



**“AN OVERVIEW OF THE BRAZILIAN TAX SYSTEM AND OF SOME
INTERNATIONAL EXPERIENCES CONCERNING TAXATION:
PROPOSALS FOR BRAZILIAN TAX REFORM FROM 2003 ON”**

FINAL PAPER SUBMITTED AS REQUISIT OF CONCLUSION OF THE PROGRAM
“THEORY AND OPERATION OF A MODERN NATIONAL ECONOMY”

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“In the world nothing is certain,
except death and taxes.”
(Benjamin Franklin, 1789)

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1. OBJECTIVE

Due to impending of Brazilian tax reform - which should occur totally by the end of 2003 but was transformed long process - the objective of this paper is to discuss some aspects that could be considered relevant to reach a more rational tax reform in Brazil. This is done comparing some aspects of Brazilian tax system with models experimented in some other countries, and aims to propose alternatives that can be translated into the increment of the following aspects: tax equity, progressivity of the system and equilibrium of levy distribution between the various federative units. Are also being considered, when pertinent, their effects on economic factors, mainly those related to growth and unburdening exportation. For that, it is used information from Latin America, United States, United Kingdom and Sweden.

2. INTRODUCTION

In Brazil, the levying of tax revenues of federative units (federal government, states and municipalities) occurs according to the parameters established by 1988's constitution and its posterior modifications.

Since some time ago that diverse economic sectors, directly or through their representatives (associations, commissions, etc.), criticize Brazilian tax structure, arguing that it is extremely burdensome to production, creating obstacles to job creation, to GDP increasing and demand increasing and to the improvement of external competitiveness, being an entanglement to growth and development of the country.

Recently, during the 1990's, there was government's intention of accomplishing a tax reform that could solve the diversity of private and public sectors needs. Although, this intention was translated just in punctual alterations, that did not imply in deep modifications intended by productive sectors or by the rest of society. For that reason, present federal government suffers pressure to accomplish alterations in the tax systems in a more effective way; adapting legislation to needs not attended beforehand. Some authors consider, however, that if by one hand tax reform can increase levying from R\$40 up to R\$60 billion reais, by the other side it could change the ratio of taxes over GDP from 36.45% to around 41%, what could result in negative effects on economy (Otoni, L. *et al.*).

Currently, states and municipalities have been absorbing, respectively, around 25-30% and 15-20% of what is collected, while the Union keeps the remainder (Brandão, C. *Gazeta Mercantil*, 15/08/03; *Diário do Comércio*, 15/08/03). Despite the fact that representatives of each level of government are aware of perverse effects of excessive tax burden on economy, the process of passing the constitutional amendment in National Congress which treated on tax reform demonstrated that each level – and, inside it, each branch - reached to increase their participation in tax levying to the detriment of other ones. It happens because each federative unit and each level are rubbed, by one side, by social demands for better services and programs of health, education, transportation, etc, and, by the other, by the Fiscal Responsibility Law, which limits the expenditures of all levels in each federative unit and branch, even forecasting severe penal sanctions to representatives that spend over what is levied.

Thus, can be perceived that the search of federative units for resources coming from tax revenues as a whole exhibits an adverse position to that intended by private sector, which aims tax burden diminishing.

3. FISCAL, PUBLIC AND TAX POLICIES IN MODERN GOVERNMENTS

Public transactions are different from private ones, and people's attitudes toward both vary. Private transactions occur as relations of exchange, where one pays a specific amount for a specific good or service. With taxes, by the other side, the payment is for services or goods not directly received, giving the impression that taxes are confiscatory and not a payment. Besides, different groups want to pay for different public services, giving the sensation that taxes pay for something that is disliked, putting government in a political troublesome (Steinmo, 1993, p.194).

As public transactions are different from private ones, people's attitudes toward both are distinct. Compensation is what directs private transactions, because generally one pays for a specific amount for a specific service or good. With most taxes, although, payment is for services that are not directly received, leaving the impression that taxes are forfeiting not a payment. Besides, taxpayers often correctly believe that their taxes pay for something they do not like. For example, for left wing voters, taxes can pay too much for military expenses, and for right wing ones, taxes pay for too many welfare programs.

To understand how fiscal, public and tax policies are intertwined, it is necessary to understand what population expects from politicians and their policies concerning those three subjects.

It is necessary because modern states present an amazing dilemma: voters are largely uninformed but rationally self-interested. As some benefits are diffuse, citizens are insensitive to or unaware of the benefits received. Benefits as clean air, good roads, educated workforce, national defense and the reduction of poverty are not well felt. By the other hand, because taxes are direct, citizens are painfully conscious of the costs of government, but they oppose paying for benefits that they do not perceive, and it happens due to the complexity of modern government, which scope and reach of activities makes difficult for citizens to evaluate cost versus benefits (Steinmo, 1993, p.193). Besides that, people do not have a single definable and stable hierarchy of preferences that can or should be used to decide between competing choices (North 1900 *quoted by* Steinmo 1993, p. 198).

Besides, there is another dilemma, which is the fact that citizens have an insatiable desire for increased public spending, but they hate to pay taxes. It means that citizens want higher public spending and lower taxes (Steinmo, 1993, p. 17), what puts public officials in a difficult political position, and to attend citizens demands by one side of the budget, they must go against what citizens want on the other side of the budget (Downs, A.

“Why the government’s budget is too small in a democracy”. *World Politics* 12, 1960: 541-63 *quoted by* Steinmo, 1993, p.17).

Taxation differs from other policy issues because even antipolitical citizens pay taxes, and it is reasonable to infer that taxation is a unique policy in that citizens are more in contact than any other one. Although, it does not mean that citizens are well informed about taxation. Otherwise, citizens are generally badly informed about the structure, effects and design of their country’s tax system, being unaware of taxes that themselves pay, being an exception the citizen who knows the percentage of tax on income, social security, property and consumption (Steinmo, 1999, p.194). In Brazil, for example, this unawareness of taxpayers concerning consumption tax is reinforced by the public power, because it is not clearly informed purchase receipts what is the value of the good and what is tax, what makes the ordinary taxpayer believe that what is paid in a purchased refers just to the whole value of the good.

3.1 The role of fiscal policy

Fiscal policy is the set of instruments used by government to influence the working economic system in order to maximize economic welfare. The fiscal authorities develop their role through four different functions: allocation, distribution, stabilization and growth.

Allocation, in an organized society, is a function that is related to production of certain output, called as public goods and services, whose collective or social consumption makes them unprofitable for private production, and are basic to a continuation of organized social life, including areas as defense, law, order and justice. The original justification of taxation was the provision of government's resources for the supply of these public goods and services (Tanzi, 1991, p.1). Currently, with the complexity of governments, each level of government may be more efficient in delivering certain governmental goods and services. For example, national government is superior in delivering national defense or national health programs, while fire and police protection are more suitable for local government. Usually, allocation is a political factor, but should, as nearly as possible, reflect the aggregate preference of community members (Kee, 2003, p. 5; Wolman, 1997, p.27 *quoted by* Kee, 2003, p.7).

Redistribution (or distribution), differently from allocation, is not basic to the existence of organized society, since can be observed the existence of many societies without an adequate redistribution of income. Brazil, one important regional economy in South America and consistently ranked around the 10th economy in the world, is an interesting example of that, being among the worst income distributions in the world. Although, redistribution is a legitimate function of the government, because any organized society that survives without this function could not be considered optimal by the most of its citizens. A more even income distribution might increase total private saving because an increase in the consumption of the lower income classes could increase their productivity and incentives and, consequently, it would be seen as investment rather than consumption since it would lead to an acceleration in the rate of growth (Tanzi, 1991, p.10). The existence of regional and local redistributive policies is necessary, based on the fact that subnational levels of government can provide, in a more specific way, the services most used by low-income families, though most economists view the national role as primary (Kee, 2003, p.5).

