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FISCAL POLICY AND TAX REFORM IN BRAZIL:

A BRIEF STUDY FOCUSED ON THE PERSONAL INCOME TAX

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1. INTRODUCTION

In a global economy, it's urgent for developing countries to define and harmonize the fiscal and financial policies of their governments. Tax reform is a very important issue in this context. The reconstruction of the tax system may involve new taxes, but may at the same time imply the elimination or reduction of others. A majority of opinion is agreed that income tax should have a more important place in tax structure.

This paper is a brief study of Brazilian federal personal income tax, it's importance and it's relationship with the total revenue collected.

Historical and political backgrounds, the weight of Brazilian taxation, history of income tax, comparison to developed and liberal countries are part of this study.

2. HISTORICAL AND POLITICAL BACKGROUND OF TAXATION IN BRAZIL

2.1 COLONIAL PERIOD

Portuguese explorers landed in Brazil in 1500. At first Portuguese economic activity there was limited to the extraction of natural products such as redwood. In the beginning, they didn’t find obvious deposits of gold and silver to stimulate colonization and the huge mineral deposits of Brazil were left untouched for nearly two centuries. Instead, development took place gradually.

No local industries were established until the middle of the sixteenth century. Even then they were restricted, and the imports of raw material and of manufactured products was prohibited except from or through Portugal. This failure to develop the mining sector established agricultural as the early basis of Portuguese taxation in Brazil and sugar and tobacco enriched the crown well before the discovery of gold.

With the discovery of gold, diamonds and semiprecious stones, Portugal tightened it’s grip on Brazil. The crown controlled trade into and out the mining areas of Brazil, confiscating enough gold to finance several decades of government spending in Lisbon. Local taxation rates were as high as 20% for the production taxes, called *quintos* (fifths), but the chief sources of colonial revenue were direct exploitation by the Crow and the farming of land concessions.

The absence of an organized taxation system and the constant raise of Portuguese expenditure determined frequent increase in taxes. Therefore, taxes imposed in Brazil started financing Portuguese expenditures and extraordinary taxes, as *derrama* - which was used every time when revenues on gold where below a expected quota - were created.

2.2 KINGDOM AND EMPIRE

In 1808, when Napoleon's army invaded Portugal, the Portuguese court took refuge in Brazil, which was then raised to the status of a kingdom united with Portugal. The ban on imports was lifted and customs duties were instituted at a basic rate of 24%, reduced to 16% on imports from Portugal and to 15% on imports from England.

After Napoleon's downfall, king John VI of Portugal returned home, leaving his son Pedro in Brazil as prince regent. In 1822, Pedro declared Brazil independent of Portugal and was crowed as emperor Pedro I. By the imperial constitution of 1824, the new country was divided into provinces roughly corresponding to the present states. These provinces were granted limited political autonomy but no taxing powers. The constitution was amended In 1835 to grant to the provinces the right to levy all taxes not specifically reserved to the crown, but most taxes then in use were on the reserved list.

Unfavorable economic conditions, aggravated by the war of 1864-1870 with Paraguay and by discontent precipitated by the abolition of slavery in 1888 without indemnity to landowners, led to the proclamation of the republic in the following year.

2.3. THE REPUBLIC

The newborn republic adopted a federative system that has kept its same characteristics until today. Under federation the provinces of the empire were transformed into states. The parliamentary system was replaced with a presidential one, a bicameral congress (chamber of deputies and senate) was created, as well as a completely independent supreme court. At the states’ level the same structure was adopted.

The republican constitution of 1891 reserved to the federal government all taxes considered to be national en character and reserved to the states those taxes on property and business that were considered to be local. No limitation were imposed on the power to levy taxes other than those specifically designated, so that, as to the remaining taxes, there was no restriction on the overlapping of state and federal jurisdiction.

In 1930, immediately after his assumption of power, President Getulio Vargas suspended the constitution of 1891. The new constitution voted in 1934 , reserved the income tax, which had been instituted in 1922, to the federal government and the sale taxes to the states. For the first time, municipal governments received an exclusive power to levy taxes.

The constitution of 1934 was created after 1929 crises. At that moment, revenues couldn't be based on trade taxation anymore. More importance was given to sales taxes.

After, new constitutions were elaborated in 1937 and 1946.

Brazilian national tax code (law 5.172 of October 1966) sets general rules of incidence regarding the taxes listed in the constitution promulgated in 1988.

2.4. AN OVERVIEW OF INCOME TAX IN BRAZIL

The introduction of a general income tax in Brazil, although proposed at the time of the empire and again in the constitutional assembly of 1891, was not adopted until 1922. The taxation of income in the 19t^{h} century had been limited to some types of receipts such as the emoluments of public officials and corporate dividends. The first constitution of the republic (1891) made no reference to the income tax, which thus remained a subject of concurrent legislation by the federal government and the states. No state, however, made use of its prerrogative to introduce a general income tax.

