those absent subject to the provisions of the agreement. This law created CONFAZ, consisting of those secretaries whose main purpose was to regulate special ICM tax treatment by consensus" (Prado, 2005: 5).

In other words, since the mid-1970s all the proposed waivers of ICMS by any state government must pass CONFAZ scrutiny. The conflict has unfolded, especially since the 1988 Federal Constitution, alongside increased state financial autonomy and greater political decentralization, which ultimately weakened CONFAZ's control. This is explained by the state ICM revenues, which became ICMS revenues after the 1988 Federal Constitution. These revenues increased significantly with the incorporation of former specific taxes, such as those on mining, electrical power and fuel, in addition to now covering transport and communication services (Alves, 2001).

Besides these observations, Alves (2001) indicated which mechanisms states used to get around CONFAZ rules: principally tax deferral and what is known as "triangular transactions,"¹⁸ widely used since the 1980s, but not very visible, which could be explained by the low degree of dynamism of the economy and, consequently, of investments at the time.

In the 1990s, the fiscal war intensified with investments in the automotive industry, which were normally large investments with a large impact on employment. The many cases filed by the states with the Federal Supreme Court against other states' fiscal incentive

¹⁸ States carry out triangular transactions by creating fiscal funds to finance working capital for firms. The firms pay its ICMS liabilities and receive a long term loan of equal value, which, according to Prado and Calvacanti (1998, cited in Alves, 2001: 12), is just a way to exempt companies or allow them to defer payment of ICMS. "In other words, the tax incentive was disguised as a financial incentive" (Alves, 2001: 15).

measures introduce the question of responsibility for refunding ICMS excess credits—to be addressed next—and illustrate the inability of the Federal Government to control the conflict.

In fact, what has occurred since the mid-1990s is a complete disregard for the regulations: "The law is ignored and no one takes the initiative to demand the imposition of sanctions, despite the expression "fiscal war" being always used with negative connotations" (Varsano, 1997: 6).

Supplemental Law No. 87/1996, known as the Kandir Law, tried in vain to reinforce the legal mechanisms for controlling the fiscal war, but faced strong opposition from governors. Varsano (1997) lists the following changes to the ICMS incorporated by the law: established that tax paid on inputs would become tax credits for the purchaser even if the input is not embodied in the good produced, which brought the ICMS closer to the concept of a value added tax; established the tax credits tax paid on goods incorporated into the permanent assets of the taxpayer; and adopted the destination principal in foreign trade, which exempts exports of all goods from ICMS, in addition to guaranteeing the exporter the use of tax credits.

The changes that introduced the tax credit mechanisms, however, ended up distorting the ICMS incentive model, creating a controversy with respect to the responsibility for compensation of credits, even in the absence of tax incentives.

Summary of Interstate Operations Involving Exports	
Direct Exports	Indirect Exports
A company located in state A, which exports its production directly, is exempt from ICMS. If it acquires inputs that generate credits, it will not have liabilities to liquidate them, and should receive a refund. It turns out that if the inputs are purchased in state B, this state will collect ICMS on the inputs, but state A will be responsible for providing tax credits to the company. Thus, state A loses revenues by having exporting companies within its borders.	Instead of selling directly to foreign clients, the company in state A sells its products to a firm located in state C. It receives the ICMS on the goods sold; state B receives the taxes on inputs and state C pays the taxes on previous transactions. In this case, there are incentives for state A to attract exporting companies, as it gains some revenue, whereas the cost of granting tax credits falls on state C.

Source: Varsano (1997: 14)

Another challenge has arisen with respect to ICMS on imports, in what has become known as the "Ports war." Some states, attempting to favor their ports, increasing their use and revenues, reduce tax rates on imports. This practice spread in the second half of the 2000s, stimulated by the higher exchange rate and the consequent increase in imports to Brazil.

According to the Federation of Industries of the State of São Paulo (*Federação das Indústrias do Estado de São Paulo*, or FIESP) (2011b), some states provide benefits for the import of machinery, equipment, raw materials and even consumer goods and, further, ensure that, provided there is no production of similar good in the state, the company receives a tax credit upon resale, without actually having paid the tax on import. The advantage to the state is increased ICMS revenues because, though in reduced amounts, the product pays tax to enter the country through its ports. In addition, the measure also allows the state to resell the imported product to another state without benefiting it, since the purchasing state will end up having to pay the tax credits for tax that was not in fact paid in the origin state of the inputs.

If, on the one hand, the law does not punish this practice, on the other hand, a system designed in this way encourages state governments to grant tax incentives at the expense of the other states involved. That is, the ICMS model itself provides incentives for tax concessions, but other factors could also have encouraged non-cooperative practices in the Federation. The significant increase in state political and financial autonomy, especially in regard to the ICMS, along with a weakening capacity to regulate, coordinate and implement Federal regional development policies, led to the adoption of unilateral policies and a fiercer fiscal war. The states, by law, are free to determine their rates, while the Federal Senate set the interstate and foreign (import and export) rates

Coupled with state political and financial autonomy, the adoption of taxation, which is a hybrid of the principles of origin and destination¹⁹ in the transactions between states, is described by many authors as a "detonator" of the fiscal war. This is due to the fact that the

¹⁹ The levying and collection of ICMS occurs both at the origin and at the destination, and the producing state generally keeps most of the tax collected. The exceptions are the states in the North, Northeast and Midwest, plus the state of Espírito Santo. The 1988 Federal Constitution, with its democratic ideal, confirmed the authority of the Senate over the mixed regime and, as a way to promote the de-concentration of economic development in the center-south region, allowed differentiation of rates in favor of less developed regions, or with few economic attractions for businesses. The net importing states are almost all in the North, Northeast and Midwest regions—historically less developed, with weaker infrastructure and fewer skilled workers. Thus, the Senate set lower interstate rates for them and for Espírito Santo for products originating in the South and Southeast, namely 7 percent rather than 12 percent. This measure guarantees more revenue for states that are net importers, while the principle of origin ultimately benefits exporting states.

appropriation of ICMS revenue by the state where production occurs enables states to reduce this tax to attract productive investments. Varsano (2007) stresses that there is a greater incentive for the producing state to use this instrument under the origin regime than for the consuming state to use it under the destination regime, as the mobility of factors of production, especially capital mobility, is greater than the mobility of consumers. The question of the principle of coordination between jurisdictions will be addressed further in the section on solutions for the fiscal war problem.