Stabilization, which is a relatively recent role of the government, is the objective usually most associated with fiscal policy, and is normally the most important short-run objective aimed by developed countries¹, which government's role is to keep the actual level of national income close to its potential, with a small level of frictional underemployment of labor or capital. In those countries, stabilization policy is meant the manipulation of aggregate demand in order to achieve, at the same time, full employment and price stability. In developing countries, however, the situation is more complex, and stabilization as an objective loses the simple and well-defined nature that exhibits in the developed countries as, in the former, the concept of potential level of income is not easily definable because substantial proportion of the labor force is underemployed rather than openly unemployed and there is not an evident correspondence between full employment of labor and full employment of capital. Despite balance of payments not be generally the major objective of stabilization policy, it has, also, to be considered, because movements toward full employment may be stopped by limitations of foreign exchange (Tanzi, 1991, p.10-11).

Although it is widely agreed that stabilization should be assigned mainly to the national government because this function involves the management of overall economic activity, in one analysis of 58 countries was demonstrated that exists a positive relationship between economic growth and fiscal decentralization, suggesting, even, that some role of infrastructure has to be conceded to local governments (Oates Wallace E. 1993. "Fiscal decentralization and economic development". *National Tax Journal*. 46 (2): 237-243 quoted by Kee, 2003, p.4-5).

The function of growth promotion is extremely important². Developed countries do not have to concern too much with it because, to them, stabilization and equity may be more worthwhile objectives. For developing countries, however, where per capita incomes are generally very low, growth has to be an overriding target (Tanzi, 1991, p.11).

The acceleration of the rate of growth can be obtained with adequate taxation and public expenditures. Although, in some cases, it can cause conflict with some specific interests, because tax system has to transfer resources from some private sector to the

¹ According to Tanzi (1991, p. 10) many economists consider stabilization and fiscal policy as synonyms, and the latter is generally considered the logical outgrowth of the Keynesian theory.

² The argument that redistribution should be related to growth but that growth is more important is not completely true. In fact, despite the importance of growth, a more even distribution of income has to be preferred because it means a larger market for products produced by local industry, possibly leading market to a greater use of industrial capacity which was not being used and workers who were not being employed (Tanzi, 1991, p.10).

public sector by reallocating private investment and consumption in directions that would be beneficial to the growth of whole economy. With this transference, the public sector will get to perform the following functions: (1) those which are basically role of the government, as defence, police, administration, justice, etc.; (2) those which are related to the development of the country, as creation of infrastructures both economic (roads, railroads, dams, power plants, etc) and social (education and health); (3) and redistribution of income (Tanzi, 1991, p.11-12).

The importance attributed to fiscal policy stems from the fact that productivity of public investment is closely related to the level and quality of investment in private sector, because, sometimes, the first is seen as a kind of input to the second. Although, the direct contribution of public investment to potential output is generally very low, and the effect of productivity of private investment is what makes public investment desirable. Because of that, in developing countries, the government has the responsibility of, besides creating infrastructure, also monitoring the level and the quality of the private investment forthcoming so that public investment can be maximized. Although, this fiscal policy does not always receive the attention that it deserves (Tanzi, 1991, p.12-13).

3.2 Public policies

Public policies vary among countries, reflecting the importance of political interests and values acting over the State. Those interests – mainly the short-term ones - have to be considered because they influence the acquisition of more power, what commonly is associated by each group as diminishing tax burden away from themselves. It means that, the distribution of taxes is, mainly, the corollary of achieving interests by specific groups or deriving from selfish ends³. This kind of situation can be observed in Brazil mainly concerning income tax and consumption taxes, which are extremely regressive. It happens because legislative branch suffers lobby from the elite to maintain a more regressive system, although a more progressive system in this kind of income should bring more benefits to the country.

The difference in public policies is based on the demand of each constituency, which has distinct values, but, as political values and ideas can be broad, hazy,

³ Steinmo (1993) argues that there are some exceptions. For example, socialists - who have prevailed in Sweden - should tax their supporters more lightly and the capitalists more heavily. Though, this did not happen, but the contrary. Some empirical observations demonstrate, is cross-national verifications, that some groups tend to define their interests distinctively in different national experiences, refusing the explanation that tax policy effects is based just on self-interest (Steinmo, 1993, p.4-5).

and, sometimes, contradictory, they are not easily transformed into specific policies, that is, any policy can be justified by a vast rank of values, and actual policy effects do not obligatorily approach the values that supposedly dominate a nation's political culture. Furthermore, there is a scarcity of empirical evidence that citizens in different societies have different preferences in areas of public policy. For example, Almond and Verba (*quoted by* Steinmo, 1993, p.5) affirm that Americans express more hostility than Europeans to the government. Although, Coughlin (Coughlin, R. "Ideology, public opinion, welfare policy: attitudes towards taxing and spending in industrial societies", Berkeley: Institute of International Studies, 1980 *quoted by* Steinmo, 1993, p.5) and Lewis (Lewis, A. "The psychology of taxation". Oxford: Martin Robertson, 1982 *quoted by* Steinmo, 1993, p.5) showed that this attitude does not mean necessarily differences toward policy choices. This demonstrates that values do not explain correctly general ideas to specific policies.

Anyway, the state is not a neutral judge that just divides the resources impartially, because it has to be analyzed the way groups reach power and the people that are responsible for public policy effects and the role of the state in shaping and mobilizing political ideas (Steinmo, 1993, p.6).

3.3 Tax policy

To be succeeded in performing their wide gamut of public policies comprehended in their functions, governments need resources, which are levied in way of taxes. The special significance of the power of taxation is that governmental authority is inconceivable without public funds (Steimo, 1993, p.1; Vogel, W. *quoted by* Lehner, M., 1999). Thus, the power of taxation is not an end in itself, but it ensures the sovereignty of the state, understood, domestically, as the supreme authority and, abroad, as independence under international law (Lehner, M.; p.88).

It means that public officials are under pressure to think out taxes that produce higher amounts of revenue but that have to be acceptable by the components of society who pay those taxes. This causes a trend toward broad-based taxes⁴, *i.e.*, taxes that

⁴ Steinmo (1999, p.18) argues that, taxes with very high rates tend to exhibit strong incentives to reduce activity or behavior that evokes the tax. From a purely administrative or technical point of view, a simple head tax would be the best and broadest-based. For example, if U.S. government decided to tax each inhabitant of the country in \$5,000.00 a year, it would generate a slightly lower revenue (\$1.25 trillion dollar) that the one generate by all other taxes in 1990. Although, this kind of tax is not conceivable, because would be considered unfair by everyone. For example, in UK, as Margaret Thatcher tried to introduce this head tax, it caused a substantial riot that almost had, as a consequence, her left from the government.

everyone pays and whose revenues increase gradually as the whole economy grows, like the indirect taxes⁵ (Steinmo, 1993, p.17).

Although, this argument - used to justify the amount of taxes on the rich in developed countries - has to be contextualized in the case of developing countries, where indirect taxes really burden lower income people. In Brazil, for example, indirect taxes are much more used than direct ones as means of levying. For example, the average rate in 1995 was 25% for food, 17.5% for clothing and 27.2% for shoes. It can be pointed as a cause of inequity, as indirect taxes burden more low-income classes. Siqueira et. al argue that in Brazil, indirect taxes show a great dispersion in a diversity of goods and services, but it is considered economically inappropriate (Siqueira et. al, 2000, p.29-30). As the most of population is formed by low income people, they pay, proportionally, much more taxes than upper income classes, i.e., while the lower income class spend up to 26.5% of its income in taxes, upper income classes spend around 7.34% (Fenae, 2001).

In OECD countries, personal income taxes are the largest source of revenues, because, as income increases, income tax revenue does so even faster⁶. This phenomenon, called bracket creep, assures that, once income tax rates are set, revenues will increase faster than the GNP. The introduction of indexing on brackets in the 1970s and 1980s - considered one of the most important shifts in tax policy environment - was designed to eliminate or minimize the bracket creep and the automatic revenue expansion generated by it (Steinmo, 1993, p.19-212).

