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**Tax Incentive War Among Brazilian States**

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To Michelli, Maria Eduarda and Ana Luísa, my wonderful family, that helped me to support all the adversities, including the missing time and the distance, giving me strength to stand firm in my journey.

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# 1 INTRODUCTION

All public governments must think about how to improve welfare for its represented society. Mostly, there are three ways to do it: taxing, issuing currency or issuing debts. This research will focus its subject on the first hypothesis – a more common path to flow money to public treasury (BELL 2003).

This research will face the bigger problem in the Brazilian tax system. The named Tax Incentive War (most known in Brazil as “Guerra Fiscal”) is a result of a pretended well intentioned development policy of state governments (and local, sometimes), who has been creating tax-incentive for companies (BARTIK 1991). This is so that companies must install new plants inside states territory, or to bring more investments on exiting companies, looking for increase development in their region, resulting in new jobs, rising life quality, allowing people to spend more money caused by increased jobs and incomes. Political leaders implement policies that they believe will benefit their citizens (BRUNORI 2011).

Although this policy seems to be good, the point is that Brazilian Constitution, Tax Code and specific Complementary Tax Laws say that for a state to create tax incentives, unanimous authorization is needed from all the other states. And mostly times, state governments that intend to grant tax incentives do not respect this legal requirement. Nevertheless, these states approve laws granting tax incentives illegally.

Actually, the Brazilian states runs the Value Added Tax (VAT) system, and tax payers (companies, mostly) may offset all tax due with almost all imput taxes paid before, even on interstate trade. This tax is called ICMS<sup>1</sup> in Brazil.

Tax analysts use to say that tax incentive wars are damage for the Brazilian federalism system, arguing that poor states will always suffer more damages than rich states because they can't support revenue losses created by tax incentives or tax breaks granted without affecting their stability and “financial healthy”.

The greatest controversy that will be approached in this research is about taxation on interstate tradings. Brazilian's ICMS requires in these cases that buyers located in a different state as the seller may compensate the seller's due ICMS with tax payed on inputs purchases, which is measured monthly.

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<sup>1</sup> In Portuguese, Imposto sobre a circulação de mercadorias e serviços.

Considering all the assumptions above, when a tax incentive is granted on interstate trades, the seller (located at state A) will pay less ICMS than due on a regular purchase example, and the buyer (in state B) will compensate accounting for the full due ICMS value, and as a consequence the state B will suffer damages caused by this revenue diminishing.

It severely affects the interstate ICMS revenue on cases that involves tax incentives conceded. The main question is that neither destination state accepts “credits” (over input purchases) when another state seller is benefitted by a tax incentive on cases when the buyer’s state disagrees with incentive concession granted by the state where seller is located.

In conclusion, mostly the injured are the buyer’s state and the buyer itself, that must be punished by imposition of fines, in cases when it intends to use ICMS credits disrespecting existing tax rules banning these cases.

Experts says beyond this disequilibrium situation, tax-incentive war delays development, causes other sorts of injuries that affects society, which will be examined further.

## **2 BRAZILIAN TAX FEDERALISM**

As told before, the Brazilian Constitutional Tax System determines three-level taxation possibilities, as established by federal and subnational government levels.

Federal government has some tax creation possibilities: import/export taxes, income tax, industrialized goods tax, credit, exchange, insurance operations tax, rural estate tax and large wealth tax.

Local governments can impose taxation on property tax, services tax and tax over real estate paid transactions.

States governments have three hypotheses of incidence tax basis *stricto sensu*. 1) Sales and services tax; 2) Vehicles property tax; 3) *Causa-Mortis*<sup>2</sup> and donations tax (non-onerous property transference of goods and properties).

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<sup>2</sup> Inheritance cases.



The largest state tax revenue is the first possibility, that in Brazil is called ICMS (Imposto sobre a circulação de mercadorias e serviços), and involves taxation over almost all sort of goods, and over the most important services executed (transport, energy production, communication).

This research will focus on ICMS, the major revenue and most important state tax source (BRUNORI, 2011), and exactly where the tax incentive war causes more discussions. In 2011, ICMS represented 20.32% of the Brazilian GDP, and 83.1% of total states revenue (Brasil 2011).

The following graph shows the relation between the Brazilian GDP and the total ICMS collected on 2010:

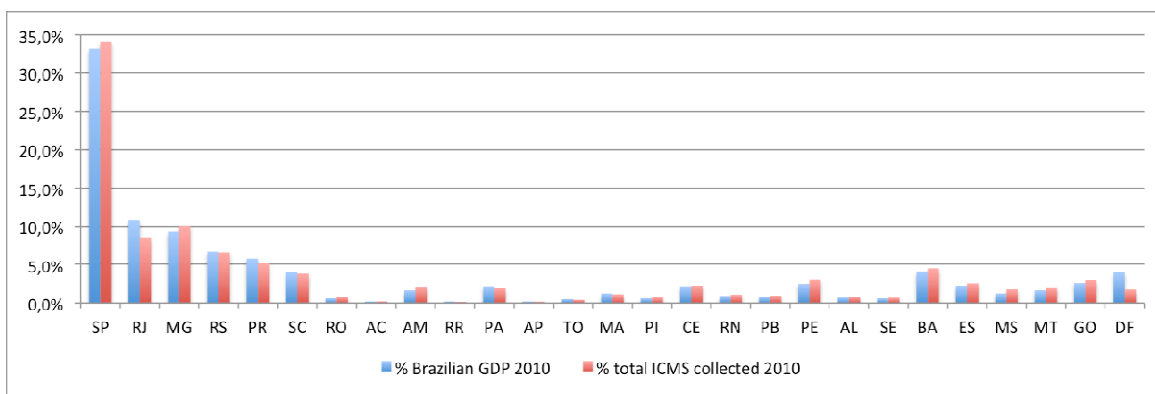


Table 1 - Relation between Brazilian GDP and total ICMS collected in 2010.

This information is necessary to form a framework pointing *developed* and *developing* states in Brazil. These two state categories was created by the 1988 Brazilian Constitution to allow ICMS sharing according Constitutional model

In this model, on interstate trade there is a tax sharing when goods, merchandise or services are addressed for states less developed from companies located in states more developed (from SP, RJ, MG, PR, SC, RS to RO, PI, MT, *i.e.*).

### 3 THE BRAZILIAN ICMS SCENARIO

After the 1988 Brazilian Constitution was passed (published on October 5<sup>th</sup>, 1988), all states in Brazil granted competency to create, audit and charge legal

determined taxpayers, value-added tax over goods and most important sort of services (interstate commercial transport for people and merchandise and, communication and energy production).

Brazil is composed of 26 states and a Federal District, where Brasília is located. People say that Brazil, like the USA, is a continental-sized country, with lots of problems related to public administration generated by its size.

On an attempt to fix such regional development disequilibrium over the country, the 1988 Brazilian Constitution created a concept to countervail social and economic differences over all the Brazilian regions. Interstate ICMS rates are different among states, based on how developed the regions (and states) are. Goods and services traded from the South and Southeast region, which are considered *developed* states to North, Northeast, Midwest region, which are considered *emergent* states, interstate ICMS rate is 12%. Going counterclockwise – from North, Northeast and Midwest region to South and Southeast region, the rate is 7%. Trades among *emergent* states (and among developed states) are taxed by 12% ICMS rate. It permits that developing states may maintain the biggest part of the tax burden on accounts in the Brazilian ICMS system.

When Brazilian policy-makers were discussing and voting on the Brazilian Constitutional tax system, the presented solution, compiled by experts, was adopted as a destination dual principle, by the way on taxation would be levied over consumption instead production. This would permit, on states economic inefficiency cases, should bring federative equilibrium gains, because consumption sharing is less concentrated than production sharing (REZENDE 2013).

The Brazilian Constitution adopted a federalism system over the country, including on this model, a federalism tax system. Each state has autonomy to create its own taxes, according the Constitution given limits.