Another factor that may have supported the fiscal war in the 1990s was the increase in investments flows after a long period of stagnation. The process of economic liberalization in the early 1990s, amid growing globalization, gradually began to attract foreign capital flows in search of investments in Brazil. This fact, along with the end of hyperinflation and the return of macroeconomic stability in July 1994, as a result of the Real Plan, and the consolidation of MERCOSUR contributed to the increasing attractiveness of the Brazilian market to multinational companies wishing to expand their markets (Dulci, 2002). In this context, the states began to compete for these resources, offering a wide range of tax incentives. Moreover, the incentives are based on the waiver of ICMS on future or incremental revenues of the company attracted, which does not harm the current budgetary balance and gives states more freedom to use such methods.

Regional disparities—developed areas next to less developed regions which have less ability to attract investments—encouraged the use of tax incentives to offset this deficiency, i.e. the fiscal war is "detonated" by certain states using defense mechanisms. Accordingly, Alves (2001) states that the fiscal war arose as an alternative for the excluded regions, which sought to reverse the spatial concentration of industry in their favor.

Thus, tax breaks for specific industries eventually became common and widespread and, above all, more concentrating. Varsano (1997) points out that the most developed states are the main beneficiaries of the fiscal war because they have greater financial capacity, larger markets and better infrastructure.

In addition to this side of the fiscal war, there are other issues which are described imprecisely due to the lack of empirical evidence, such as questions related to the measurement of *fiscal costs*, as well as future *fiscal gains* -due to incentives granted by certain local governments-. While exemptions or rate reductions persist—which, according to Alves (2001), occur before the maturation of the investment—, the state may lose revenues

but the new economic activities attracted by this initial investment, if not benefiting themselves, become a new source of revenues.

Among the fiscal gains for the state receiving the investments are the tax revenues generated by the investments induced by the initial productive activity installed and its increased income and jobs generated in the state. The fiscal costs of this policy include the greater need for logistic infrastructure for the companies, plus public services corresponding to the increase in population (transport, health, education, housing, etc.).

The recurrent use of the mentioned strategy does not seem to indicate that losses are very common. Indeed, the Fiscal Responsibility Law, established in 2000, requires that there must be a correct estimate of the revenue lost due to tax waivers, i.e. the impact on the budget should be planned and properly compensated for by increases in other revenues.²⁰

For state finances, and especially for the government in exercise at the time of the investment, there are fiscal and political gains, respectively, at least temporarily. This is not the case for the states affected by the distorted scheme for refunding tax credits, specifically, and for overall national finances. According to Alves (2001), tax incentives only affect the spatial location of new investments in the country, whether or not they occur, from which it follows that the losses from tax breaks occur at the national level, not the local level. Varsano (2007) argues that tax competition is a zero-sum game for the nation. The loss of overall revenue resulting from exemptions that cause the displacement of companies already established in the country is even more obvious. Khair (2011) shows that, despite the growing amount of ICMS collected since 1995, the tax now represents a smaller percentage of states' revenue streams.

The effects on fiscal capacity and public spending may worsen if incentive measures are replicated by competing states and could start a "destructive tax competition" (Varsano, Ferreira and Afonso, 2002: 7). In the limit, when the incentives balance, the criteria guiding investments will once again be the proximity of the consumer market and skilled labor; transportation infrastructure, electrical power, telecommunications etc.

In the specific case of the port war, the loss to the country as a whole goes beyond tax revenues. The problem, in this case, lies in the unfair domestic competition between national

²⁰ The 1990's were marked by renegotiation of debts by Brazilian states, which were in a critical financial situation with complete lack of budget control. Control measures were necessary to implement the federal government's inflation control policy.

products, which are taxed, and imported products, which are not. Income and employment is transferred overseas, instead of just from one state to another.

Thus we conclude that the distortions in the market caused by the lack of harmony among ICMS rates renders the tax non-neutral harming efficiency of the mechanisms for competition and allocation of production. Baratto and Macedo (2007) analyze the distortions caused by the evasion and tax avoidance mechanisms, confirming that both neutrality and tax simplification are compromised by the way in which the ICMS is currently implemented (differing tax rates and types of benefits and tax incentives).

"The different rates in different states, plus the variety of rates applied to interstate transactions—due to the principle of selective taxation according to the essentiality of the goods and services—together have resulted in a multiplicity of rates that create an extremely diverse, complex and unpredictable tax situation. In addition to the difficulties both for taxpayers and auditors, and the stimulus provided to evasion, they create distortions in interstate trade and in the localization of productive investments" (Baratto and Macedo, 2007: 22).

Both in the context of the fiscal war to attract investments and in the war of the ports, the simple effectiveness of legislation would be sufficient to prevent federative competition and friction. Recently, several actions against ICMS benefit mechanisms claiming unconstitutionality were upheld by the Federal Supreme Court. Given the recurrence of cases, a proposal for a Binding Precedent²¹ to address the subject was published by the Federal Supreme Court in late April 2012.²² In practice the proposal, authored by Justice Gilmar Mendes, makes it illegal to grant ICMS exemptions through state law without CONFAZ approval. There would be a radical change in the tax system if the proposed Binding Precedent were approved.