The use of direct taxation is an important means for income and wealth distribution. However, if implemented – and sometimes it is - in levels of high burden, can be a risky tool for the economy, because may: (1) lead to skillful evasions; (2) decrease risk taking because the growth of capital depends on the strength of individual saving, and large proportion of this growth is dependent on the rich out of their superfluity (Keynes, J.M. “The general theory of employment”, London, Mcmillan, 1936, p. 372 *quoted by* Steinmo, 1993 p.17).

Those facts show that taxation is a fundamental policy in the modern states because necessity of money, besides raising questions of how to get it and whom to take

⁵ Mainly at the end of the twentieth century, trying to reach the equilibrium between demand revenue from the State and the desire of not obstructing economic growth within the capitalist system, policymakers had to count on taxes that could either be hidden or that could grow on their own.

⁶ In 1989, personal income taxes accounted for around 29.4 percent of total revenues in the OECD. Social security taxes contributed an average of 23.2 percent and general consumption contributed with 17.2 percent.

it from, turns clear that taxation and expenditure allocation cannot be separated because a modern tax system is a complex mix of both revenues and payments.

Tax policy, besides being related to redistribution, has a role much more complex than just redistributing wealth and generating revenues, involving competing goals, ambitions and considerations, namely: raising revenue, redistributing income, encouraging savings, stimulating growth, penalizing consumption, directing investment, and rewarding certain values while penalizing others. Those are just some of hundreds goals that any modern government tries to promote with its tax system, demonstrating that taxation can be considered the major instrument by which governments intend to influence the private sector through giving incentives or creating entanglements (Steinmo, 1993, p.3).

4. TAX REFORM: SOME EXPERIENCES

4.1 The 1986 tax reform in USA

The Tax Reform Act of 1986 in United States took away tax benefits from some powerful political interests. It just happened because the fragmentation of authority in American politics made it difficult for political elites to impute costs on influential elements of society (Steinmo, 1993, p.164-166).

The business community was against the new tax bill, because it would finance large individual income tax cuts by raising corporate taxes by approximately \$120 billion dollars in the next five years. Despite it can seem controversial, this bill was fulfilled to attend concerns related with international competitiveness. Anyway, large sections of American business - which included high-tech industries, service industries and certain multinationals - really supported the plan. Other sectors, like real state, retail trade, construction and rust-belt industries were against the reform. Those divergences in tax policies occurred in a scenario of internationalization of American economy (Steinmo, 1993, p.166).

Traditionally, tax incentives had the tendency of lockinf business, what was not interesting for emerging mobile corporate, whose interests had become much more included in international economy. In addition to trade, which contributed to expansion of the share of the American economy in the 1980s, the confidence of American firms on foreign products and production had as a corollary the fact that tax incentives found in U.S. tax code were being less attractive (Steinmo, 1993, p.166).

By the mid-1980s, American companies had much more varying interests, and companies that produced finished manufactured goods for domestic market were much more worried with international market than before⁷. The proposal of executive power with the Tax Reform Act was to simplify the tax system, but the reality was the opposite, because the 1986 act took an incredibly complex tax code and transformed it in an even more complicated code. It happened because, intending to warrant the equity, congressmen insisted on a number of accounting changes and requirements for “minimum taxes” that raised the complexity of the code. Moreover, to get the act be passed through Congress, it was necessary that reformers give away a large number of tax breaks to many

⁷ As an example, import content of supplies of finished manufactures represented 9 percent in 1971 and 24 percent in 1985. In this same period, those figures grew in some other countries, like U.K. (from 12% to 29%), Sweden (from 37% to 45%), Germany (from 16% to 26%) and Japan (from 4% to 6%) (OECD. “Structural adjustment and economic performance”. Paris: OECD, 1987 *quoted by* Steinmo, 1999, p.166).

political interests. Despite an array of loopholes were cut in this tax act, other ones were introduced or expanded. The cuts in personal income tax were costly, and were largely financed by raising taxes of corporate sector (Steinmo, 1993, p.167-169).

It is interesting how the tax reform to be implemented in Brazil from 2003 on keeps the same similarities with the American tax reform made in 1986, namely: (1) the need to conform economy to international competitiveness; (2) existence of dispute between sectors (USA) or levels of government among them and those with private sector (Brazil); (3) the reach for a simplification of the system.

4.2 Tax reform in the UK during Thatcher's period

In United Kingdom, three successive electoral victories led by Margaret Thatcher gave to the Tories the possibility of imposing a lot of tax reforms that culminated in the following: (a) personal income tax was cut from top rates of 98 percent to 40 percent, bottom rates decreased from 33 percent to 25 percent and the “reduced rate” paid by the poor was eliminated; (b) tax expenditures were reduced and corporate tax were cut from 53 to 35 percent; (c) capital transfer tax was reformed by both cutting rates and opening new loopholes; (d) consumption taxes were reformed by hiking excise taxes, enlarging the VAT base and increasing the VAT rate from a split 8-12.5 percent to a flat 15 percent. Besides all those changes, Thatcher abolished local property taxes rates and substituted them with an extremely unpopular and regressive head tax called a Community Charge (Steinmo, 1993, p.170).

All of those actions implemented by Thatcher were due to the historical context because, compared to other developed countries, United Kingdom was not in a very favorable economic condition at the end 1970s. Of course that Britain had been undergoing from long-term decline, but in the 1970s Britain's economic and political problems were deeper: economic growth stagnated, real incomes decreased, union disagreements with government caused first a Conservative then a Labour government. Furthermore, public spending rose abruptly causing budget deficits. These facts resulted in crisis of confidence on the part of both British and foreign investors⁸ (Steinmo, 1993, p.170-171). In short, when Thatcher's conservative government came into office, it was desperately

⁸ Net fixed capital investment as a percent of GNP decreased by more than one-third between 1969-1971 and 1978-1980. While direct investment in Britain rose from \$631 per year in 1967-69 to \$1,353 in 1976, the outflow of direct investment in the same period went from \$1,027 to \$3,379 (Pollard, S. “The development of the British economy”. Baltimore: Edward Arnold, 1983 *quoted by* Steinmo, 1999, p.171).

looking for new solutions for Britain's sorrows (Krieger, J. "Reagan, Thatcher and the politics of decline". Oxford: Polity Press, 1986 *quoted by* Steinmo, 1993, p.171).

In sum, the Tories focused on distributing tax burden within society, by reducing personal income tax rates (mainly for the rich), rising consumption taxes, and liberalizing capital taxation. Although the tax burden has been largely shifted downward, the Tories tried to do more than just redistributing the tax burden, attempting, in the same manner, to make their tax system more economically efficient and, factor that was less successful, use tax limitation to restrain government spending (Steinmo, 1993, p.173).

Margaret Thatcher's government undertook a corporate profits tax reform in 1984, resulting in a growth in the overall tax burden borne by British corporations. The previous tax system encouraged British companies to invest locally in plant and equipment, and the system decisively favored the manufacturing industry over financial institutions. These distortions in the market, according to the government, undermined Britain's international competitiveness because British companies had invested in assets yielding lower rate of return than the investments made by their competitors. This reform had the following aspects: corporate taxes were reduced from 52 percent to 35 percent for large companies and from 42 percent to 25 percent for smaller companies; major investment incentives and stock relief deduction were removed or reduced; corporate capital gains were indexed; National Insurance surcharge was abolished; stamp duties on stock and bond transfers were halved; and the investment income surcharge was eliminated (Steinmo, 1993, p.173-175).

The objective of the government was to reduce tax paid by companies. However, what happened was the opposite, and it occurred because this reform was drawn up by a small group of Treasury, and no one outside the government knew what was to come (Steinmo, 1993, p.176).

The most infamous tax reform introduced during the Thatcher era was the Poll Tax, which was a community charge. The plan for this kind of tax was to extinguish property taxes for both businesses and individuals and substitute them with a flat head tax on all adults over the age of eighteen. There was not a belief in government's affirmation that the community charge would be less regressive than the rate system it substituted because the actual distribution of new tax burdens was not explained in the government's proposal. Population believed that the tax would set a much greater burden on the poor and diminishing the tax burden of the rich and redistribute the tax burden among all the communities. Despite the fact of this new tax be considered unpopular - not only by government's opposition, but

by its allied - Thatcher's government tried to impose this new rule. It was considered as a huge political mistake, an example of the imposing spirit of the Thatcher's government and a huge embarrassment to Tory politicians, bringing serious political damages to the party as a whole, causing the fall of Margaret Thatcher (Steinmo, 1993, p.177-178).