In article 155, § 2º, XII, is determined that is necessary a complementary law to define the most important ICMS' legal requirements, like tax-payers definition, tax substitution (a kind of auditing tool), tax offset aspects, and, what matters to this discussion, how states may grant tax incentives into your territory.

This specific law<sup>3</sup> was voted in 1996, and, although was voted in the Federal Congress, has its power over all the Brazilian states and FD. It means that each state has your own competency to make the rules concerned about ICMS, but have to observe and respect the Constitutional mandates and limits imposed by LC 87/96.

In the Brazilian tax system, these kind of laws are known as Tax Law General Rules, used to give general limits on tax regulations and must be observed by all the states and FD. Brazilian Congressman who created the 1988 Constitution adopted this system to preserve equity, harmony and respect for the Brazilian citizens and taxpayers. It means that to change a state level ICMS law it's not so easy, and any change must observe all the limits imposed by the LC 87/96.

On LC 87/96, article 20, is expressed that to use income ICMS value for compensate on due tax value, is mandatory that income tax value has been EFFECTIVELY paid by the supplier. It means that, if supplier has received a tax incentive, in fact, the amount of tax appurtenant on this purchase wasn't totally paid. Consequently, the buyer cannot use the total ICMS amount to offset its tax due at the end of the period of time (monthly).

Adding to this assumption it's very important mentioning what LC 24/75<sup>4</sup> establishes about tax incentive concessions. To any state grant tax incentives for taxpayers (companies) into your border, it's necessary that the case be analyzed by all the Brazilian states inside a *forum* known as CONFAZ<sup>5</sup>. To allow a tax incentive concession, all the CONFAZ voters (states) must support the concession, unanimously.

This rule, obviously, leads to the conclusion that tax incentives only will be accepted by the states, if the measure won't harm another state interest. If just one state understands that the incentive will affect your finance situation for instance, it's sufficient to prohibit the concession. In other words – as commonly been said by Paraná State Finance Secretary Luiz Carlos Haully – tax breakings and tax frauds or withholding cannot be used as a competitive advantage on businesses competition.

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<sup>3</sup> Complementary Law 87, published in September 13<sup>th</sup> 1996 (LC 87/96).

<sup>4</sup> Complementary Law 24, published in January, 7<sup>th</sup> 1975. This law specify the rules to be observed in tax incentives concessions. Although it was voted before 1988 Brazilian Constitution term, Brazilian Supreme Court has judged this law is valid according Constitution.

<sup>5</sup> Acronym for *Conselho Nacional de Política Fazendária* (Financial Policies National Council), a national organism compound by all the States Finance Secretaries plus a Federal Revenue Department representative.

As a result, despite this legal mandate, State Governors insists on breaking LC 24/75 rule, justifying that tax incentive concessions will ensure growing social, technological and financial development on their states. On Chapter 5, it can be clearly observed.

It's possible to conclude the whole country loses on tax incentive war, and almost always policy-makers are guilty about this situation. Because the fact that elected officials normally make their plans and policies for over four or eight years – their terms length. Rarely Brazilians citizens may observe politicians making their job thinking on the future, 10 or 20 years ahead. They really don't do it.

### **3.1 An actual Brazilian ICMS approach**

After more two decades, Brazilian ICMS change on its core and regulation. In the late 1980s, national legislators thought a tax that could substitute oldest taxes that were finished by the 1988 “new” Constitution.

Democracy was installed in Brazil, and then, a new federalist system was just forming.

Looking at Brazilian National Tax Code<sup>6</sup>, it's possible to observe the clear and strong federal intervention in state and local taxation. After 1988, the Brazilian society did start to live freely and starts to experience transparency, equilibrium relationships over tax-payers rights and mostly, a national tax system completely limited by law, that is usually called in Brazil, as a “Democratic State of Rights”.

Some Brazilian experts think ICMS as a different way. According MARTINS and CARVALHO (2012), ICMS is a tax that should be a federal tax, as occurs in the most countries that adopted VAT system.

ICMS in Brazil was designed to be a fair tax model. After some adjustments made by constitutional amendmants and law changings, the interstate rate system created aimed to deliver a larger tax share typical of VAT system to states less developed, as quoted before.

However, over time, people realized the ICMS system created, instead of equilibrium, lots of distortions over distribution tax quota. Fernando Rezende (2013), one

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<sup>6</sup> The Brazilian Tax Code (CTN) was published on 1966, inside the military dictatorship regim.

of the most respected Brazilian tax analysts of today explains that along this period of time, less developed regions checked 2% gain on global ICMS revenues incomes, accompanied by losses occurred over South and Southeast Brazilian regions between 1990-2010.

Two of the main consequences of this process were tax incentive shifting and progressive concentration of ICMS collect process on high taxation on producers. Regarding first consequence, revenue shifting allows state governments to shift tax incentive grants too, which begin with internal trades and recently with import trades also. The second consequence was that revenue incomes separated from state GDP, so that shifting economic basis weren't reflected on increasing revenues as well (REZENDE 2013).

Concluding this section, it's possible to assume that ICMS is passing by a necessity of reformulation, which is a natural consequence of ICMS system erosion.

This erosion was caused by successive tax incentives granted by all state governments, intending to increase development on their region, or to neutralize incentives granted before. The state VAT system was sufficiently proved as a positive experience in Brazil. The problem is the ICMS needs deep reformulations respected by tax incentives conceded on interstate trade among states.

Another issue that deserves deep studies and reformulation is the interstate tax rates. These two linked issues are the main cause of the actual Brazilian Tax Incentive War.

#### **4 THE BRAZILIAN ICMS INTERSTATE RATES (BROKEN-DOWN) SYSTEM**

Lots of things have been said in this paper about interstate ICMS rates effects. Certainly, this is one of the most complex problems existing in ICMS nowadays.

This conclusion was taken by Brazilian tax policy-makers not only in the state but also the federal level.

This common perception taken by the Brazilian politicians is positive, and started a process of public intervention aiming for a deep reformulation on ICMS. The federal government published an act establishing: 1) ICMS interstate harmonization in

4% until 2025; 2) creation of a fund to be used to compensate harmed states when the interstate ICMS rates change in future. This regulation will occur by Provisory Law (MP<sup>7</sup>) n. 599/2012 in the Federal Branch, and by Senate Resolution Proposal n. 1/2013 (PRS<sup>8</sup>), following discussed.

#### **4.1 MP 599/2012 – A Federal Branch proposition**

The following is a transcription of grounding arguments presented by Brazilian Finance Minister, Mr. Guido Mantega (BRASIL 2012):

ICMS tax rates reduction are necessary by the fiscal war outlook held by the Federal States, which have been seeking investments to their territory by irregular tax incentive concessions over ICMS, granted without CONFAZ authorization.

[...]

One of the issues proposed is that interstate rates be gradually reduced, shifting taxation to the destination side, which certainly will discourage tax incentive grants.

By the way, financial offset to revenue income harmed states as a result of interstate rates diminishing is necessary to allow discussions among states to implement this proposition, considering it has been often argued by some states.

According to Mr. Mantega, the *urgency* and *relevance* of this issue (which are constitutional requirements to publish Provisory Laws in Brazil) is due to the judicial non-safety situation addressed in all these discussions, after the Brazilian Supreme Court had decided several times that tax incentives granted without CONFAZ agreement are unconstitutional.

Following this important argument, one of the conclusions that's be intended by this research is that the Brazilian ICMS must be renewed and that the largest part of all future modifications is concerned with a reduction on interstate rates, or if it would be possible, a settlement of a zero ICMS rate on these trades.

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<sup>7</sup> MP is inicial of "Medida Provisória", a Portuguese term used to a kind of regulation created by 1988 Brazilian Constitution, that allows Brazilian President publish regulations with same law value. The effects' rule proposed are valid since its publishment, but must be discussed and voted by Brazilian Congress and, if passed become a positive law.