Harmonization through centralization of the power to legislate on the ICMS is not an option favored by most researchers. The large dependence of state governments on ICMS resources makes attempts to change tax collection processes difficult to carry out. At the same time, reducing the administrative and decision-making power of states would mean the acknowledgment of an error in the 1988 Constitution and would be a step back, even in

²¹ A Binding Precedent is a jurisprudence that, when voted on and approved by the [Federal Supreme Court](#) by at least 2/3 of justices, becomes binding, and which all other courts and judges, plus direct and indirect public administrators, must follow.

²² Available at: <http://www.conjur.com.br/2012-abr-25/stf-publica-edital-proposta-sumula-vinculante-guerra-fiscal>.

relation to world trends in decentralization of authority (Varsano, undated). Alves (2001) explains in greater detail the implications of reform in this direction.

The majority of proposals are based on the adoption of the destination principle as a deterrent to fiscal war, with consumer states collecting state value added tax instead of producing states. Furthermore, in principle the change would eliminate the distortions in the application of ICMS credits on interstate transactions involving exporters, as commented above. In the current model, states can apply tax concessions in a way that the burden falls on another state and, even in the absence of tax incentives, a state that did not collect tax may have to provide refunds because of the origin principle.

The importance of such a measure is emphasized in several proposals to reform Brazilian taxation on consumption: "[...] In addition to adopting the destination principle for transactions like the rest of the world, the same principle should be adopted for interstate transactions and services, which is consistent with a tax on consumption. [...] Adoption of the destination principle for subnational taxation on goods and services is a necessity that has enjoyed wide recognition for some time now, and was analyzed with a reasonable degree of detail in previous Brazilian State Fiscal Forum studies" (Baratto and Lobato, 2007: 20).

According to Varsano (2007), the positive consequences of applying the destination principle, in addition to correcting distortions, include the possibility of providing subsidies for essential products, which make up a larger part of the expenses of poorer families, and the possibility of redistributing fiscal resources in favor of net importing states, which are the least developed in the Federation.

Khair (2011), in order to assess the impact of variations in ICMS rates on interstate transactions, simulates the losses and gains of states under the destination principle, assuming a significant reduction of interstate rates (between 2 percent and 4 percent)²³ and a transition period of 10 years—the period during which the rates would be gradually reduced until they reach the level of 2 percent or 4 percent. The author concludes the following: states that are currently net exporters (net importers) will incur increasing losses (gains), which will be larger the lower the tax rate adopted; the greater the current surplus (deficit), the greater the loss (gain); 19 states would be ahead with the change, while 8 would lose resources and

²³With the reduction of interstate rates, the destination principle would automatically apply because, according to the current methodology, the consumer state receives the difference between the internal rate and the interstate rate. With the latter almost zero, the consumer state would collect almost all of the state value added tax. Khair allows for a rate between 2 percent and 4 percent to cover the producing state's auditing costs.

would have to be compensated by the Federal Government in order to make this reform politically viable. The benefits of the change would represent an important step towards the modernization of the tax system: "Elimination of the fiscal war [...] improvement in the relationship between states [...] benefits for the North and Northeast [...] simplification and unification of the 27 laws existing today" (Khair, 2011: 31).

However, many states politically oppose change, according to Baratto and Macedo (2007), even some states which have an interstate balance deficit and, therefore, would be better off with a change to the destination principle. The authors believe these states suffer from a "tax illusion."

This is why all recent, broad ICMS reforms have failed. As a palliative measure, the Federal Senate passed Resolution No. 13- 2012 which attempts to reduce the "ports war" by standardizing and reducing the rate on interstate transactions for imported products. Since January 1, 2013, all interstate trade of imported products is subject to a rate of 4 percent, regardless of the origin or destination. Imported inputs that undergo some type of processing in the state of origin before being transferred to the destination state are exempted from the "imported" classification, among other exceptions provided for in the legislation (which still requires regulation on these aspects).

7.3.2 – Distribution of Oil Royalties: A Federative Battle

Until the mid-1990s, tax revenues from oil and natural gas exploitation were small. However, an institutional change in 1998 was crucial to the change in revenue collected from this activity. Through Administrative Acts No. 155 and 206 of 1998 and 2000, respectively, the Brazilian Oil, Natural Gas and Biofuel Agency (ANP) established criteria for setting the price of oil produced locally for the purpose of calculating royalties.

According to Fernandes (2007), this change, combined with increased Brazilian oil production and an increase in the rate to 10 percent, resulted in a large revenue increase. Comparing two years, before and after the changes, the difference is significant: while in 1997 revenues were R\$190 million, in 2006 they exceeded R\$6 billion. It is important to note that the increase in oil production in Brazil only occurred due to the rise of international oil prices, which made very costly offshore activity profitable.

Beginning in 2000, another important factor for understanding the federative conflict over oil royalties entered the picture: special participations, collected (in addition to royalties)

in the case of larger, more profitable exploration projects (the equivalent of a progressive income tax). In fact, this new instrument now plays a dominant role due to the growth of production, and in the last few years has surpassed royalties collected, as can be seen in Table 26.

Table 26 - Distribution of Royalties and Special Participations from Oil, by Sphere of Government, in % of GDP - 1998–2010