The first federal income law of 1922 was limited to a sole article which merely introduced the tax and described it's general characteristics. This law, like subsequent and increasingly elaborate income tax laws of Brazil, received it basic orientation from the income tax law of France. The field of income taxation first became an exclusively federal area under the constitution of 1937 and it retains this position under the present constitution of 1988.

3 - MAIN FEATURES OF THE TAX STRUCTURE IN BRAZIL

The federal constitution, promulgated in 1988, grants taxing power to the federal government, the states, the federal district and to the municipalities.

The main taxes collected by the federal government are: import and export duties, tax on industrialized products, tax on financial transactions, income tax, rural land tax and tax on great fortunes. States secretaries of finance administer the following taxes: tax on circulation of goods and on transportation and communications, inheritance and donations tax, tax on the property of motor vehicles and additional tax on income tax. Municipal secretaries of finance administer the following taxes: services tax, property and urban land tax, tax on retail sales of fuel.

4 - INCOME TAX AND FISCAL POLICIES

Examination on a range of fifty-five countries showed that the relative importance of income taxes, as a proportion of central government revenue, was markedly less in underdeveloped territories than in developed ones. In the case of personal income tax, there is a very great deal of difference between the two types of countries. We can see this in a number of different ways. In UK some nineteen millions individual pay income tax each year and in the USA some fifty million of the total population of the country (***PREST-1962***).

The personal income tax is widely regarded as one of the best form of taxation. The net income of natural persons is a broad measure of capacity to contribute to the support of the state and, it’s often considered the most nearly adequate single basis of taxation. A progressive income tax is a prime method of "demanding more form those who have most" and reducing excessive inequality.

Personal income tax is still the most important fiscal mechanism a democratic government has in a capitalism economy. This tax reduces the disparity in income distribution that accompanies rapid capitalization; it has great flexibility from standpoint of fluctuations and growth in economic activity and it brings the government substantial resources from individuals with large incomes, which permits financing the increasing expenditures for economic and social developments.

Another school of thought, however, hold that income taxes and other forms of progressive taxation should be minimized or avoided in less developed countries because they have adverse effects in savings, enterprise and work. The industrialized countries of Europe and North America, it’s pointed out, did not begin to impose heavy income taxes until they accumulated a large capital stock and have gone far toward the establishment of modern economies.

In Great Britain, to be sure, the income tax was in effect during most of the nineteenth century, but usually the rate was low and the graduated surtax was not introduced until 1910. The person income tax dates from 1917 in France.

4.1 CONDITIONS FOR SUCCESFUL INCOME TAXATION

The income tax requires for its efficient operation a trained staff and favorable social and economic environment. The prerequisites of a successful use of the person income tax as a major revenue source are (***GOODE- 1965***):

1) The existence of a predominantly monetary economy;

2) A high standard of literacy among taxpayers;

3) Prevalence of accounting records that are honestly and reliably maintained;

4) A high degree of voluntary compliance on the part of taxpayers;

5) A political system in which the rich are no dominant; and

6) Honest and efficient administration.

PREST- 1963, describes that It would seem that there are four reasons for the radically different performance of personal income tax in underdeveloped and developing countries:

1) There are problems of defining income;

2) There are difficulties of assessing any one individual’s income, even if one knows how to define income in general;

3) There are matters connected with the fixing of rates and allowances;

4) There are problems of assessment (difficulties of tax collection).

In the opinion of ***KALDOR - 1965***, effective income tax reform in Latin America requires that the rate schedule should be both simple and moderate. There is no point in starting to levy tax at a very small rate: 10 per cent should be regarded as the minimum chargeable rate for the excess or income above the exempted amount, and there’s no point in having too many steps. He thinks that the schedule should provide for no more than six to eight separate income brackets, any incomes in excess of a certain level been charged at a uniform rate. The rate of tax on the successive levels of income should rise by steps of 5 per cent to a maximum of 40 to 45 per cent. The maximum rate should not be an immoderate one.

4.2 - THESIS ON THE GROWTH OF INCOME TAX COLLECTION IN BRAZIL

During the period from 1965 to 1980, Brazil experienced an impressive growth of 274,3% (in real terms) in the income tax collection.

Personal income tax was the major factor behind the general trend. It's collection increased 313,5% in the period (***REZENDE DA SILVA - 1970***).

How can the growth in income tax collection be explained? One hypothesis is that the number of tax payers has rapidly expanded, which would not be surprising.