Some politicians, from many countries including Brazil, propose the unique flat tax as the solution of many problems concerning the burden and the complexity of their countries' tax system as a theoretical exit. Although, as seen in UK, the political cost of that is immense, because, if *a priori* this kind of tax seems to be fairer, when implemented it shows being unfair because treats equally the ones that are not in similar economic position, resulting in an even higher inequity of the system.

Economic situation in Brazil has some similarities with those presented in UK before tax reform implemented by Thatcher: economic growth stagnated, real income decreased and public spending with deficit. However, the British model is pointed as unsuccessful because resulted in a more regressive system.

4.3 Swedish tax reform during the 1980's

Sweden experimented tax reforms by the end of the 1980s, simplifying personal and corporate income taxes, removing or scaling back many tax incentives, and increasing both consumption and social security taxes, harmonizing with the worldwide tax reform movement of giving more freedom to capital and distributing tax burden downward. As constitutional reforms of the decade before had altered the strategic context of some major political actors, with many institutions and patterns of the fifties and the sixties being kept, resulting in a reform representing a mix of old-fashioned compromising, plodding, technocratic reformism and the new confrontational and frequently unstable high politics of a new era (Steinmo, 1993, p.179).

Although the institutions of each country that lead tax reforms create their outcomes, the tax policy agenda has developed beyond the limits of the nation-state. But it is important to know if the new institutions can or will be created to deal with this new scenario (Steinmo, 1993, p.192).

Brazil keeps some similarities with Sweden concerning the necessity of a tax reform: necessity to harmonize its system with the movement happening worldwide (as already pointed in the part treating on "The 1986 tax reform in the USA"); more freedom to capital (fewer burdens to productive sector so that economy can grow in Brazil). Contrary

to what happened in Sweden, which distributed tax downward, Brazil has to distribute taxes upward, becoming a more regressive system.

4.4 Tax reforms in Latin America during the 1980s and the 1990s

Many Latin American countries that had undertaken tax reform in the 1980s experienced an increase in their tax-GDP ratios in the range of 2-4% of GDP, within about five years of undertaking reform. Some countries could have had revenue generation as a specific objective of reform, but in others, the objective might not necessarily have been revenue enhancement. The revenue increasing could be attributed, then, to the likelihood that tax reform was carried out in an overall reform environment in the economy, with improvements taking place at the same time in many sectors, including the fiscal sector. This could have generated the higher incomes necessary to yield revenues in proportions higher than income growth (Shome, 1999, p.116).

Around the mid-1990s, in Latin America, there were no clear examples of fundamental or continuing reforms, and the late 1990s was a period of introduction of awkward or inefficient taxes and continuing tax-base erosion, rather than one of fundamental improvement. It is important for some countries to address tax reform as a renewed challenge and embrace the necessary systemic changes for other countries to follow (Shome, 1999, p.116).

In sum, following the example of Latin America – which Brazil is part – during the 1980s and the 1990s, it is advisable that Brazil looks for not only increasing its revenue, but get it with an overall reform environment in economy, taking care of introducing efficient taxes.

5. BRAZILIAN TAX SYSTEM AND THE TAX REFORM

5.1 Current Brazilian tax system

The competence to collect taxes in Brazil is determined by 1988's Constitution, and is divided as following:

Federal government:

- ? Import tax
- ? Export tax
- ? Industrialized products tax (IPI)
- ? Income tax (on individuals and corporations)
- ? Financial operations tax (IOF)
- ? Rural property tax
- ? Tax on wealth (not regulated yet)
- ? Extraordinary taxes (in case of war, calamities, etc)
- ? Social contributions (Cofins, PIS/Pasep, CSLL, CPMF, on payroll and self-employment earnings)
- ? Contributions for intervention in the economic order and in the interest of professional or economic categories
- ? Compulsory loans under special conditions

States and Federal District:

- ? Consumption tax (ICMS)
- ? Death and donation tax (ITCMD)
- ? Automotive vehicles tax (IPVA)

Municipalities and Federal District:

- ? Real estate property tax (IPTU)
- ? Services tax (ISS)
- ? Real estate transfer tax on lifetime (ITBI)

Contributions, collected by federal government, can be collected by states and municipalities in two situations: (1) for payment of social security of their servants to finance their own social security and social assistance benefit plans; (2) for evaluation of private real estate due to public constructions. The fees can be established by all levels of

government, either for their regulatory activities or for the public services they offer which use can be effective or potential.

Direct taxes account for only 30 percent of all tax revenues, while indirect taxes (such as value-added taxes) account for the remaining 70 percent (Kee, 2003, p.15), what demonstrates that the Brazilian system is extremely regressive.

Besides, there are two categories of taxes: own-source, which are collected and spent by the same level of government, and shared, which are collected by one level and distributed to lower levels. For example, the major sources of revenue for the federal government are the personal income tax and the industrialized income tax. Although, the federal government keeps 56 percent of the revenue from those two taxes and distributes 21.5 percent to the states and 22.5 percent to municipalities, with part of the distribution providing greater funding to poorer states and municipalities.

The main source of own-source revenue for states is the tax on circulation of goods and services, which is a value-added tax at the state level, and that is retained in 75 percent by the states and shared 25 percent to municipalities.

5.1.1 Discussion on the five great revenue generators

Although the existence of different classifications for taxes based in diverse criteria, Steinmo (1993) argues that there are two types of taxes: traditional and new. Traditional taxes are the ones on property, customs and tariffs, and excises on particular goods and services. New taxes - introduced gradually in, approximately, the last one hundred years - are the ones on personal income, corporate profits, general consumption and social security.

Nowadays, modern states rely on broadly similar types of taxes, and those had to be changed, adapted and reformed according to their particularities because, as each country has its own characteristics, the degree of their dependence on each tax varies extremely. According to statistics from the period comprehending 1965-1990, in all OECD countries, new taxes correspond over 65% of revenues, since, in many of them, this percentage reaches an amount over 80% (Australia, Belgium, Denmark, Finland, New Zealand, Norway, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, USA). Joining the new taxes with property tax, the similarities become even greater because, until 1999, with 79.5% of total government revenues in OECD countries came from those taxes (Steinmo, 1993, p.19). In Brazil, federal government collected, from those five taxes almost 94% of its

revenues in 2002 (<http://www.receita.fazenda.gov.br/Historico/Arrecadacao/Historico85a2001.htm>).

Then, due to the importance of those five taxes – namely on property, personal income, capital, consumption and social security⁹ – it is discussed below some of the specific characteristics of each one.

A - Social security taxes

Democratic institutions that made possible the expansion of taxes brought government into the management of both the society and economy, and governments became responsible for the public welfare. Being small at first, these insurance taxes and social security programs became main elements of modern welfare states. Nowadays, they are deeply fixed in many societies and cultures, and no serious and worthy group would propose its extinguishment, because efficient taxes gave governments the possibility, through expansion or constriction of them, to regulate and manage economy at both macro and micro levels.

Social security taxes have been considered as popular as income taxes because even though they are not benefited by bracket creep, they are partially concealed from taxpayers, being paid, in many countries, in part or in whole for the employee by their employer, and few taxpayers know that their employers are paying part of their wages directly to the government. Besides, citizens tend to view social security taxes as fairer than other kind of taxes because they are often considered as insurance payments, and taxpayers often believe, wrongly, that their contributions are put into an insurance fund from which they will draw benefits later in life (Steinmo, 1993, p.19).