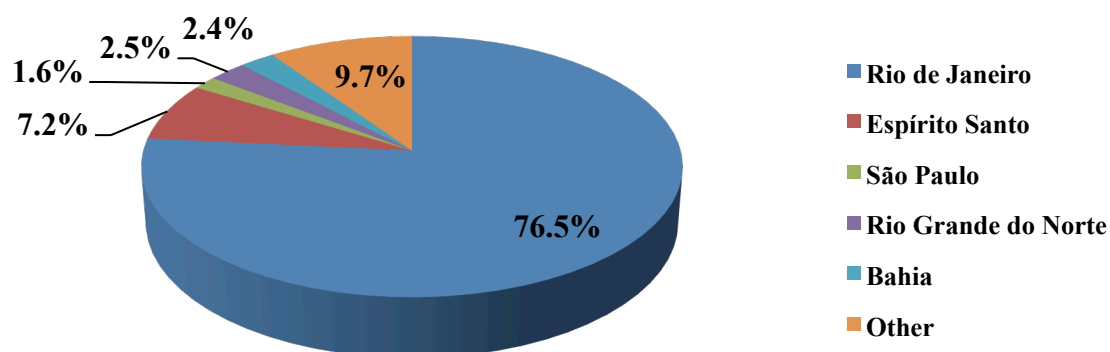
Year	Royalties + Special Shares	Royalties	Special Shares
1998	0.03%	0.03%	0.00%
1999	0.09%	0.09%	0.00%
2000	0.25%	0.16%	0.09%
2001	0.31%	0.18%	0.13%
2002	0.39%	0.22%	0.17%
2003	0.55%	0.26%	0.29%
2004	0.53%	0.26%	0.27%
2005	0.61%	0.29%	0.32%
2006	0.70%	0.33%	0.37%
2007	0.55%	0.28%	0.27%
2008	0.75%	0.36%	0.39%
2009	0.52%	0.25%	0.27%
2010	0.52%	0.25%	0.27%

Source: Authors calculations based on ANP and National Accounts System (SCN)/Brazilian Institute for Geography and Statistics (IBGE).

Except for 2007, the special participations have brought in more revenues than royalties since 2003. In 2010, special participations surpassed royalties by 0.02 percent of GDP, with royalties totaling about 0.25 percent of GDP. This was a fundamental reason for the concentration of revenues in the Federal Government and in the oil extracting states and municipalities.²⁴ Figure 14 shows the distribution of compensation (royalties and special participations) from the exploration of oil and natural gas.

²⁴ As was mentioned in chapter 6, revenues obtained as special participations are distributed exclusively to the producing states (40 percent) and municipalities (10 percent) or those bordering them, with the remainder to the Federal Government (50 percent). When we combine this rule for distributing special participations with the enormous growth in this area since the start of the twenty-first century, the consequence is two phenomena at the heart of the fiscal war over oil royalties. First, as the Federal Government is entitled to half of the special participation funds, there has been a significant increase in the Federal Government's oil revenues. While in 1998 it received only 20 percent of revenues from oil, in 2010 it received about 40 percent. In other words, centralization of revenues from oil royalties is clearly taking place. Second, the same effect occurs with respect to states and municipalities producing or bordering exploitation zones. Given that the special participations are not shared with other states and municipalities, resources have concentrated in a few areas, especially in the state of Rio de Janeiro.

Figure 14 - Distribution of Royalties and Special Participations from Oil Among States and Municipalities, by Federative Unit - 2010



Source: Authors' calculations.

Governments in the state of Rio de Janeiro receive more than three-quarters of revenues distributed to states and municipalities, since most of the current production in Brazil occurs in the Campos Basin, which borders the state.

With the discovery at the end of 2007 of pre-salt oil deposits, a large reservoir of oil and gas deep under water extending from the state of Espirito Santo to the state of Santa Catarina, there are great prospects for growth in oil exploration revenues. A source of resources that has become more attractive is now attracting even more attention from states not benefiting from the distribution of oil revenues. This led, at the beginning of 2010, to what became known as the "Ibsen Amendment," which proposed a reformulation of the criteria for distributing royalties and special participations from oil exploitation. The idea was to distribute revenues to all states and municipalities, regardless of their geographical location, adopting the criteria used for the FPE and the FPM, based on the argument that oil is a national asset, rather than belonging to just a few regional governments. Since then, the debate over the sharing of oil resources has been a topic much in vogue in the media and Brazilian political debates. In fact, it created a real war for resources between two government blocks: on the one hand, state and municipal governments with no relation to oil production, defending the sharing of resources among all the regional governments; and on the other hand, the state and municipal governments of regions directly involved in oil

production (or operations related to this activity), which defend the system distributing most of the resources to them (Gobetti, 2011).

However, the concentration of resources in a few regions, although justifiable²⁵ in the Brazilian case, is the most criticized point. In fact, just a few municipalities receive a large amount of resources to the detriment of others. Even within the State of Rio de Janeiro there is great inequality in the distribution of resources. Municipalities such as Campos do Goytacaz, Macaé, Rio das Ostras, and Quissamã highly benefit, to the extent that some of them are among the cities with the highest per capita revenue in Brazil (Aequus Consultoria, 2011). Some authors are emphatic in this regard: "... the division of royalties and special participations from oil exploitation 'has no association with the local impact of oil exploitation activity and ultimately makes some municipalities privileged recipients of a windfall'" (Mendes, Miranda and Cosio, 2008: 93).

There are other aspects, which are somewhat unrelated to theory and technical aspects, but which deserve to be addressed due to the specific characteristics of the legislation and Brazilian fiscal federalism. The first is the levying of ICMS on the production and sale of fuel. Although the general rule provides for mixed levying (origin/destination) of ICMS in interstate trade, the 1988 Constitution, states that in the case of fuel, the tax should be levied exclusively by the destination state. This small difference causes states producing/selling oil and its derivatives, such as Rio de Janeiro, to lose a considerable portion of ICMS revenues. That is, the royalties could also be used as compensation for producer states' historical losses—even though, according to the Rio de Janeiro State Secretary of Finance accounts, the ICMS losses are greater than the royalties received (*Valor Econômico*, 2011). Another relevant point was raised by Afonso and Castro (2010), the authors suggested