<sup>8</sup> PRS is inicial of "Proposta de Resolução do Senado Federal", a Portuguese term used to propositions made to Brazilian Senate, to be discussed and voted, and it will pass, in this case, can fix new interstate ICMS rates, as provided in Brazilian Constitution.

## 4.2 PRS 1/2013 (A new Federal Senate Resolution proposition)

This proposition was assigned by the Brazilian President, Mrs. Dilma Rouseff and has an objective to provide constitutional requirements to fix interstate ICMS rates at lower level.

The Brazilian Constitution says that interstate ICMS rates must be fixed by The Federal Senate (article 155, § 2). As actual interstate ICMS rates are fixed at 7% and 12%, as told before, and that there is a consensus that these different levels of taxation are mostly responsible for tax incentive war in Brazil, these changes are necessary and indispensable for re-organization of the interstate trade taxing.

Both MP 599/2012 and PRS 1/2013 proposals fix a timeline to adjust rates that will begin in 2014. The proposal fix harmonization on 4% the interstate ICMS rate until 2025. *Developed* states, however, might impose 4% rate by January 2016, while *developing* states will get this taxation level only by January 2025.

This criteria is partly fair and correct. But the time period thought to make this transition, according to some experts and analysts, is too large. Unanimously, those people agree that changes are necessary. And it could happen within a shorter period of time.

The Paraná State Secretary of Finance, Luiz Carlos Hauly said recently: “We have been negotiating for two years and now the proposal must keep the rates gap, in a too large period of time. We need this reformulation right now!” (HAULY, 2013).

Two particular situations has been discussed: 12% rate for the whole period for Manaus’ Duty-Free Area (ZFM<sup>9</sup>) trade and with natural gas; 0% rate for the whole period over electricity energy, oil and its derivatives (in this last situation, rates would never change because these are the actual ICMS interstate rates for these products).

There are some other proposals, made by Brazilian Governors that change those steps: 1) rates at 4% in 4 years; 2) rates at 4% in 8 years; and 3) rates at 4% in 12 years.

Remember that the rates final uniformization is fixed to occur in 12 years, according to the official discussed proposal.

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<sup>9</sup> Acronym for Zona Franca de Manaus.

The following is a graph showing transition period:

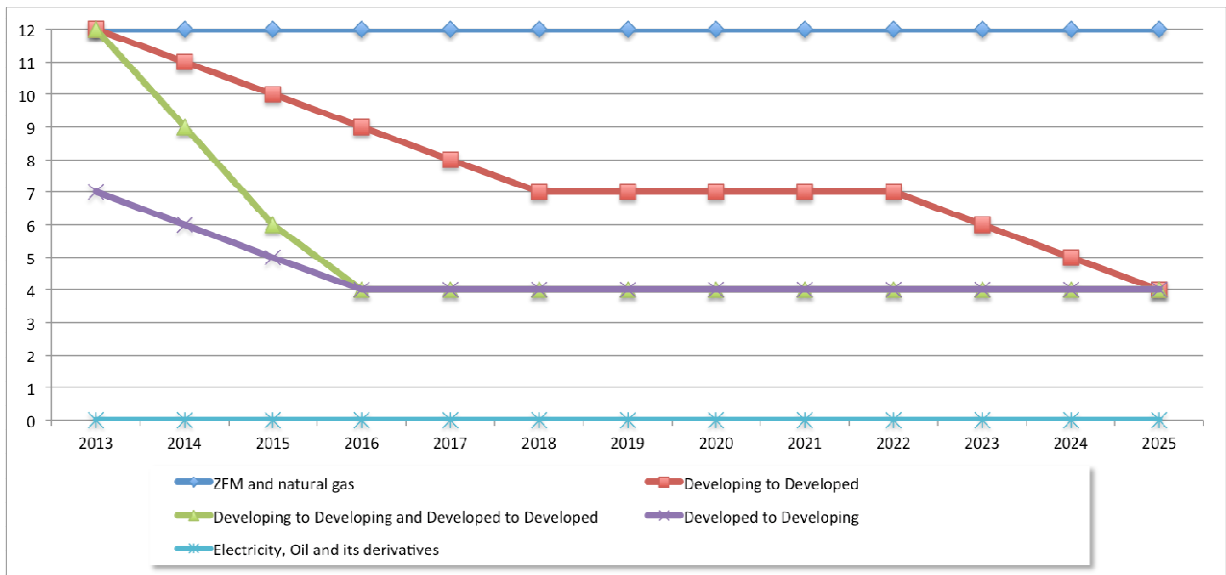


Table 2 - PRS 1/2013 interstate ICMS rates transition period.

### 4.3 The 4% interstate rate landscape

Something must be changed in the Brazilian ICMS. The system created by the 1988 Brazilian Constitution was designed to be a fair taxation solution and to give equilibrium on inequality seen in social and economic development on different Brazilian regions.

After two decades, however, in attempting to attract investments, the states' governments granted tax incentives to companies expecting job creation at high levels, what would result in increasing wages/incomes for the population, and a corresponding increase in consumption and more tax collected.

Those consecutive tax concessions brought unstable scenario among state relationships in Brazil. The fact is the wished development didn't come as imagined. As told before, if was measured the total amount of resigned revenue from public treasury to private companies, compared with total improvement on economic development (jobs created, infra-structure investments, education, health, welfare, etc.) certainly the balance won't be the expected.



The conclusion is that there's only one change to be made: decrease interstate ICMS rate. It's possible to conclude this, because tax incentives were conceded preliminarily, as a correct public policy. However, when elected offices' greed speaks aloud and persuades them, as Adam Smiths' *invisible hand* (ABEL, BERNANKE and CROUSHORE 2011), those policy-makers start to affront the actual constitutional and legal system, creating tax incentives at law's disagreement.

The actual official proposals quoted before are a very important attempt to fix the current chaos in ICMS.

Nevertheless, specialized States Finance Department servants have studied this issue deeply. Preliminary conclusions address to a situation where some states will increase and some will decrease their revenues.

The proposal actually discussed in the Brazilian Federal Senate provides a new fund creation, with federal resources, to compensate observed losses when interstate ICMS rates will change. This is a very consistent way to convince losers' states to a general agreement for this passing tax law and Senate Resolution (MP 599/2012 and PRS1/2013).

In the Paraná State case, after some simulated calculations, the future situation shows better results in financial gain, according to the following spread sheet based on 2011 total ICMS balance revenue:

2011 PARANÁ INTERSTATE ICMS (R\$)		
	ACTUAL SCENARIO (7% AND 12 RATES)	FUTURE SCENARIO (4-to-4 RATE)
2011 ICMS PARANA TOTAL BALANCE REVENUE 15.961.798.000,00		
<i>INTERSTATE ICMS TO TAX-PAYERS</i>		
DEBTS ON OUTCOMES TO TAX-PAYERS	14.057.411.056,98	4.853.544.054,67
CREDITS ON SUPPLIES FROM TAX-PAYERS	13.290.658.516,83	4.061.034.546,81
USE OR CONSUMPTION BALANCE	93.613.427,40	200.228.719,71
SIMPLIFIED TAX SYSTEM BALANCE	631.147.456,33	1.349.954.281,59
ICMS BALANCE	1.491.513.423,87	2.342.692.509,17
IMPACT: (-) LOSSES; (+) GAINS		851.179.085,29
IMPACT: % ON TOTAL PARANÁ ICMS		5,3%
<i>INTERSTATE ICMS TO NON TAX-PAYERS</i>		
DEBTS ON OUTCOMES TO NON TAX-PAYERS	1.077.692.451,42	316.783.068,00
BALANCE SUPPLIES FROM NON TAX-PAYERS	-	729.739.242,00
ICMS BALANCE	1.077.692.451,42	1.046.522.310,00
IMPACT: (-) LOSSES; (+) GAINS		(31.170.141,42)
IMPACT: % ON TOTAL PARANÁ ICMS		-0,2%

Compiled by Parana Finance State Department - Economic Issues Committee - Coord. Gedalva Baratto

Table 3 - Simulated calculations of expected future ICMS balance on 4-to-4 ICMS interstate rates situation.