B - Property taxes

Despite the fact that equity is probably one of the most important considerations that go into the making of tax policy, tax policymakers generally confront powerful incentives to increase taxes that grow automatically. Property taxes tend to decrease as a percentage of revenues because raising property taxes requires direct intervention of authorities, and many politicians do not want to take this risk (Steinmo, 1993, p.19). It causes regressive taxes, as the ones met in Brazil, where rates are much higher over urban estate,

⁹ Conceptually, in Brazil, social contribution is a genus, which presents the following species: COFINS, PIS/Pasep, CLSS, CPMF and social security contribution. The latter will be treated here, to keep uniformity with other countries, as “social security tax”, while all the other contributions are being considered in the part reserved for “capital taxes” (letter “D” below).

which is paid by lower-income and the middle class, than over rural estate, which comprehends immense areas, that sometimes are not productive.

At the federal level in Brazil, the Finance Ministry recognizes, referring to the Rural Territorial Tax (ITR), that property tax is not important in terms of levying (<http://www.fazenda.gov.br>). It happens because, although the rising of the brackets, up to 20% for large non-productive estates, the quantity of exemptions is so huge that, in reality, this tax represents around 0.1% of federal collection.

C - Income Tax

This kind of tax is the major revenue generator in some countries, as Australia, Canada, Denmark and USA it corresponds to, respectively, around 45%, 40%, 50% and 30% of the total collected. France, by the other side, has around 10% of its revenues coming from income tax. In Brazil, around 20% of what was collected by federal government in 2002 came from income tax (<http://www.receita.fazenda.gov.br>).

However, the structure and incidence of any particular tax in one country can be quite different from the structure and incidence of the same type of tax in another country. The result of this is that, even when two countries have revenues from a tax in similar amounts, the incidence of that tax can be widely different. This means that a particular type of tax used by a country or how much this revenue is generated by it will not explain clearly about who pays and who avoids or evades the tax (Steinmo, 1993 p.14-16). It can be observed in Latin America, where some aspects concerning taxation are quite similar. For example, the initial exemption level in terms of per capita GDP both in the rest of Latin America and in Brazil did not follow the raising of the lowest rate during the 1990s, leading a greater number of potential taxpayers to become actual taxpayers. Although, while in Brazil top personal income tax rate decreased from 60% to 25%, and lowest rate increased from zero to 15% at the end of the 1990s, in the rest of Latin America top personal income tax rates decreased from 50% in the 1980s to around 34%, and the lowest rate declined from an average rate of 7% up to 8.7% at the end of the 1990s (Shome, 1999, p.106-107). It demonstrates that, although both in Brazil and in the rest of Latin America the top rate has begun to be applied at a lower multiple of per-capita GDP, Brazilian income tax became more regressive than other countries of the same region.

D - Capital taxes

While in Brazil top rate of corporate taxes changed from 50% to 15%, in the rest of Latin America rates fell from 43.3% in the mid 1980s to 27.6% at the end of the 1990s (Shome, 1999, p.107), demonstrating, again, Brazilian system becoming more regressive than other countries of the same region.

The decline of those rates moved the top personal tax rate considerably above income tax rate average, which includes corporations. These trends happened especially in the context of globalization and the difficulty in tax factors of production that are mobile across international boundaries (Shome, 1999, p.109). In many countries, the trend towards easing the tax burden on capital is revealed through changing structures in other forms of taxation of capital as well. For example, capital gains tend to be either taxed at normal income tax rates, or are exempt, or taxed at lower than normal rates. Similarly, withholding tax rates on remittances of dividends, interest, and royalties from capital have also continued to decline. In Latin America, the average tax on capital gains was 27% in the mid 1980s, and went to 22% at the end of the 1990s. In Brazil the changes went from 25% to 15%. This lower taxation of capital is visible in the form fewer countries in Latin America applying capital taxes on net worth or assets in the 1990s than in the 1980s, and few are considering its introduction. The overall prospects for the minimum corporate tax based on gross asset seem to be bleak for the foreseeable future (Shome, 1999, p. 109).

Brazil increased concentration of federal levying on contributions. It happened mainly due to its easiness conferred to contributions in Brazilian legislation, as contributions are simpler to levy, rates can be changed with a provisional measure, take ninety days to be vigorating, and are not divided with states and municipalities. Although, they cause distortions in economic activities due to the cascade incidence, with perverse effects on the economy, compromising the employment level and efforts to increase exports (Shome, 1999, p.107-113; http://www.unafisco.org.br/estudos_tecnicos/estudo_arrecadacao_imposto.htm).

The growth of levying of contributions in Brazil can even weaken the federative pact because the share of states and municipalities, compared to the amount levied by the federal government, comes declining steeply. In 1995, around 21.8% of federal levying with taxes and contributions pertained to states and municipalities, in 2001 this percentage decrease significantly to 18.3 %. In case of being kept the share of 1995, states and municipalities would receive in 2001 the amount of R\$ 41.43 billions, but received only R\$ 34,82 billions. That is, federal government did not share R\$ 6.60 billions with states and

municipalities in 2001, as result of its policy of concentration of federal levying on contributions over other taxes (<http://www.unafisco.org.br>).

In Brazil two contributions - PIS (Social Integration Program) and Cofins (Contribution for the Financing of Social Security) – are considered taxes that simultaneously burden the productive sector and penalize national production vis-à-vis imports. The provisional measure 135/2003 enacted in Brazil tried to correct part of the distortionary effect of the COFINS, changing it rate from a 3 percent cumulative tax to 7.6 percent rate non-cumulative tax. Although, it is not clear the real effect it will have on the economy.

E - Consumption Taxes

All consumption taxes taken together went down in all seventeen OECD countries between the period comprehending 1960's and the beginning of the 1990's. However, comparing general consumption taxes like VATs, which grows with the economy and are hidden from the consumer, and taxes on specific goods and services, the first one increased from 12 percent to 17 percent, while the second decreased from 24 percent to less than 12 percent (Steimo, 1993, p.196-201).

Shome (1999, p.103) affirms that some countries experienced a period of perceptible slowdown in the optimal design of taxes with the introduction of distortionary levies such as tax on financial transactions or the inability to design or collect appropriate property taxes. Besides, while the value added tax (VAT) had played a leading role in improving efficiency and revenue productivity of the tax system, its structure became complex, exhibiting signs of aging. According to the author, it happened due to an overreliance on consumption taxes and a neglect of the potential taxable capacity of incomes. This low reliance on the income taxes is caused by structural factors such as the inability to reduce significantly exemptions and deductions even as tax rates are scaled back, changes in the composition of the labor force and the increasing difficulty in taxing internationally mobile capital. Although, oversimplified administrative practices – with inclination for targeting mainly large taxpayers with the consequent slowness in expanding the overall universe of taxpayers, simplified contribution structures for small taxpayers, and emphasis on self-assessment and financial control (opposed to physical), can exacerbate the problem.

United States did not introduce broad-based consumption taxes, although has a federal income tax. Thus, the main difference between the American and European tax systems is the fact that United States does not have a national consumption tax,

although its amount is higher, i.e., 12.7 percent versus 4.9 percent of the European OECD countries. Steinmo (1993) argues that national consumption taxes have been proposed many times in the United States, but each time those proposals were launched, they are defeated in committees, and it happens because of the loss of power of collecting taxes makes the states less autonomous, and autonomy is an extremely valorized aspect in the American federalism (Steimo, 1993, p.196-201).

Concerning this aspect, as Brazil - except for a federal VAT (IPI – industrialized product tax) - has the same characteristics showed by the American model, with VATs collected both at the state level and at the local level. Shome (1999, p.103) affirms that Brazil has demonstrated a capacity for innovation and experimentation in tax concepts with the decentralization of value added tax. Some Brazilian politicians, mainly those ones attained to the federal level and interested in managing this elevated amount of revenue pertained to the states, usually defend a unique federal value added tax, arguing that the centralization is a worldwide model. Although, the American example of keeping autonomy of the states as a way of maintaining the federative equilibrium can be considered as a much more rational model¹⁰. Fiscal decentralization is a part of a reform agenda of many nations to strengthen their regional and local governments, because (1) it is impossible for central governments to meet all the competing needs for their various constituencies, and they are attempting to build local capacity by delegating responsibilities downward to regional governments; (2) central governments are looking to local and regional governments to assist them on national economic development strategies; and (3) regional and local leaders are demanding more autonomy and want the taxation powers that go along with their expenditure responsibility (Kee, 2003, p.3-4). Besides, from the common public finance tenet “finance should follow function”, leads to the assumption that, if certain expenditure roles are assigned to a level of government, each governmental level must have the resources to meet those responsibilities, and taxes are the main origin of own source revenues for governments of all levels (Kee, 2003, p.6).