²⁵ There is extensive literature on the use and distribution of resources obtained from exploitation activities. Friedmann and Montalvão (2003) provide a broad overview of the compensation, based on David Ricardo's rent theory, and show that the goals of financial compensation are related to: control of the use of non-renewable resources; control of impacts, especially environmental impacts; verification of public revenue and generation of economically efficient results (use of the "proper amount" of natural resources). In relation specifically to the first aspect, the concept of equity or intergenerational justice is important. This concept is based on the basic idea that current generations should "save" for future generations (Rawls, 2002). Applied to the debate on oil compensation, the royalties and special participations would be a type of resource to be employed for the benefit of the future generations who will inhabit the location where exploitation of mineral resources is taking place. As these resources are finite, at some point exploitation will cease and lead to a depressed local economy, since it was dependent on this activity. In order to avoid this future socioeconomic problem, oil royalties should be used to stimulate alternative activities, for education, science and technology etc. "Thus, the main concern must be future generations, which will not have the revenues when the resource is exhausted and its capacity for production and income generation is diminished. Thus, its optimal use is intimately linked to a temporal issue, i.e. the decisions made now that determine the prices of these natural resources and the period most appropriate for their exploitation" (Carvalho, 2008: 35). Taking these aspects into account, the uneven distribution of resources, prioritizing those regions in direct contact with the exploitation activity, is justifiable.

that federative "justice" should be measured based on a single indicator called the "federative ratio," calculated as the relation between how much resources the Federal Government takes from and gives to each federal unit.

Citing only the case of Rio de Janeiro, which is the beneficiary of more than 75 percent of oil revenues distributed to subnational governments, the results are expressive. In 2009, the state and municipalities in the state of Rio de Janeiro had the worst federative ratio of all states. That is, in relative terms, the state of Rio de Janeiro was the largest contributor of revenue to the Federal Government, and the one receiving the least amount of federal funds. Despite the concentrated distribution of financial compensation from oil, Rio de Janeiro is the entity most "harmed." The explanation given by the authors is the following: "[...] the total amount of royalties is not that significant compared to the total amount of constitutional transfers made by the Federal Government and, principally, compared to the total amount collected by the Federal Government. In 2009, only 5.35 percent of all transfers from the Federal Government to states and municipalities [...] were royalties and special participations from oil, with the remainder coming from traditional funds such as the FPE and the FPM. Likewise, of the almost R\$514 billion collected by the Federal Government in 2009, only 3.21 percent was derived from royalties and special participations from oil" (Afonso and Castro, 2010: 20–21).

One way or another, the competition for funds continues. The solution for the impending problem could be greater flexibility by the Federal Government with respect to sharing its revenues from this source. In other words, make no change to the revenues belonging to the governments of the producing states, but increase the funds distributed to the regions that do not produce oil and natural gas.

7.3.3 - Changes in FPE Apportionment

Created in 1989 by Supplemental Law No. 62, the criteria for FPE apportionment have remained the same. When these criteria (summarized in Table 20, Chapter 6) were developed, there was intense ad-hoc negotiation between governors, who stipulated fixed distribution coefficients for states, with 85 percent of resources for the North, Northeast and Midwest, and the remainder for the South and Southeast. Since then, the criteria have remained static, without taking into account the economic, social and demographic changes occurring throughout the 1990s and 2000s, with the result that the current distribution is no longer redistributive and is concentrated in a few states, as shown in Table 27 below.

Table 27

GDP, Current Revenues, and FPE by State/Federal District - 2009

State	R\$ per capita			
	GDP	Current Revenue Net of FPE	FPE	Total Current Revenue
Roraima	13,270.5	2,724.4	2,130.9	4,855.3
Federal District	50,438.5	4,473.8	95.9	4,569.6
Acre	10,687.4	2,681.6	1,792.2	4,473.8
Amapá	11,816.6	2,328.4	1,971.5	4,299.9
Tocantins	11,277.7	2,128.3	1,216.2	3,344.5
Espírito Santo	19,145.2	2,866.0	155.7	3,021.8
Mato Grosso	19,087.3	2,677.8	278.4	2,956.1
Mato Grosso do Sul	15,407.0	2,751.5	204.3	2,955.8
Rondônia	13,455.6	2,247.0	677.8	2,924.8
São Paulo	26,202.2	2,736.7	8.7	2,745.5
Sergipe	9,787.3	1,797.2	744.9	2,542.1
Santa Catarina	21,214.5	2,375.8	75.7	2,451.5
Amazonas	14,620.9	2,148.9	297.7	2,446.6
Rio de Janeiro	22,103.0	2,407.6	34.5	2,442.2
Rio Grande do Sul	19,778.4	2,318.6	78.1	2,396.7
Goiás	14,446.7	1,946.5	173.7	2,120.2
Rio Grande do Norte	8,893.9	1,576.6	482.1	2,058.7
Minas Gerais	14,328.6	1,969.2	80.5	2,049.7
Paraná	17,779.1	1,930.5	97.7	2,028.2
Piauí	6,051.1	1,170.2	497.4	1,667.7
Pernambuco	8,901.9	1,380.1	283.6	1,663.7
Paraíba	7,617.7	1,199.8	459.9	1,659.8
Alagoas	6,728.2	1,069.7	477.2	1,546.9
Pará	7,859.2	1,161.2	297.8	1,459.0
Bahia	9,364.7	1,196.5	232.4	1,428.9
Ceará	7,686.6	1,092.2	310.8	1,403.0
Maranhão	6,259.4	890.9	410.5	1,301.3

Source: Authors calculations.

As can be seen, the relative (per capita) revenues of some states are greatly increased by the FPE, preventing a more balanced, fair revenue distribution. The most extreme case is the state of Roraima, the greatest beneficiary of the FPE despite its current relatively high revenues and its per capita GDP near the national average (R\$16,917 in 2009). Due to the FPE, Roraima's total per capita revenue is almost twice the per capita current revenue of the State of Rio de Janeiro, which, though richer, has a much greater demand for public services than Roraima. The contrast becomes even greater when analyzing the case of Maranhão, which has one of the lowest per capita GDP figures in the country and the worst current revenue per capita in Brazil, but receives a relatively small share of the FPE.