These calculations show that the Paraná state situation is much better than observed in other states. According to the next graph, many losses are checked. Two particular situations must be highlighted: 1) Amazonas State (AM) case, and 2) Larger tax incentive granters states (ES, MS, GO, MT, SC, BA).

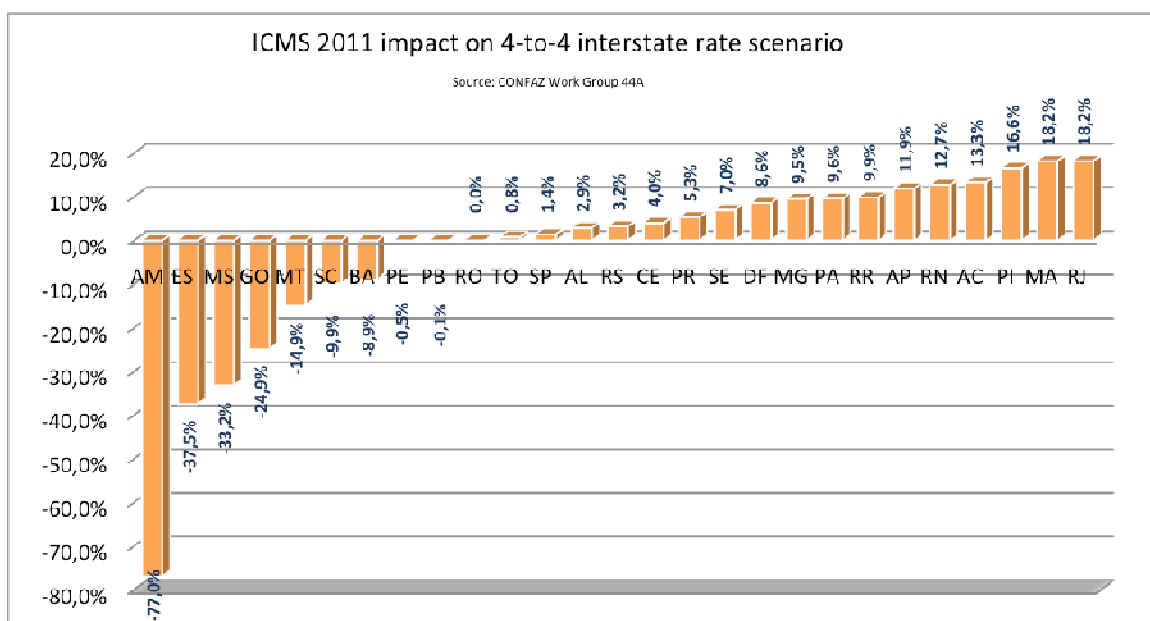


Table 4 - ICMS 2011 impact on 4-to-4 interstate rate scenario.

In Amazonas' case, which are showed the largest possible losses, it certainly will happen because the Amazonas' economy is based on interstate trade with industries located in the state since late 1960s when Manaus Duty-Free Area Department (SUFRAMA<sup>10</sup>) was created.

Since then, when all sorts of manufacturing industries were installed at Manaus region (motorcycles, electronics, home appliances, etc.), tradings made by the Amazonas state are mostly based on interstate trade to all other Brazilian states. In 2012, the total Manaus Duty-Free Area (ZFM) companies' production was around US\$ 40 billion (SUFRAMA 2013).

As told before, the Amazonas case is one example of offsetting help that must be granted by the Federal Government with the special fund to be created, according to MP 599/2012 and PRS 1/2013 propositions, as quoted before.

The second losses situation observed is about some of the largest tax incentive granter states in current times. Espírito Santo (ES), Goiás (GO) and Santa Catarina (SC) are the most famous ICMS incentive granters in Brazil (FIESP 2012). These three states are commonly prosecuted in the Brazilian Supreme Court because they are always main actors in Harbor War ("Guerra dos Portos", as known in Brazil), a typical discussion about tax incentive concessions on import trades made by companies located in these states through their harbors and airports. Curiously, Goiás is a state located inland the Brazilian territory and consequently doesn't have harbors.

In Goiás' case, tax incentives are represented by a kind of presumed credit around 65% of average tax due by the companies.

Other losses cases shown are about Mato Grosso (MT) and Mato Grosso do Sul (MS), whose tax incentives are basically over agricultural products (meat, soy, corn, etc.) produced inside these states and addressed to other industrialized states. In these cases the ICMS due was offset by a compensation granted by presumptive credits on interstate trade.

The numbers on Table 4 shows that when interstate ICMS rates will be changed, the biggest losers will be the states that actually are concerned to granting fiscal incentives. Maybe because this assumption they are against ICMS restructure that's coming.

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<sup>10</sup> Superintendência da Zona Franca de Manaus – SUFRAMA.

The next graph represents all the Brazilian states simulated losses on a 4-to-4 interstate tax rates that will be fixed. These losses are referred by 2014-2025 period and show the cumulative losses imposed for all the Brazilian states together.

These calculations were made by a specific department inside Paraná Finance Secretariat – CAEC<sup>11</sup> – included in CONFAZ Work Group called COTEPE – GT44A, which works specifically with interstate ICMS impact over states.

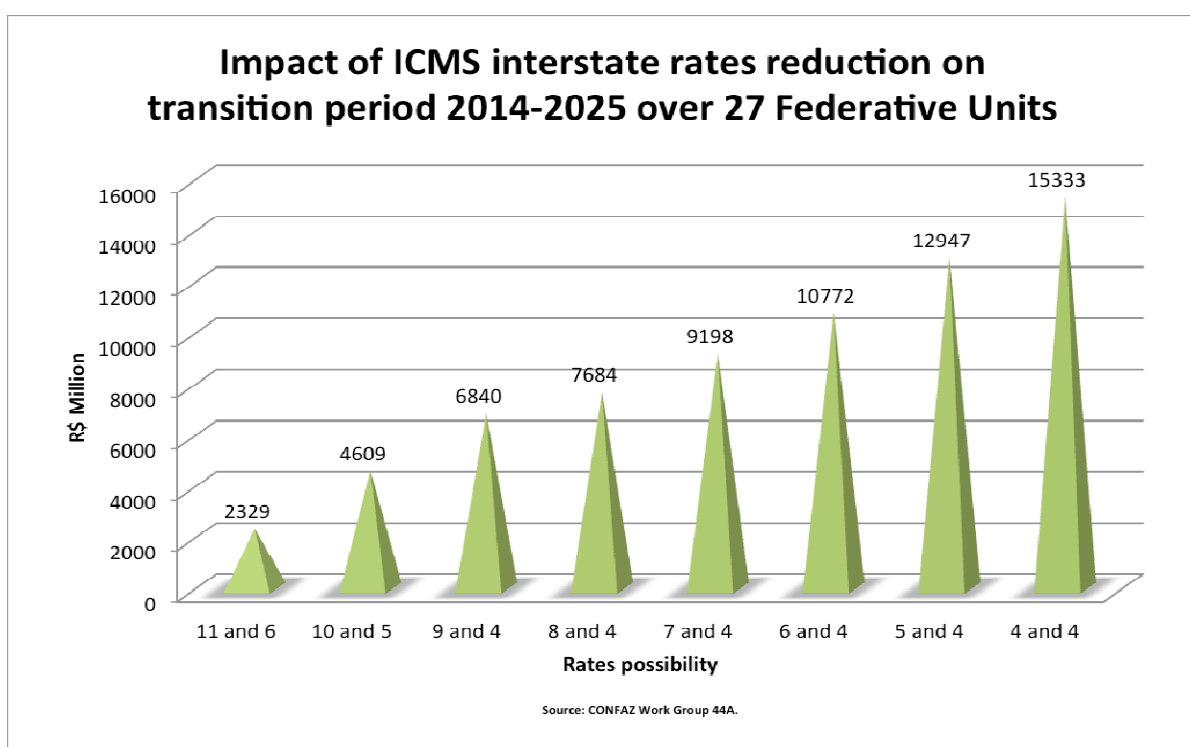


Table 5 - Impact of ICMS interstate rates reduction on transition period 2014-2025.