In most countries of Latin America, the VAT has gone up in recent years. It can be considered that, on the whole, the objective of tax policy has been to continue relying more heavily on the VAT than on the income taxes. Taxes on the domestic

¹⁰ Countries with bigger territories, like United States and Brazil, are federal states and prefer decentralized consumption tax, which it is better to manage regionally than from the federal government. Smaller countries, which generally are unitary states, have centralized VAT because they do not need incur in great efforts to manage it.

consumption of goods and services comprised the most important component of tax revenue in Latin American countries as many of them introduced the VAT that replaced cascading turnover taxes and most simplified prevailing complex income tax structures by reducing rates and raising personal exemption levels (Shome, 1999, p.112).

This same tendency can be observed in Brazil, which continues to collect much of its revenues from VATs, in a practice that contradicts the general virtue of diversification in revenue sources as observed in developed countries (Shome, 1999, p.19-21,112). On average, during the 1990s, revenue from the VAT and similar taxes, in terms of GDP, has been significantly higher than either personal income tax or corporate income tax and, when combined, revenue from taxation of goods and services has been significantly higher than income tax revenue (Shome, 1999, p.112).

Although, it is necessary to be cautious with the share of VAT among other taxes, because if, initially, a focus on it represented an improvement in overall efficiency. Although, currently, the underutilization of the income tax could reflect a combination of factors, including structural deficiencies such as a preponderance of exemptions, deductions and allowances that erode the tax base, as well as an oversimplification on administrative grounds to attend the extreme complexity (Shome, 1999, p.112).

Some positive alterations have been introduced in Brazilian VAT by complementary legislation, like the exemption on exports, but some problems related to the complexity of the tax still remain, which will be treated on next session, causing an elevation of costs for taxpayers with the management of bureaucratic subjects. Those problems are mainly related to: (1) different brackets linked to the type of product or to the state of origin or destination; (2) differentiated brackets covering internal and interstate operations, making it one of the main reasons for high evasion; (3) combination of complex institutes, such as a reduction of the basis for calculation (sometimes “of x%”, other times “to x%”), presumed credit, postponements, and partial or total exemption; (4) the significant changes from one state to the other engenders horizontal conflicts, as fiscal wars, or vertical ones, as exports exemption, hindering harmonization in integration processes such as Mercosul and globalization (<http://www.fazenda.gov.br/ingles/ajuste/taxrefor.html>).

This is especially so since it is clear that, in some countries, the VAT is beginning to exhibit signs of increased complexity in structure in the form of an increase in the number of rates and erosion of the base as well as a deterioration in administration that is often the counterface of a complex structure resulting in difficulty or manipulation in

interpreting the tax code. To add to this, the personal income tax may be covering less and less potential taxpayers in relation to the growing incomes being experienced by economic agents in many of these countries and, where not applied at all, an important tax instrument is being ignored.

5.2 Some aspects that should be considered on Brazilian tax reform process

In a tax reform, there is a diversity of facts that have to be considered to reach a succeeded process. The current paper discusses two main aspects concernin Brazilian tax reform: problems of the current structure and the importance of tax administration in the process.

5.2.1 Problems of the current structure

Currently, the main problems that Brazilian tax system exhibits concerning the relationship among states or among those and federal government are (<http://www.unafisco.org.br>; <http://gateway.proquest.com/openurl>):

- difficulty in exercising social control since an unequivocal association is not established among the various levels of the government and their respective obligations. It hampers the political overseeing of public accountability by the citizen, making the social control by the state vulnerable;
- financial unfeasibility affecting a large number of states, as a result of problems of flows (excessive payroll obligations) and stocks (excessive debts as a proportion of annual income), including some leading states;
- limited initiative and state action in its power to levy taxes (competence shared with the Senate and with the Confaz – National Council for Financial Policy).

Problems in regulating the formation and distribution of participatory funds, foremost among them:

- a contribution that is incident only upon two of the federal taxes (it should be said that if it affected all those taxes, the proportional federal contribution would have to be correspondingly reduced) causes restrictions on the handling of the federal tax policy, generates mistrust and resistance on the part of the states and municipalities, and makes it necessary to resort to instruments such as the CSLL (Social Contribution on the Net Profit);
- there is a high level of linkage to income, involving the federal government more extensively and leading those responsible for the administration of federal public resources, including the National Congress (it is remarkable how there is a generalized, but false idea

that only the executive branch is affected by those linkages) have a limited ability to allocate such resources and that they find themselves unable to introduce modifications that respond to inevitable temporary changes in the priorities in need of attention;

- discretionary treatment of national products: besides the duplicate contributions, already mentioned, the CPMF (Temporary Contribution on Financial Operations), as well as differences in the incidence of the ICMS on imported products, contribute to exacerbate the discretionary treatment of national products;

Problems related to tax burden and tax management:

- costly obligations related to employee benefits, although there is intense debate of this issue (indirect salary versus obligations);

- the levying of taxes on bank spreads introduces pressures for the reduction of interest rates;

- the ICMS tax have 27 different state regulations actually in force;

- the states would not be allowed to grant any tax incentive on their own - this is an attempt to extinguish the current tax disputes between states (the so-called tax war);

- the ICMS rates have about 44 different existing rates;

- regarding interstate transactions, the ICMS tax would be collected, except for electric energy, petroleum and its derivatives, in the state of origin of the merchandise, goods or services;

- the CPMF contribution would be converted into a permanent social contribution at a maximum rate of 0.38% and a minimum rate of 0.08%;

- the tax on wealth is not regulated yet;

- real-estate transfer tax lifetime and death and donation are not progressive.

5.2.2. Role of tax administration on a tax reform process

A concern related to any country located in Latin America, Asia, Africa or Europe is that it has to be considered, together with tax reform, how tax structure is effectively administered, i.e., how closely administration system resembles legal structure.

The power a state has to tax is part of its power of having resources and actually comprehends legislative power in matters of taxation, entitlement to tax revenue, judicial authority in tax matters and administrative power in tax matters. Tax administration is a so important factor that without proper tax administration practices, tax policy could not be achieved (Shome, 1999, p.118; Vogel, W. *quoted by* Lehner, M., 1999).

When the conception of a tax structure is enacted into law, the tax administrator assumes the control of the implementation of what is actually applied, and considers what part is modified in order to simplify the achievement of revenue goals according to the budget, and what part is ignored because is considered impractical for field application. In that sense, tax administration is tax policy in every country – developed or developing - because, in any setting, it is the administration of a tax structure that is ultimately faced and perceived by the taxpayer. Thus, if there is little difference between tax policy and tax administration, it is extremely probable that the taxpayer's burden reflects the tax structure as clearly present in the law. However, if this difference increases, the taxpayer's burden begins to increasingly reflect the way the tax is administered and away from the framework of the tax structure (Shome, 1999, p. 104, 117-118).

It seems that there are greater responsibility and onus on tax administrators regarding that, at a certain extent, they can even attempt to implement the tax structure sacrificing the strict compliance with the law for the sake of simplification. For example, tax administration can work strongly with large taxpayers, giving low priority to potential taxpayers, such as nonfilers in sectors like services, and operating without a perceptible strategy for expanding the universe of taxpayers to reduce the population of nonfilers.

Targeting large taxpayers can be an efficient strategy in the short run, but, in the long run, it can be an insufficient approach because can stimulate evasion of small and even medium taxpayers. Another example is the use of withholding schemes, which objective is to facilitate tax administration, but that, effectively, negates or modifies the intended base and rate structure under a global income tax. In this way, tax administration often summarizes to a matter of compromise between appropriate structure and effective administration, and the solution is to arrive at an optimal combination of the two (Shome, 1999, p.117).