At the beginning of 2010, the Federal Supreme Court began to question the static nature of the FPE distribution coefficients. This arose out of judicial claims by some state governments—especially in the South—which felt cheated by how the fund was being distributed. The same Court found the fixed apportionment coefficients unconstitutional and determined that a new, dynamic distribution formula (with criteria adaptable to changes due to economic development) should be established by the beginning of 2013. Given this, some proposals—not always new—began to appear. In fact, the claims of unconstitutionality questioning the FPE distribution requested a return to the original National Tax Code apportionment rules prior to Supplemental Law No. 62-1989. The previous rule, which was limited but dynamic, distributed 5 percent in proportion to land area and 95 percent proportional to the population inversely weighted by per capita income.

Prado (2011) provides a complete overview of how the distribution system worked before and after the 1988 Constitution and also presents simulations of FPE distribution under various apportionment criteria: both adopting different parametric arrangements²⁶ and innovating with formulas prioritizing the equalization of (per capita) budget revenues among states. The findings emphasize the practicality of adopting a parametric system, but point out its deficiencies and clearly prefer a revenue equalization system: "Parametric systems have the advantage of immediate application with no administrative cost. On the other hand, [...] parametric systems suffer from a fundamental flaw, which is the exact opposite of the main virtue of revenue equalization systems: they will always be just another fund and totally ignore the enormous diversity in states' collection capacity, as well as differences in tax

²⁶ Prado (2011) suggests the following apportionment criteria, which are defined as parametric: 1) the initial National Tax Code rules, using the population and area tables, with a special reserve of 20 percent of revenues for the North and Northeast and 80 percent for all states; 2) the initial National Tax Code rules, using the population and area tables, with a special reserve of 85 percent of revenues for the North, Northeast, and Midwest and 15 percent for the South and Southeast; 3) the initial National Tax Code rules, using the population and area tables, with a special reserve of 85 percent of revenues for states with per capita income below the national average and 15 percent for states with per capita income above the national average; 4) 5 percent proportional to the land area and 95 percent proportional to the inverse of the state HDI less the inverse of the country's maximum HDI (Federal District) using the correction table for population and without reserves for any region or state; 5) the same rule as item 3, but without the National Tax Code population coefficient table; and 6) the same rule as item 4, but without the National Tax Code population coefficient table. In the first four of the six proposals presented, "we followed the table of population factors, as stipulated in article 3° of the National Tax Code. It determines that, to obtain the principal coefficient for apportionment, the state population must be adjusted [...]. For states with a population between 2 percent and 10 percent of the total population, the table is neutral. The adjustment results in imposing 2 percent as the percentage for small states (DF, MT, MS, AC, AP, AM, RO, RR, TO based on current data) and 10 percent for SP (which has 20 percent of the population). For some small states, this quadruples their coefficient. It is odd and absurd that this table penalizes São Paulo, whose coefficient is reduced by half, and increases the coefficient of the Federal District, which is the "state" with the highest per capita income in the country, but has a population below 2 percent" (Prado, 2011: 38-39).

collection growth rates. Whatever the parameter is, the system will calculate shares for states that result in very heterogeneous final spending capacities. Our view is that the adoption of a revenue equalization system, understood as an intermediate step for future development of a more sophisticated system that incorporates calculations of fiscal needs, is the most appropriate option for Brazil at the present time" (Prado, 2011, pp. 61-62).

A comprehensive revenue equalization system that includes states' ability to generate their own revenue and the efficiency of public spending appears to be the most appropriate to satisfy the equalization and flexibility requirements imposed by the Federal Supreme Court. However, Ter-Minassian (2012) warns that the application of a model of this type in Brazil would be impossible at the moment due to the difficulty in calculating the potential increase in state revenues (due to differing ICMS legislations), the lack of reliable, standardized data, and the lack of reliable information on the cost structure of public spending categories. Thus, "the best possible approach for reforming the system in the short term seems to be to limit equalization on the revenue side and use the basic, real revenue of each state as criteria to determine each state's ability to generate per capita income " (Ter-Minassian, 2012: 22).

FINAL REMARKS

This study presented an updated diagnosis of the structure and performance of the tax system, and also a brief summary of the main debates that surround it, including reform proposals. Long-awaited reforms of many types have been proposed repeatedly, but have never been close to being implemented.

Every tax system around the world is marked by peculiarities, but the Brazilian system is among the strangest. The tax burden stands out for two reasons: its size (no other emerging economy collects as much, with levels surpassing even the average of advanced economies) and, worse, its quality (unfair, anticompetitive, costly, and complex, among other distortions). As a Federation both in law and fact, the most salient features of the Brazilian system are reinforced and concentrated by the intense decentralization. Brazil is the only country that has allocated the broadest VAT to subnational governments (levied with so much autonomy by the intermediate government sphere that it provoked one of the best-known—and indeed disgraceful—fiscal wars in specialized international literature on taxation).

Now that the currency has been stabilized, growth has begun again, and social well-being has improved, including important improvements in poverty reduction and even inequality, the structural changes in the Brazilian economy and society in the last decade and a half have further reinforced the strange features of the system, which has been immune to a wave of institutional reforms. The tax burden has continued to grow, and more importantly and sadder, its quality has worsened. Reform proposals have traditionally focused on the ICMS, which is still the most important tax levied in the country, but is increasingly a smaller percentage of total tax collected, in part because of the small tax base, which does not include most services. The Federal Government, on the other hand, continues reacting to decentralization, which could perhaps be considered excessive in the case of taxes, taking increasing advantage of sources whose revenues it is not obligated to share, including economic and social contributions and even fees, which lead to multiple taxation of the same base.

There is no doubt that the system needs to be reformed. What is missing is a consensus, even a minimal one, about how to make it happen—some advocate major changes, including the establishment of a new system, while others prefer more specific,

surgical corrections. However, neither the former nor the latter path has been taken to improve the system.