#### 4.4 Some examples of ICMS incentives granted in Brazilian States

In an attempt to neutralize a lot of tax incentives granted by various states, Paraná’s Government published an act fixing regulations to admit ICMS credits over interstate trades. The “Decreto 2.131/2008” imposed restrictions on credits occurred on interstate trade when supplier’s state granted tax incentive without CONFAZ authorization, in the following way:

<sup>11</sup> Coordenação de Assuntos Econômicos (Economic Issues Committee).

Art. 1º Credits related to purchases with merchandises and goods are forbidden, and services from interstate trades when tax due to the original state have been reduced, partially or totally, by tax incentive without CONFAZ authorization, according to act's appendix.

According to this appendix, it's allowed maintain accounting credits over interstate trade from pointed states on fixed limits. The following, some exemples:

STATE	MERCH/GOOD	BENEFIT	ALLOWED CREDIT IN PARANA	PERIOD
<b>AMAZONAS</b>				
	Main board for audio/video assembling; Capital goods (machinery, vehicles, etc.)	Presumed credit 75% ICMS due	3% trade value	From 09/29/2003
	Boats, cell phones, computers, clothes, shoes, toys, tyres, bicycles	Presumed credit 75% ICMS due	Zero	03/31/2004
<b>BAHIA</b>				
	Computing parts and products	Debit reverse	Zero	06/19/1995 to 12/31/2014
	Machinery production, electric and electronic devices, telecom equipments, optical fiber	Presumed credit equivalent to all ICMS due	Zero	From 21/31/1999
OBS: On Bahias' case there is more than 80 different tax benefits granted over the time.				
<b>DISTRITO FEDERAL</b>				
	Cachaça	Presumed credit 9% over trade value	3% over trade value	From 18/12/2008
<b>GOIÁS</b>				
	<i>In natura</i> cotton	Presumed credit 75%	3% trade value	From 05/29/2006

		ICMS due		
	Ethanol	Presumed credit 30% ICMS due	Up to 3,4% over trade value	From 08/01/2008
	Meat	Presumed credit 11% over trade value	1% over trade value	04/05/2000 to 12/31/2003
	Marble, granite	Presumed credit 100% ICMS due	Zero	From 07/01/2000
<b>MATO GROSSO</b>				
	Coffee	Presumed credit 75% ICMS due	3% over trade value	From 03/29/2001 to 10/19/2008
	Corn	Presumed credit 20% ICMS due	9,6% over trade value	From 06/27/2007
	Soy	Presumed credit 20% ICMS due	9,6% over trade value	From 06/27/2007
	Biodiesel	Presumed credit 5% over trade value	7% over trade value	From 01/07/2008
<b>MATO GROSSO DO SUL</b>				
	Leather shoes and other leather products	Presumed credit 75%-80% ICMS due	2,4%-3% over trade value	From 09/22/2000
	Interstate trade with several goods and merchandises	Presumed credit 2% ICMS due	10% trade value	From 2003
OBS: As Mato Grosso do Sul is an important cattle producer state, there is a extense list of tax benefits over this sort of business.				
<b>PARAÍBA</b>				
	Shrimp	Presumed credit 100% ICMS due	Zero	Until 12/31/2015
	Cachaça	Presumed credit 80% ICMS due	2,4% over trade value	Until 12/31/2015
	Sugar	Presumed credit 9% over trade value	3% trade value	Until 12/31/2015
<b>SÃO PAULO</b>				
	Boats	Presumed credit that	7% trade value	From 07/01/2009

		results in 7% tax burden		
	Meat	Presumed credit 7% over trade value	5% trade value	From 02/01/2007
	Food	Presumed credit 8% over trade value	4% trade value	From 02/01/2007
	Milk	Presumed credit 6,7% over trade value	5,3% trade value	From 02/01/2007
	Beer	Presumed credit 2,9% over trade value	9,1 trade value	From 09/27/2003
	Cheese	Presumed credit up to 12% over trade value	Zero	From 11/01/2008
<b>PARANÁ</b>				
<i>(All examples are referred to presumed credit)</i>				
	Ethanol*	6% over trade value		Until 12/31/2014
	Feather cotton, soy*	12% over trade value		Until 12/31/2014
	Rice*	6%-11% over trade value		Undefined
	Biodiesel*	8% over trade value		Undefined
	Dairy products*	5% over trade value		Undefined
	Locks, doorlocks* **	5,25%-9%-15% over trade value		12/31/2013
	Coffee*	5% over trade value		Until 12/31/2014
	Meat*	7% over trade value		Undefined
	e-Commerce	12% over trade value		12/31/2014
	Home appliance*	2,5% over trade value		06/30/2015
	Wheat flour*	5% over trade value		Undefined
	Fertilizer*	75% ICMS due		06/30/2015
	Wine*	100% ICMS		12/31/2014

		due		
*	Industrial companies.			
**	Targeted benefits (there are lots of targeted benefits granted by Parana State).			

Table 6 - Some examples of ICMS incentives granted in Brazilian states.

As shown above, this situation is unsustainable. It's impossible to admit that irresponsible state politicians keep granting tax incentives inside their territories, even when the Constitution and all the related laws says that it's illegal.

The Brazilian Supreme Court has been attempting to solve and judge all the cases presented to The Court. But it has been shown as impossible, due to the fact that day-by-day, new tax incentives come in to the tax system despite been illegal.

The Paraná's case above demonstrates that without counterattack measures, it's impossible for Paranaenses's companies to compete with goods and merchandises produced on states who are tax incentive granters.

## 5 FORUM FEDERALISM AND FISCAL WAR – IDP/FGV – BRASÍLIA, 2011

In September 2011 in Brasília, at Instituto Brasiliense de Direito Público – IDP, supported by one of the largest Brazilian education institutes, Fundação Getulio Vargas – FGV, a great fiscal, law and financial event called Federalism and Fiscal War Seminary occurred.

The event's objective was to put together the top Brazilian tax analysts and experts, state governors and all three Brazilian federation level politicians and policy-makers.

A large sort of actual issues were discussed in this forum, such as revenue sharing, royalties on oil production, and moreover, questions related to the Brazilian states' tax incentive war.

The organization's staff produced a book, with the same event's name, collecting the most important speeches. This section will summarize some ideas, according the focus adopted with some comments.



## 5.1 Mr. Guido Mantega (Brazilian Finance Minister)

[...] ICMS has been used by most states to improve and attract investments. Fiscal war became a big auction, where companies' staff visit states looking for the best bid. These auctions benefit only the companies, creating conflicts among states, as known as Fiscal War. In this context, producer states grant ICMS incentives that won't be accepted by consumer states.

[...]

Generalizations of the Fiscal War drive to its overvaluing, which becomes inefficient because if all states adopt it, there aren't advantages for any one.

[...]

The most harmful part of Fiscal War is about importing trade benefits. In this situation, imported goods have better taxation than Brazilian goods. States who benefit importing trades are stimulating these imported goods, exporting jobs to other countries, in a delicate moment when international competition becomes stronger than before.

[...]

If this damaging behavior stays in the future, states which are against Fiscal War will adopt it to protect themselves, and the whole Federation will lose. [...]

The Brazilian Federal government is worried about ICMS' war. However, this preoccupation is a little bit late. It's important to be highlighted that one of the most important goals of The Federal Government is to promote balance and equality in the whole Brazilian territory, according to the 1988 Brazilian Constitution in its articles 155, I; and 161, I.