This could put the tax administrator in a position of advantage over the tax policy designer, adding a degree of responsibility in assuring that its application should resemble, at the maximum it could, the tax structure as represented in the tax code. However, particularly in Latin American countries, the tax code tends to become full of executive orders for administrative convenience, but day-to-day interpretation and application sometimes are from the original design and intent behind the law (Shome, 1999, p.118).

A tax reform process usually is carried out by a committee of experts, usually consisted of tax policy technicians, supported by tax lawyers, influenced by lobbyists

representing various sectors of economic activity, but not including experienced tax administrators. The latter gain control at a subsequent stage, after the tax reform is passed, having the influence over how new tax configuration is enforced. Tax policy experts tend to distance themselves from this next stage, with no or scarce continuing links with the tax administration (Shome, 1999, p.118).

In a tax structure appropriately designed, tax administrators simplify practices for administrative convenience only under extreme occasions. It means that, further simplification could – besides affecting the efficiency and equity of the tax structure – lead to a lower levying than planned, with a consequent reduction of governmental expenditure. It shows that, without proper tax administration practices, tax policy targets can even not be reached (Shome, 1999, p. 118).

Sometimes, the separation of functions being strictly of tax policy maker or tax administrator can, inadequately, serve as purpose of providing their comfort, as both do not have to assume entirely the responsibility for the unsuccessful delivery of a system of taxation. The policy expert can always blame the administrator for his inability to implement ideas – tending to undervalue the task of mere administration – and the tax administrator can, similarly, blame the policy specialist for designing an impractical set of tax laws, tending to put aside the background tenets for a meaningful set of laws based on economic efficiency, equity and stabilization, being extremely influenced by revenue targets (Shome, 1999, p. 118-119).

The main strategies currently used by tax administration to maximize efficiency are focusing in large tax payers and using simplifying schemes. Those two items are treated below.

5.2.2.1 Focus on larges taxpayers: advantages and disadvantages

The structure of a tax policy should not distinguish sources of income, if they are from industry or services, or from organized or unorganized sector. But it is a difficult task, because services are more difficult to control than industry, and unorganized sector often includes small taxpayers that are not easy to identify. Then, the changes in focus should emphasize the need for a clear strategy for enlarging contributors base, including an increasing number of potential taxpayers from the growing sectors (Shome, 1999, p. 119).

Though tax administrator agrees that all taxpayers need to be monitored to generate revenue, it is usual that tax administrator tends to create strategies to control large taxpayers than trying to develop strategies to control the overall universe of

taxpayers. A strategy commonly used is the creation of new criteria that expands the number of large taxpayers.

An impressive indicator is the structure of large taxpayer units in contrast to the lack of allocation of comparable resources, or the assignment of specific responsibility for revenue generation for the taxpayer population as a whole. This is not to minimize the role of large taxpayer units especially in the short run but, rather, to point towards the need for broadening the overall taxpayer base in the medium to long run (Shome, 1999, p.120).

Although large taxpayer units are made of short term measure with the assertion that, in the medium term, all potential taxpayers would be targeted, an examination of a country's taxpayer profile, even over decades, is likely to demonstrate that the large taxpayer unit has effectively transcended from short-term to long-term policy, and that the share of small taxpayers in the taxpayer list has declined or remained static. A few countries have set up departments to reduce the number of non-filers, but such cases are hard to identify in Latin America (Shome, 1999, p.120).

The resources allocated to large taxpayers under each activity of registration, collection, assessment and audit would show that a great number of that goes to control large taxpayers, because of the much greater share of revenue collected from them (Shome, 1999, p.120).

However, are three counterpoints to the fact of focusing in great taxpayers: is has to be directed more resources to large taxpayers than to small ones; because of that, the targeting in great taxpayers should be temporary; calculations refuse the common sense does not justify that spending revenue with small taxpayers is not worth (Shome, 1999, p.120).

Besides, the focus on large taxpayers is against the concept of vertical equity, and that even horizontal equity suffers, when a wage earner is taxed and a self-employed that is not, and this unequal treatment can not be accepted more than temporarily with the risk of destroying the equity tenet (Shome, 1999, p.120).

Although some authors, like Shome (1999, p.119-120) are against the attention of the tax administration on the great taxpayer because, in Brazil's case it would be necessary in some situations. For example, banks located in Sao Paulo city pay, comparatively, much less taxes on services than self-employed professionals, because the legislation, full of loopholes, permits that companies that are well-assisted juridically fulfill tax elision.

5.2.2.2 Simplification Schemes

This kind of mechanism confirms the general belief that small taxpayers should pay less. In Brazil, some state governments and the federal government created some simplifying mechanisms with use of simplification regimes in which small taxpayers can pay all taxes together with just one denominator, being a “once-for-all contribution”, being an important change introduced recently and which fulfills the constitutional principle of propitiating favorable conditions to small and micro-enterprises. It includes income and consumption taxation with one single calculation basis – the company’s invoicing – and has brackets ranging from 3 to 10%.

It substitutes the IR (Income Tax), the CSLL, the PIS, the Cofins, the IPI, the management’s contribution on payrolls, the quasi-fiscal contributions (that have been zeroed), and, depending on the adhesion of the states and municipalities, the ICMS and the ISS, respectively.

Some 1.6 million taxpayers have already adhered to it, among those 170,000 new corporations and corporations that have left the informal economy.

It encourages formalization and job creation, since management contribution is independent of the number of employees.

But the truth is that some sectors, like the self-employed one, keep underdeclaring their incomes, which results in a vertical inequity in many countries (Shome, 1999, p.121). This self-assessment, which is a way of taxpayers filing their tax return on their own, presumes a mature taxpaying attitude, does not exist in every country, and can take some time to be correctly performed. Because of that, if self-assessment occurs in a place with high rates of tax evasion and avoidance, would be better to use more basic procedures based on physical checks and controls so that equity and efficiency can happen. In those situations, tax administrators do not have resources to use adequate techniques for controlling and auditing.

5.3 Tax reform and the global economy

In some Latin American countries, the relative shares in GDP of various economic sectors are changing over time with different economic rates among them. With globalization, these changes have been increased, and some economies shift from extremely regulated structures to unregulated ones, with services sector enlarging more

rapidly than industrial sector and, in some countries, inciting agricultural activity (Shome, 1999, p. 119).

The most important characteristics of the changing world economy that have effect on tax policy are the great mobility of capital and the growing flexibility of production technologies. It is notorious that capital has become substantially more mobile over the past several years, what was dramatic¹¹ (Steinmo, 1993, p.158). This mobility is affected by national tax systems, bringing what an OECD study called the “progressive globalization of financial markets” (Organization for Economic Cooperation and Development. “Economies in transition: structural adjustments in OECD countries”. Paris: OECD, 1989b *quoted by* Steinmo, 1993, p.159). According to this study, globalization is encouraging companies to allocate debt and investment strategies according to varying national tax policies. Besides, tax policies affect rates of return and portfolio choice without necessarily increasing saving, and international differences in tax treatments have an effect on cross-boarder portfolio movements. For example, the differential treatment of interest payments gives an incentive to change profits and debts with possible important implications for individual countries’ revenue receipts. The booking of debt by multinational organizations was an important factor in the recent tax reform in Canada and is relevant for EC countries, mainly because of the objective of internal market unification. Tax considerations have been a major factor behind the growth of the Eurobond and Eurocurrency markets (OECD, 1989b *quoted by* Steinmo, 1993, p.159).

Some changes in production technology, communication and transportation costs are, also, affecting the way firms locate their operations in different parts of the world according to domestic policymakers, and this permits companies to take advantage of domestic policies, such as tax policy, in ways that could not be imagined some years ago, and companies extend their business among countries reflecting local advantages. Tax policy is a fact that companies are paying closer attention to when conducting international activities, and sometimes is the critical factor for investment decisions¹² (Steinmo, 1993, p.159-160).