The purpose of this study was to present an updated assessment, both through a statistical diagnosis and through a summary of the current debates, in order to offer a modest contribution that will allow foreigners and non-specialist Brazilians to better understand the state of the tax system. We also hope it will serve as an additional source of knowledge to help those who work with taxation and federalism in Brazil discuss and agree on the long awaited and necessary reform of the Brazilian tax system.

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APPENDIX

Current List of Taxes Levied in Brazil

1. Freight Fee for Renewal of Merchant Marines (*Adicional de Frete para Renovação da Marinha Mercante*, or AFRMM) - [**Law No. 10,893/2004**](#)
2. Contribution for Management of Ports and Coasts (*Contribuição à Direção de Portos e Costas*, or DPC) - [**Law No. 5,461/1968**](#)
3. Contribution for the National Fund for Scientific and Technological Development (*Contribuição ao Fundo Nacional de Desenvolvimento Científico e Tecnológico*, or FNDCT) - [**Law No. 10,168/2000**](#)
4. Contribution to the National Fund for Education Development (*Contribuição ao Fundo Nacional de Desenvolvimento da Educação*, or FNDE), also called "Education Contribution" - [**Decree No. 6,003/2006**](#)
5. Contribution to Funrural
6. Contribution to the Brazilian Colonization and Agrarian Reform Institute (*Instituto Nacional de Colonização e Reforma Agrária*, or INCRA) - Law No. 2,613/1955
7. Contribution to Occupational Accident Insurance (*Seguro Acidente de Trabalho*, or SAT)
8. Contribution to SEBRAE (Brazilian Micro and Small Business Support Service Organization) - Law No. 8,029/1990
9. Contribution to SENAC (Brazilian Commercial Training Service Organization) - [**Decree-Law No. 8,621/1946**](#)
10. Contribution to SENAT (Brazilian Transport Training Service Organization) - Decree-Law 8,706/1993
11. Contribution to SENAI (Brazilian Industrial Training Service Organization) - Law 4,048/1942
12. Contribution to SENAR (Brazilian Rural Training Service Organization) - Law 8,315/1991
13. Contribution to SESI (Industry Social Service Organization) - Law No. 9,403/1946
14. Contribution to SESC (Trade Social Service Organization) - Law No. 9,853/1946
15. Contribution to SESCOOP (Cooperative Social Service Organization) - art.9(I) of [**Provisional Measure No. 1,715-2/1998**](#)

16. Contribution to SEST (Transport Social Service Organization) - Decree-Law No. 8,706/1993
17. Worker Confederative Contribution (employees)
18. Employer Confederative Contribution (employers)
19. Contribution for Intervention in the Economic Domain - Fuel (*Contribuição de Intervenção do Domínio Econômico*, or CIDE fuels) - [Law No. 10,336/2001](#)
20. 19. Contribution for Economic Intervention in the Economic Domain – foreign remittances (CIDE on foreign remittances) - [Law No. 10,168/2000](#)
21. Contribution for Social and Educational Assistance for Professional Athletes (*Contribuição para a Assistência Social e Educacional aos Atletas Profissionais*, or FAAP) - [Decree No. 6,297/2007](#)
22. Contribution for Funding of Public Lighting Services - [Constitutional Amendment No. 39/2002](#)
23. Contribution for the Development of the National Film Industry (*Contribuição para o Desenvolvimento da Indústria Cinematográfica Nacional*, or CONDECINE) - art. 32 of [Provisional Measure No. 2,228-1/2001](#) and [Law No. 10,454/2002](#)
24. Contribution for the Promotion of Public Broadcast Radio - art.32 of Law No. 11,652/2008.
25. Worker Union Contribution (not to be confused with the Worker Confederative Contribution, see comments on the Employer Union Contribution).
26. Employer Union Contribution (not to be confused with the Employer Confederative Contribution, as the Employer Union Contribution is mandatory under [art. 578 of the Consolidated Labor Law](#), and the Confederative was established by [art. 8\(IV\) of the Federal Constitution](#) and is mandatory if the Union establishes it for its members, independent of the contribution provided for in the [Consolidated Labor Law](#).
27. Additional Social Contribution for Replacement of FGTS Losses Due to Inflation - [Supplemental Law No. 110/2001](#)
28. Contribution for the Financing of the [Social Security \(Contribuição para o Financiamento da Seguridade Social](#), or COFINS)
29. [Social Contribution on Net Income \(Contribuição Social sobre Lucro Líquido](#), or CSLL)
30. [Contributions to Professional Oversight Bodies](#) (OAB, CRC, CREA, CRECI, CORE, etc.).

31. Betterment Contributions: asphalt, paving, drainage, water supply, sewage system, etc.
32. Air Transport Fund (*Fundo Aeroviário*, or FAER) Decree Law No. 1,305/1974)
33. Fund to Combat Poverty - art.82 of [**Constitutional Amendment No. 31/2000**](#)
34. Telecommunications Supervision Fund (*Fundo de Fiscalização das Telecomunicações*, or FISTEL) - [**Law No. 5,070/1966**](#) with new provisions in [**Law 9,472/1997**](#)
35. Severance Pay Fund (*Fundo de Garantia do Tempo de Serviço*, or FGTS)
36. Fund for Universalization of Telecommunications Services (*Fundo de Universalização dos Serviços de Telecomunicações*, or FUST) - art.6 of [**Law No. 9,998/2000**](#)
37. Special Fund for Development and Improvement of Oversight Activities (*Fundo Especial de Desenvolvimento e Aperfeiçoamento das Atividades de Fiscalização*, or FUNDAF) - art.6 of [**Decree Law No. 1,437/1975**](#) and [**art.10 of Brazilian Revenue Office Directive No. 180/2002**](#)
38. Fund for Technological Telecommunications Development (*Fundo para o Desenvolvimento Tecnológico das Telecomunicações*, or Funttel) - [**Law No. 10,052/2000**](#)
39. [Tax on the Circulation of Goods and the Provision of Communication and Transportation Services \(*Imposto sobre Circulação de Mercadorias e Prestação de Serviços*, or ICMS\)](#)
40. Export [Tax \(IE\)](#)
41. Import Tax (II)
42. Vehicle Tax (*Imposto sobre Propriedade de Veículos Automotores*, or IPVA)
43. Urban Real Estate Tax (*Imposto Predial e Territorial Urbano*, or IPTU)
44. [Rural Real Estate Tax \(Imposto Territorial Rural, or ITR\)](#)
45. Tax on Income and Earnings of Any Nature (individual and [corporate](#))
46. [Tax on Financial Operations \(*Imposto sobre Operações Financeiras*, or IOF\)](#)
47. [Municipal Services Tax \(*Imposto sobre Serviços*, or ISS\)](#)
48. [Real Estate Transaction Tax \(*Imposto sobre Transmissão Intervivos*, or ITBI\)](#)
49. Inheritance and Gift Tax (*Imposto sobre Transmissão Causa Mortis e Doação*, or ITCD)
50. Brazilian Social Security Institute (*Instituto Nacional de Seguridade Social*, or INSS) contribution for self-employed and business owners