A second hypothesis is that the legislation has become more stringent, something that would be shown by the fact that tax ratios to be applied to each income bracket were raised. Unfortunately for the proposed interpretation, there has been no trend toward a more stringent tax legislation in the sense mentioned. This is especially true as to the treatment give to the highest income groups. The conclusion is that tax legislation has in fact become less stringent specially as it applies to the highest-income groups. The highest tax ratio has been drastically lowered from 1965: it was 65 percent until 1965, and it was reduced to 50 percent until 1974. Nowadays it's still less: 25 percent.

The growth in income tax revenues, so, can't be explained as a consequence of the enforcement of strict legislation. Since the law has become less stringent to the very rich, one implication of the above discussion is that, once again, the facts fail to tell a story of state autonomy in relation to the very rich. Simultaneously with the reduction in the highest tax ratio, there has also been a reduction in the upper limit of each class, as measured in units of per capita income.

GOMES - 1986 , believes that, in an ever increasing manner, middle-class people came to be treated by the income tax regulations on an equal footing as compared to upper-class individuals. Gradually, the reduction in the upper limits of the income brackets produced the effect that the individuals of the middle-income classes are obligated to pay more income taxes, relative to their income.

Add to this the fact that per capita income was growing fast for the most part of the 1964-80 period, and also that the distribution of income was becoming more concentrated, and the growth in income tax collection gets explained.

From 1965 to 1980, the average income of the richest 5 percent of the population – which can roughly be identified as the population of income-tax payers – grew in real term as much as personal income tax revenues. Since the total income of the richest people was growing far above the national average, the mass of taxable income increased at a high rate.

4.3 - ALTERNATIVE SOURCES OF REVENUE

When tax policy issues are discussed and alternative sources of taxation are studied, Adam Smith's criteria for a tax structure (equity, certainty, convenience and economy), established in 1776, are still used today.

1) Equity: The incidence of taxation should be borne by those who have "ability to pay", based upon income levels of wealth;

2) Certainty: A tax must provide taxpayers with some degree of certainty concerning the amount of their annual liability. Tax must be simple to understand and administers;

3) Convenience: An efficient tax structure should be easily assessed, collect and administered;

4) Economy: An efficient tax structure should require minimal compliance and administrative costs.

4.3.1 - SALES TAX

Sales tax is an important source of revenues in the United States. Today, thirty -seven states in the United Sates levy sales taxes. In almost all of these states the sales tax is the most important source of revenue.

Opponents to sales tax blame its regressiveness and its burden on large families. Those who are favorable emphasize that the tax is easy to administer, it raises a great deal of money, it is relatively favorable to saving and investment.

4.3.2 - VAT

Value added is the difference between the value of a firm's sales and the value of the purchased material inputs used in producing goods sold.

A VAT is a percentage imposed on each taxable transaction, based generally on the price charged. Each taxable entity involved in the production and distribution of goods and services would be allowed to deduct from this tax liability the amount of VAT paid on its purchase of goods and services.

The value-added tax appeared in France in 1954, initially covering the industrial sector alone. In 1979 the VAT was responsible for 48% of the revenue of the French government. The European experience shows that each country adopted VAT in order to replace an inferior sales tax. In a sense a VAT has the same effect as sales tax, but collected at each stage of the process of production and distribution.

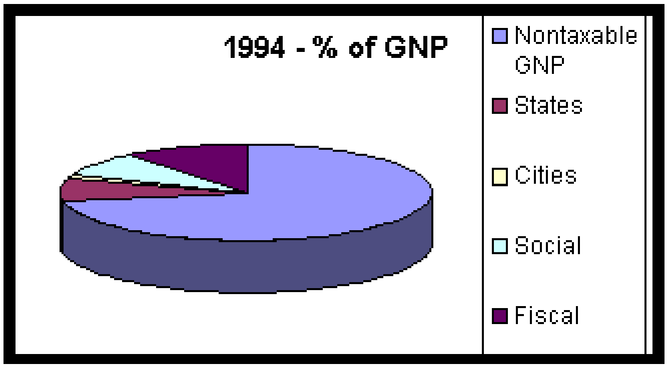
A value-added tax cannot be analyzed as though it would or could exist in isolation. The adoption of a value-added tax must be associated with one or more other changes in the government fiscal situation, as for example a reduction in other taxes and avoidance of any increase in other taxes.