¹¹ Some indication of the degree of the changes can be found in the following statistics: between 1975 and 1985 the annual turnover of the top eleven international stock exchanges grew by more than 600 percent from \$236 billion to \$1,578.9 billion; between 1984 and 1989 the sales of the top twenty nonoil multinational corporations grew from \$486.4 billion to \$966.7 billion; finally, the number of international transfers of capital from one banking institution to another has exploded from 24 million in 1978 to 680 million in 1985, a growth of 2,800 percent (Steinmo, 1993, p.159).

¹² Wallace (Wallace, C.D. “Foreign direct investment in the third world: U.S. corporations and government policy”. In “Foreign direct investment in the 1990s: a new climate in the third world”, edited by Wallace, C.D. Doerdech, The Netherlands: Nijhoff, 1990 *quoted by* Steinmo, 1999, p.161) argues that “host government tax policies” is considered the second critical factor in foreign investment decision by American multinational

In few words, the shifts in world economy readjusted the way policymakers designed domestic tax policy in the 1980s. This changing context helps to explain the rising movement toward tax reform in the United States, Britain, Sweden and an uncountable number of other countries (Steinmo, 1993, p.160).

Brazil has extremely high rates on imports, factor that entangles the competitiveness of the country in the world scenario, because, although the nominal rate¹³ on imports in 1995 was only 2.5% for total taxes and 1.4% for sales tax, the average real rate¹⁴ was around 11.7% for total taxes and 6.7% for sales taxes (Siqueira et. al, 2000, p.29).

corporations, with 60 percent of answers, and “U.S. tax policy” is the sixth, with 53 percent. The other ones are: 1st – “projected market growth” (61%); 3rd – “host pricing controls”; 4th – “foreign exchange rates and controls on transfers (58%); 5th – “competition” (56%).

¹³ Nominal rate is the rate strictly defined by the legislation.

¹⁴ Real rate is the rate that some ways of calculation – like double taxation, cascading effect, etc. – have on nominal rate, increasing or decreasing it.

6. CONCLUSION

In general, citizens and elites in any country would make similar decisions if offered similar choices and conditions. That happens because, in many countries, there was a necessity to increase revenue, what meets the citizens' resistance to pay taxes. The demand, then, was for more fair taxes with economic growth.

The pressures faced by taxing authorities everywhere since Second World War had, as the resultant, increasing importance in taxes related to income, general consumption, and social security taxes, which have increased both as a percentage of tax revenue and as a percentage of GDP (Gross Domestic Product). By the other side, property, corporation, excise and other smaller taxes have tended to decrease.

Despite the existence of general similarities, from the operational viewpoint, neither citizens nor political elites have choices that can be considered simple and obvious; and the real choices in one country are not likely to be offered exactly in the same way that they are in another country. Decisions are made differently because the institutions that offer them are diverse.

Because of that, economic development level and transformation of each country bring different political ideas on the function of the state and the tax system upon which it is financed, being a constant challenge the adequate combination of population's demand for public service and the amount of levying.

The decision to introduce or reform tax system has to be made with the intention of adapting, reshaping and redefining a current system to a new fiscal and/or new political context. In case of taxation, a new structure can create new policies of multiple effects, establishing not only new policies of taxation, but also new policies of spending. It means that the structure of a nation's tax system has to be the result of a broad range of public values, public attitudes, and diverse political and economical interests that define perspectives of bureaucrats, politicians, and the role of government in aspects related to taxation.

In case of Brazil, the country had a growth in revenue at the 1990s and at the beginning of the 2000s, being, already, considered as making part of the group of high tax countries. Currently, it is gettingh across an extremely crucial moment, with a tax reform process occurring in a scenario of globalized market. Among the issues that could be raised in Brazilian tax reform process so that it can attend both government and population's needs are, mainly, the following:

- ? what level of taxation is the most efficient so that budgets could be brought back into balance;

- ? the ICMS tax is extremely complex, with different from the 27 state regulations actually in force and about 44 different existing rates, what can be considered as an obstacle to international integration;
- ? levying relies so heavily on goods and services taxes. Besides, effective rates on goods that are very important for low-income people, as food and clothing, are higher than nominal rates, what demonstrates the existence of a regressive model;
- ? the existence disputes among states, that grant incentives by their own mainly to attract great companies to increase employment but with damages to revenue collections (the so-called “tax war”);
- ? due to multiplicity of taxes and rates, indirect taxes in Brazil should be more transparent, being explicit to the citizen the rate and the amount of each tax that is paid¹⁵;
- ? the tax burden indicates that government charges heavily on goods that should apply exemption or have low rates. It happens, for example, to exports that, although explicit policies that unburden them, implicitly have charged their inputs used for goods and services;
- ? income personal tax should enhance revenue generation;
- ? which rate on capital tax really maximize economic activity and levying, and which is the adequate number of tax subsidies offered to particular interests;
- ? if social contribution on the net profit should keep the same basis as that for the corporate income tax,
- ? how to cope with the high level of fiscal abdication;
- ? as a result of the globalization process, the difficulty in levying the corporate entity tends to increase significantly;
- ? small and medium companies, the major employers in Brazil, that in the past had to support tax burden even higher than great companies, ask for improvement of

¹⁵ An example of non-transparency is the payment of consumption tax in Brazil. When the consumer receives a receipt from one commerce, usually it is not discriminated the amount paid for the good or service and the amount paid as taxes. This means that most of population does not know that is obliged to pay taxes on consumption. This awareness could have a positive effect of increasing the consumer’s feeling of citizenship.

simplying schemes that have fairer taxes and diminishes costs associated to tax management.

Despite of the fact that, probably, can exist more than just one proposal that can maximize the efficiency of a tax system, the Brazilian tax reform could contain the following items:

- ? extinction of the IPI (Tax on Industrialized Products), ICMS (Tax on the Circulation of Merchandises and Services), ISS (Tax on Services), CSLL (Social Contribution on Net Profits), Cofins (Contribution to Finance Social Security), and PIS/Pasep (Social Integration Program/Program of Assistance to Civil Servant).
- ? VAT should continue to play an important role in overall tax revenue, with the creation of a national¹⁶ legislation for VAT on goods and services, simplifying the system by unifying internal and interstate tax brackets and with fewer rates; and keeping its levying and allocation of revenues decentralized at the states level to respect federalist tenets, and exhibiting a more progressive structure;
- ? A national VAT will permit its harmonization with IVA adopted by many countries, facilitating the Brazilian international commercial integration;
- ? the lowest VAT rate would be defined for the transactions with food included in the basic food basket;
- ? regarding interstate transactions, the ICMS tax would be collected, except for electric energy, petroleum and its derivatives, in the state of origin of the merchandise, goods or services;
- ? establishment of an excise tax, of state competence, incident on sales to end consumers of a limited number of goods of a high collection capability and of difficult evasion, among them tobacco, beverages, telecommunications, energy and fuels;
- ? the states would not be allowed to grant any tax incentive on their own - this is an attempt to extinguish the current tax disputes between states (“tax war”);

¹⁶ National legislation is different from federal legislation. The first can oblige all levels - federal, states and municipalities – simultaneously or not, while the latter regulates only judiciary acts related to the federal government.

- ? maintenance of the income tax, with brackets adjusted in conformity with the extinction of the CSLL;
- ? personal income tax has to exhibit a more progressive structure;
- ? maintenance of the regulatory taxes: IOF, II, and IE;
- ? due to worldwide mobility of capital, lower taxation of it, what can improve the international competitiveness;
- ? higher taxation on immobile factors of production such as land and property;
- ? use of green taxes (that can gain force perhaps like a global tax);
- ? participation of states and municipalities on all federal taxes and contributions, with a reduction of the percentage given the widening of the collection base;
- ? the tax on wealth should be created through an Ordinary Law, instead of a Complementary Law which demands a more severe voting process;
- ? real-estate transfer tax and transfer tax causa mortis and donations would become progressive taxes;
- ? better simplifying schemes that unburden even more small and medium companies, reducing their costs with tax management.

Given the conviction that there is the absolute need for the Brazilian tax reform, it is absolutely necessary to emphasize that, before outlining the main aspects of the reform, it is mandatory the existence of studies and data surveys that have to be consistent in technical terms, which come to demonstrate the feasibility/unfeasibility of some proposals.

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