51. Brazilian Social Security Institute employee contribution
52. Brazilian Social Security Institute employer contribution
53. [Manufactured Goods Tax \(*Imposto sobre Produtos Industrializados*, or IPI\)](#)
54. Social Integration Program Contribution ([*Programa de Integração Social*, or PIS](#)) and Civil Servant's Asset Formation Program Contribution([*Programa de Formação do Patrimônio do Servidor Público*, or PASEP](#))
55. Fee for Authorization for Foreign Workers
56. Fee for On-Site Assessment of Educational Institutions and Undergraduate Courses - [**Law No. 10,870/2004**](#)
57. Fee for Compliance Assessment - [**Law No. 12,545/2011**](#) - art.13
58. Fee for Classification, Inspection and Evaluation of Animal and Vegetable Products or Consumer Products in Agricultural Enterprises - [**Decree-Law No. 1,899/1981**](#)
59. Garbage Collection Fee
60. Fire-Fighting Fee
61. City Maintenance and Cleaning Fee
62. Environmental Control and Inspection Fee (*Taxa de Controle e Fiscalização Ambiental*, or TCFA) - [**Law No. 10,165/2000**](#)
63. Fee for Control and Inspection of Chemicals - [**Law No. 10,357/2001**](#), art. 16
64. Document Issuing Fees (municipal, state and federal levels)
65. Civil Aviation Inspection Fee (*Taxa de Fiscalização da Aviação Civil*, or TFAC) - [**Law No. 11,292/2006**](#)
66. National Water Agency (*Agência Nacional de Águas*, or ANA) Inspection Fee - art. 13 and 14 of [**Provisional Measure No. 437/2008**](#)
67. Brazilian Securities Commission (*Comissão de Valores Mobiliários*, or CVM) Auditing Fee - [**Law No. 7,940/1989**](#)
68. Inspection Fee for Sweepstakes, Awards or Contests - art.50 of [**Provisional Measure No. 2,158-35/2001**](#)
69. Health Monitoring Inspection Fee [**Law No. 9,782/1999**](#), art.23
70. Inspection Fee for Products Controlled by the Brazilian Army (TFPC) - [**Law 10,834/2003**](#)
71. Fee for Auditing the Insurance, Reinsurance, Investment and Open Supplementary Retirement Markets - arts.48–59 of [**Law no. 12,249/2010**](#)
72. Annual Vehicle Licensing Fee - art.130 of Law No. 9,503/1997

73. Fee for Licensing, Control and Inspection of Nuclear and Radioactive Materials and their facilities - [**Law No. 9,765/1998**](#)
74. Fee for Operating Licenses and Municipal Permits
75. Fee for Mineral Surveys (DNPM) - Ministerial Directive 503/1999
76. Administrative Services Tax (*Taxa de Serviços Administrativos*, or TSA) Manaus Duty-Free Zone - [**Law No. 9,960/2000**](#)
77. Metrological Services Fee - art.11 of [**Law No. 9,933/1999**](#)
78. National Oil Council (*Conselho Nacional de Petróleo*, or CNP) Fees
79. Fee for Permits and Inspection - Electrical Power - art.11(I), and arts.12 and 13, of [**Law No. 9,427/1996**](#)
80. Permit Fee - Community Radio Stations - art.24 of [**Law No. 9,612/1998**](#) and arts.7 and 42 of [**Decree No. 2,615/1998**](#)
81. Permit Fee - Land and Water Transport Services - art.77(II) and (III) and art.97(IV) of [**Law No. 10,233/2001**](#)
82. Supplementary Health Fees (ANS) - [**Law No. 9,961/2000**](#), art. 18
83. Integrated Foreign Trade System (SISCOMEX) Use Fee - art.13 of [**Regulatory Directive 680/2006**](#)
84. MERCANTE Use Fee - [**Decree No. 5,324/2004**](#)
85. Business Registration Fees (Business Registry Offices)
86. Brazilian Antitrust Council (*Conselho Administrativo de Defesa Econômica*, or CADE) Procedural Fees art. 23 of [**Law No. 12,529/2011**](#)

Source: www.portaltributario.com.br.

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	Revenues (R\$ Billions)	Fines and Late Fees (R\$ Billions)	Total (R\$ Billions)	% of Total	% of GDP	R\$ per capita
Other Receipts	0.00	16.15	16.15	100.00%	0.43%	88.00
Other Fines and Late Fees (Municipalities)	0.00	7.55	7.55	46.76%	0.20%	41.15
Other Fines and Late Fees (States)	0.00	8.58	8.58	53.09%	0.23%	46.72
Other Fines and Late Fees (Federal Government)	0.00	0.03	0.03	0.16%	0.00%	0.14

Source: Authors' calculations.