The Manaus' Free-Trade Area, for instance, created in the 60s achieved its objective, but can't be considered a miracle to be applied nowadays and in the future.

## 5.2 Senator Alvaro Dias (Paraná)

[...] We live in a strong presidentialist system, and its icon is the Medida Provisória, and the chiefs of the Executive Branch, most times, have a weird strategic view, limited to their own term. Immediacy prevails when it's necessary to discuss and share revenues or debate tax system reforms.

The Senator's words reflect what was said above. Normally, elected officials make their policies by thinking limited within their mandated terms. Rarely do Brazilian politician act thinking about the future, the next decade or next generation.

The Brazilian policy-makers should think about consequences of their actions. When financial or taxation policies are discussed, normally they are based on what will happen during their terms. Usually cases are discussed in Brazilian Judicial Courts in which defendants are former officials.

### 5.3 Senator Blairo Maggi (Mato Grosso)

[...] Is it possible to make a wide tax system reformulation<sup>12</sup>? Yes. How? Will São Paulo gain more than other states? So, put a part of these São Paulos' gains in a fund and Federal Government adds the rest, until this transition rule is stable. [...] It'll be a large financial sacrifice.

This is the Middle-East Brazilian states' understanding, where huge revenue losses are expected, because we are those who produce a lot and don't consume in large scale.

Mato Grosso has 906.000 km<sup>2</sup>, is 3 times larger than São Paulo, 4 times Paraná, has 3 million total population and doesn't have consumers for all its production. If ICMS will be taxed on consumption, Mato Grosso is over. The only ones to live there will be soy farmers and cattle breeders.

[...]

In Mato Grosso, if we didn't enter the Fiscal War, we would't have attracted big vegetable protein industries, which created thousands of jobs in little Mato Grosso cities. A middle class generation was created there, that goes to malls and stores spending their money. People who work on big farms aren't the most important to consumption. Who spends more are those families that live supported by jobs created by mentioned industries.

We've got more than only crop, harvest and raise cattle after our Fiscal Incentives granted. [...]

For those who believe that Fiscal War is bad, I say: Fiscal War is too good, at least for those who have nothing and must do something.

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<sup>12</sup> The Senator refers to taxation on consumption ICMS model.

## 5.4 José Roberto Afonso (BNDES<sup>13</sup> Economist)

[...] Brazilian subnational governments never had a lobbying tradition among themselves, organized and systematized, as representative institutions in rich countries. [...] Even considering only on states level, if the natural space for lobbying is CONFAZ, it has been constrained on doing its job. [...]

## 5.5 Governor Eduardo Campos (Pernambuco)

[...] We have resolutions that at any time must be voted on the Brazilian Senate<sup>14</sup>, that impacts severely on states' by accountability. When the consumption model is instituted, it will mean billions of reais on São Paulo's accountability, millions on Bahia's treasury and some dimes on Pernambuco's. Because, in fact, we are exporters. These threats are put. [...]

## 5.6 Governor Geraldo Alckmin (São Paulo)

[...] I am completely friendly to regional developing measures. They're necessary. Moreover, ICMS has this philosophy. [...] there is a different interstate ICMS rate. But, in my understanding, regional development policies – important and necessary – are different than Fiscal War.

Why am I against Fiscal War? First, by legal aspects. Democracy logic is concerned with respecting laws. I understand that legal stability is a requirement to attract investments.

Second, because in Fiscal War states forego revenues to benefit those who don't need. It isn't done to benefit bakeries and little entrepreneurs. International billionaire companies are benefitted.

[...] And then, the peak, interantional trades Fiscal War. How many industries will be closed in Brazil? How many workers will be fired instead of job creation in China? To collect a dime on imports tax? "Import here, doesn't pay anything. Returning guaranteed. Whole, 70%, 80%". We need to have a country's project. What kind of country do we want? With serious public policies, not as the way we are seeing.

## 5.7 Pauderney Avelino (Amazonas Former Deputy)

Nobody is for Fiscal War, even if some positive effects could be seen. It's no solution, but a simple result of state governors worries

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<sup>13</sup> National Economic and Social Development Bank.

<sup>14</sup> Referring to RSF n° 13, voted on April 26, 2012.

to create tax revenue. And it also occurs because of the federal government default from 1980s, on its absence about regional development policies creation. If the federal government really wanted to do it, we wouldn't be living this nowadays, neither would exist many predatory competition leading states to fight themselves on attracting investments.

[...]

This behavior is not good enough for no one state. States lost revenues and this renounced money rarely represents real benefits for population. I insist this war should be changed by a consistent and balanced tax system reformulation.

[...]

I quote as a positive example the Amazonas' model, which has a benefitted industrial area, Manaus duty-free area, that, differently other states, has Constitutional and Legal authorization to create tax incentives, without unanimous CONFAB allowing. In Amazonas, the goals were reached, because this model developed a large forgotten Brazilian area, and besides helps to preserve the largest tropical forrest in the world, Amazonian Forrest.

## 5.8 Bernard Appy (Economist)

[...] Has the Fiscal War problems? I think so, and created serious problems, by the productivity efficiency's point of view. I give an example: Rio Grande do Sul grants incentives to attract an automobile industry that maybe, if not because the incentives, would be in São Paulo. A large percentage of parts comes from São Paulo. Then, these parts transits for thousands of miles, go there with some inefficiency and later come back. São Paulo concedes incentives to wheat industries, that is harvested in Rio Grande do Sul. Wheat, that should be industrialized in Rio Grande do Sul, more efficiently is being loaded to São Paulo because this state grants tax incentives for this productive sector.

[...] We have a serious problem that is a friendly taxation on imported goods. We have a tax incentive structure that foments imported goods instead Brazilian production, in a context which Brazilian production is threaten by exchange rates. It's a disaster, by a point of view of country which we do want.

[...] I understand that in some cases tax incentives granted has the goal to promote the regional development. But we can't close our eyes to the fact that looking to Brazil as a whole country, these incentives brings negative effects to economic growth.

[...] We have another problem that must be discussed: the regional revenue sharing. When states taxes on production, revenues are shared proportionally to production. When states taxes on consumption, revenues are shared by this criteria. It makes difference because production tends to be more concentrated regionally as consumption thus production taxation makes the revenues be more concentrated than if it will be on consumption.

[...] How do we get on this actual situation? At the beginning, some states granted incentives to companies because they didn't have an optimal regional development policy. Generally, poorest states, that's true, and it worked as an industrialization model. Supreme Court procrastinated to take care of this problem. Nowadays, all the Brazilian states grants tax incentives – all. Not only legitim incentives, but also predatory too.

[...] In some cases, states find way to cheat [Supreme Court]. Supreme Court cancel the benefitts, and states re-publish laws and acts with some little changes. Then, the discussion starts again. Even where this is going?

## 5.9 Comments

According to the speeches above, one first conclusion is there isn't consensus among all those involved in discussions related to ICMS and its Fiscal War. And by a sigle point of view, it has been happening because of the large number of conflictting points of interest.

By the states' side there are at least two. Those that agree with the tax incentive war justify your opinion based on a non-existing development federal policy, and the found solution was granting tax incentives to attract investments. Those are against the ICMS war are fighting judicial battles trying to reverse the problematic situation created. (BRUNORI, 2011)

There are some consequences on it. It's not been considered the choices made by companies itself. As told before, sometimes these choices were taken even before the negotiations with state policy makers. When the dealings are been made, the companies' goals generally are to gain more than they have already know that will be granted. Mostly times, the gains are larger than the expected.

Tax speciallists (BRUNORI 2011) quotes as *targeted tax incentives* commonly benefits a small number of corporations. Considering the Brazilian ICMS experience, it's trite to observe tax incentives granted to specific companies. Apart harbor's question, sometimes targetting incentives are offered as a kind of compensation to companies that had financed politicians electoral campaigns. Some people could call it by corruption, but often it's seen as a democracy demonstration.

Must be highlighted the Brunori's (2011) following idea about this point:

Despite a legion of scholarly articles and reports criticizing their use, targeted tax incentives remain a favorite weapon in the battle for economic development. Companies simply hint at the possibility of relocation or expansion, and state government quickly offer to pay for infrastructure improvements, help with job training, and provide numerous tax breaks.

According to author, companies' decisions about moving plants or installations over different states mostly consider tax incentive grants. In general, what induces companies to taking this kind of decision, are infrastructure (transport, roads, airports, etc.) what certainly will reflect on increasing economic development. Sometimes, decisions were taken yet, and it's just a matter of a masked auction (VARSAÑO 1997).

One issue that should be audit by tax incentive granter states – even on targeted concessions – is if there is a real economic/social increasing promoted by those tax benefited companies addressed to the society affected by the concession. In the same sense, LIEBEL (2012) believes that “A caveat must be made on account of the restricted data”.

It must be observed, because on granted tax incentives, lots of revenue won't flow to the state treasury. It means that public money was addressed to private interests, to an expected welfare, prosperity and social development. If it wouldn't be happening, something is wrong, and the state government itself is responsible to find what exactly didn't work as well and fix the situation. This is the opinion of those are against tax incentive grants (LIEBEL, 2012).

Ricardo Varsano teaches that tax incentives can be given in three specific situation and considering whatever the following, public money will always be used by private interests: 1) public money won't be used anyway in any part of the state territory; 2) state would effectively receive new industries or corporations; or 3) benefits be really offered to the involved society who, in fact, is having diminished resources from public sector (VARSAÑO 1997).

The tax incentives grants' largest problem is the fact that according to the Brazilian ICMS system, a non-authorized incentive concession becomes on a situation where the destination/consumption state won't accept those tax credits. Even knowing that the granting is illegal, states granted policy-makers insist on do it.

As told before, one state fix the illegal tax incentive, and the others probably will pay the bill, because often the tax credits are accounted by companies and the

states aren't be efficient on auditing and catching these frauds. As a result, loses for the addressee state on interstate trades will be observed, always.

## **6 AFTER ALL, TAX INCENTIVES (OR TAX COMPETITION) ARE BAD OR GOOD?**

The Brazilian Constitution, in your article 151, I, says that is allowed for the federal government grants tax incentive, only by federal taxes, when the goal is to promote social and economic development among diferent regions over the country.

The second unique way to crate tax incentives assigned in the Brazilian Constitution, is that the previously quoted, on LC 24/75.

Looking over the state perspective, it's assumed that the states government can grant tax incentives in two situations: 1) to improve economic and/or social development inside your territory; 2) to neutralize a tax incentive granted to a good's or raw materials' supplier located on a diferent state.

On the first perspective, it supposed to expect that such desirable competition be followed to an increasing on social welfare, including an attractive package of public services (BRUNORI 2011) over the state land.

Increasing jobs shall drive this economic and/or social improvement, besides social welfare. The quest for jobs (BRUNORI 2011), in the Brazilian's outlook is the most highlighted argument by the tax policy-makers. In a development country, which reaches for increasing production, a tax incentive grant can attract more investments, resulting on higher production, bringing a positive benefits chain for its society. More capital and labor absolutely can result on increasing welfare and prosperity (ABEL, BERNANKE and CROUSHORE 2011).

BARTIK (1991) has an appopriate concept about economic development policy. According the author,

[...] these policies are those that provide direct assistance to business. Direct economic development policies assist business with cash, such as tax subsidies, for example, or with services, such as training individuals in how to develop a business plan for a new enterprise.

The second perspective is that tax incentives are granted to neutralize similar measures adopted by another state(s), and it has been observed in almost all the Brazilian states.

MARTINS and CARVALHO (2012) quotes Geraldo Ataliba and José Artur Lima Gonçalves, in which tax incentives has the purpose to shift or attract private companies to do what states point as priorities, becoming participants and contributors of public sector on reaching economic and social development.

## **6.1 Understanding the Brazilian Harbors Tax Incentives War**

The most discussed situation about tax incentive war among the Brazilian states is known as “Guerra dos Portos”<sup>15</sup>, that began as a reduction tax rate granted by Santa Catarina over import trades by its harbors, in the 2000s. Paraná state gave to its importer companies the same incentive in 2006, on an attempt to offset the impact of diminishing import operations by Paranaense’s harbors and airports (Paraná and Santa Catarina are limitary states).

By following this landscape, other Brazilian states (Goiás, Mato Grosso do Sul, Espírito Santo, etc.) just started to offer the same sort of tax incentive to their companies.

About this point, Brunori (2007) says that:

State governments are competing on the international economic scene [...]. When state governments pursue companies or industries looking for investment options, the states routinely offer tax incentives.

According São Paulo State Industries Federation - FIESP<sup>16</sup>, when the states grants this sort of tax incentive, related on international trade, policy-makers are, in fact, exporting jobs that was early been created inside the country (FIESP 2012). FIESP managers affirms that imported goods, merchandise and raw materials have isonomic taxation as national goods have. It has as consequence, in other words, instead

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<sup>15</sup> Harbor Tax Incentive War. (FIESP 2012)

<sup>16</sup> Federação das Indústrias do Estado de São Paulo – FIESP.



inducing national production, tax incentives on import trades has been contributing for the economic imbalance situation for all the involved states.

A phenomenon has been observed on the Brazilian states economy. In general, after the Harbor War was started, ICMS incentives granting states have been shifting their import trade results, as compared to other states. But Goiás and Santa Catarina are classic cases of unfair tax competition on subnational level. What these states are doing is very damaging to the other competitor states.

BARATTO and GUERREIRO perfectly describes the production's evolution relatively to tax incentive grants on import goods and raw materials. According to them:

The [...] Graph [...] shows the evolution of imports in the selected states, taking 2003 as year base = 1. In that year the governors that intensified the granting of fiscal benefits of ICMS on imported goods took seat.

In the state of Espírito Santo fiscal benefits of ICMS on imports have been a regular practice since the 1970'. As that state started to face competition of the other states, the evolution of its imports became similar to the national average in the period analysed. The states of Bahia, Paraná and Rio Grande do Sul also faced an evolution of imports similar to the national average. There is evidence that those have not entered a regular practice of granting ICMS benefits on imports. On the other hand, in Goiás and Santa Catarina the increase of imports is quite above the national average due to their heavy adoption of ICMS benefits on imported goods after 2003.

In the case of the state of Espírito Santo, the tax is being financed by the Fund for the Development of Port Activities (FUNDAP). The state was a pioneer in the granting of the import benefit in the 80s, time when ICMS award credit was not used yet. In relation to the practice of returning the tax to the beneficiary company, Luciano Miguel, after detailed study states that '...it is not a financial benefit, benefit granted in such a way as to reduce the ICMS that incurs in determined transactions and services. In this case, we are faced with a fiscal benefit disguised as a financial benefit and as such, it has to be submitted to an approval process, as defined by Complementary Bill No 24/75.'

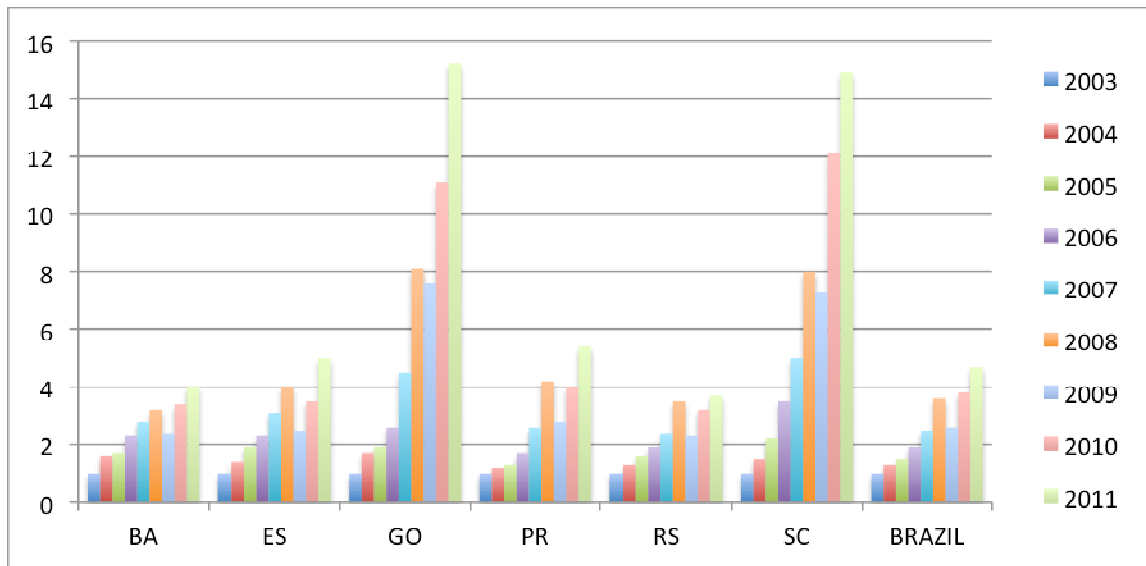


Table 7 - The Brazilian states imports evolution 2003-2011.

Recently, the Brazilian Federal Senate has voted the Senate Resolution n° 13, on an attempt to solve the Harbor Tax Incentive War question. This rule summarily says that the ICMS rate over interstate trades with goods and merchants imported will be 4%, from January 1<sup>st</sup>, 2013 (BRAZILIAN FEDERAL SENATE, 2012).

This is a very well intentioned initiative. But, after reading the rule, it's possible to observe that the problem wasn't solved. First, because the Resolution didn't impose a rate over import operations, but so, over the following sell operations happened on a future moment.

It means that the solution presented by the Senate is not definitive. This attempt to end discussions about this issue will last until the moment that some state(s) will encourage and violate the LC 24/75 rules again, starting to run the "spiral", cyclical breaking-rules bad behavior, typical of the Brazilian policy-makers.

About these assumptions, Kiyoshi Harada (2012) adds that tax incentive grants are part of the taxing Brazilian culture, and, although some cases are totally fair, LC 24/75 existence can't guarantee tax war ending.

In the same sense, Gedalva Baratto (2005) says:

Tax incentive war is ran by action-reaction movements, linking all involved states, when all of them offer the same kind of fiscal incentive, looking a way to neutralize identical benefits gave before.

At the moment that politics interests will speak aloud, new tax incentives will be granted, and all judicial battles and administrative discussions will start again, and so on.

## **7 IS THERE A SOLUTION FOR THIS CANNIBALISTIC POLICY?**

On getting to this point of research, it's possible to conclude that the interstate Brazilian ICMS on present days is a ruined mechanism to collect state revenues. It's demonstrated that in mostly cases, the states policy-makers actions related to interstate tax incentive war, generally results on judicial battles. It's necessary to discuss the current model and corrections are urgent, mainly about the great complaint point, in other words, about taxation on interstate trade operations among the Brazilian states (VARSAÑO 1997).

And it's possible to conclude this for many reasons. The first step that should be considered is that the state executive branch members stop to violate constitutional and legal rules on tax incentives concessions. The Brazilian Constitutional Tax System can be considered positive and complete. There is a list of limits to policy makers and tax-payers' rights on this system that must be observed by the politicians and government while discussions are made before tax incentive decisions were taken.

Another point to be considered is that deserves applause the Executive Branch initiative that propose a Senate Resolution change.

But by the way that things were thought, to fix interstate ICMS rates on 4% in the future doesn't means the first best choice. According all the assumptions made until here, there is no guarantee that at 4% rate, the states won't keep granting as observed in present time.

It's predictable that in a certain future, politicians won't be satisfied with this situation, and despite all the efforts, will try to deceive other states and find a way to cheat the system and start all over again.

The first best solution though in this research is to fix the interstate ICMS rates at 0%, resulting on taxation on the consumption state.

This is not a pacified proposition, although had been proposed for many experts in lates 1980, when the actual Brazilian Constitutions was created.

Linking this idea of 0% rate to the fund that is been discussed in the Brazilian Senate, certainly positive results should be observed, at least regarding to the Brazilian interstate ICMS war.

Certainly, according reasoning considered on these words, changes in the Brazilian Constitutional Tax System must be done, but, while a valid Constitution and law national system exists, all the people (including politicians) must observe these positive rules. The disrespect of laws (by politicians, inclusive) is surely a great loss for entire nation (VARSAÑO 1997).

## **8 CONCLUSION**

The Brazilian ICMS tax system has been mitigated for a long time. At the beginning, it was a taxation system designed to supply states' treasury as fairly as possible. Time passed, and things didn't happen as wished.

States wait for the federal intervention to improve social and economic conditions where the ICMS revenue weren't being sufficient for it. Then, on an attempt to do it by themselves, the Brazilian states started a very dangerous and damaging behavior as tax policy makers, in other words, granting ICMS tax incentives.

Until the tax incentive granting was restricted to states internal tax-payers, there was no reason to start the federative tax battle. But, when the Brazilian states started to grant tax incentives on interstate trades, the situation was changed. The problem is that states can't grant tax incentives neither on internal nor on interstate trades without unanimously decision in the CONFAZ discussions.

Even with these constitutional and legal requirements, tax incentives were been conceded unbridledly.

After all the assumptions exposed on this research, it's possible to make some conclusions, as following numbered:

- 1) Tax incentive war isn't healthy for the states economies. When one state grants tax incentives on interstate trade, generally another(s) related state(s) will suffer with the tax burden removed from the supplier company and forwarded for the buyer, both located in different states; following this step, the real fact is that the destination state will pay the bill created by the original state;

- 2) What the Brazilian tax experts has been thought is to change interstate ICMS rates. The expectation for this measure is try to finish with tax incentive concessions in these sort of trades;
- 3) The alternative measure that has been studied is a gradual reduction on interstate ICMS rates, that will be fixed, at a general rule, in 4%; there are many exceptions on the proposal that are been studied, related on electricity, oil and its derivatives and trades from Manaus' free trade area;
- 4) According claculations made by a CONFAZ's workgroup, some states will lose revenue when the future rates scenario will be completed; to offset these revenue reductions, a fund creation has been studied together with rates reduction; the amount inically discussed is around R\$ 8 billion/yr, and this value will be supplied by the federal treasury;
- 5) There are different opinions about the rates reduction issue: *developed* states, who concentrate either production and consumption argues that rates reduction will be positive to economic development, based on the fact that these states will gain with the new rates (or won't suffer large loses); *developing* states speeches are addressed for a diminishing on their revenues, and it certaily will be the major barrier to have a wide consensus;
- 6) Observing the graphs on the Chapter 4, it's possible to conclude that the states that are historically great tax incentive granters hypothetically will suffer loses with the 4-to-4 rates scenario; it has two probable reasons: 1) tax incentives possibility will be scarce, and as a result reducing both production and new companies installation on their territories; 2) these states are less economic developed than others, and the taxation on the consumption will not be able to keep their economies stable;
- 7) As the detachment between ICMS revenue and GDP is the major tax incentive war effect observed until now, the creation of an efficient and balanced revenue collecting environment should – gradually – result on a strong reduction on *blue chips commodities* (a very important volume of goods and services included in the ICMS basis, as energy, fuel, communication services, etc.), that generally are economicly inelastic, or in other words, are widely consumed even on pricing changes. It means a severe reduction on goods and services largely used to the society, which could be such positive as a fair ICMS taxation;

- 8) Zero rate could be a good alternative; it's not impossible to suppose that even on the 4-to-4 rates scenario, the states won't grant tax incentives to their tax-payers on interstate trades; if large damages will observe in the future in the states finances, tax-policy makers won't hesitate on repeating all known historical bad behavior observed in tax war times.

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