5 – TAXATION AND GNP

With a GDP of U$ 752,4 billion in 1996, Brazilian economy is dynamic and diversified. In 1994 industrial sector was responsible for 39 percent of economy output, agriculture for 12 percent and services accounted for 49 percent. When studying fiscal and tax reforms the fist question that arises is how to measure the weight of taxation on society. ***TEIXEIRA - 1996***, says that in 1988 it was about 20,92% of GDP; in 1989, 21,99%; and in 1990, 25,4%. Data from *Receita Federal* is shown below

TABLE 01: BRAZILIAN TAX WEIGHT (PERCENTAGE OF GNP)

YEAR	***STATES***	***CITIES***	***SOCIAL***	***FISCAL***	***TOTAL***
1984	5.06	0.58	7.57	11.21	24.42
1985	5.21	0.54	7.54	10.65	23.94
1986	5.08	0.62	5.62	11.07	22.39
1987	4.44	0.58	5.19	10.07	20.28
1988	4.48	0.60	4.74	10.19	20.01

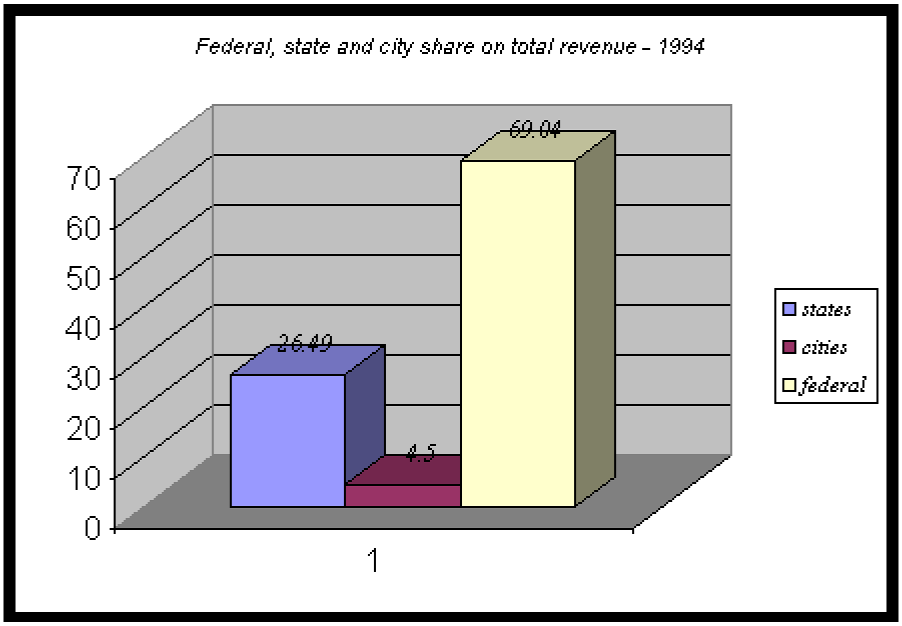
1989	6.91	0.60	5.32	9.33	22.16
1990	8.79	0.76	7.57	12.33	29.46
1991	7.03	0.57	6.28	9.84	23.71
1992	7.16	0.99	6.49	10.49	25.13
1993	6.28	0.85	7.32	10.27	24.72
 ***1994***	7.35	1.25	8.45	10.71	27.75

Source: COGET/RECEITA FEDERAL

The total showed above is shared between federal, state and municipal government as described in table 02.

TABLE 02 - PERCENTAGE OF FEDERAL, STATE AND MUNICIPAL GOVERNMENT IN BRAZILIAN TAXATION SYSTEM (1984-1994)

YEAR	*STATES*	*CITIES*	*SOCIAL*	*FISCAL*
1984	20.72	2.38	31.00	45.90
1985	21.76	2.26	31.50	44.49
1986	22.69	2.77	25.10	49.44
1987	21.89	2.86	25.59	49.65
1988	22.39	3.00	23.69	50.92
1989	31.18	2.71	24.01	42.10
1990	29.84	2.58	25.70	41.85
1991	29.65	2.40	26.49	41.50
1992	28.49	3.94	25.83	41.74
1993	25.40	3.44	29.61	41.55
1994	26.49	4.50	30.45	38.59



Source: COGET/RECEITA FEDERAL

Table 03 shows the revenues that are administrated by the *Secretaria da Receita Federal*

TABLE 03 - REVENUE ADMINISTRATED BY SECRETARIA DA RECEITA FEDERAL (PERCENTAGE OF GNP)

YEAR	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
	9.43	7.97	8.65	9.16	8.27	8.34	11.11	9.08	9.91	10.87	12.3

Source: GOGET/RECEITA FEDERAL

If we compare taxation in Brazil, measured in terms of percentage of GNP with taxation developed countries we will see that the numbers of Brazil are modest: in the United Sates taxation currently reaches 37% of the GNP, in Japan 34% and the average for Europeans countries is 40%. *(**TEIXEIRA - 1986**).*

***STOTSKY and SUNLEY* (1994)** claim that total taxes in the United States in 1991 were the lowest relative to GDP of all OECD countries other than Turkey and Australia. Federal taxes (excluding social insurance contributions) were 11.3 percent of GDP in 1991, falling from 12.0 percent in 1975. State taxes were 5.5 percent of GDP in 1991, rising from 5.1 percent in 1975, and local taxes were 3.8 percent in 1991, falling from 3.9 percent in 1975. Federal and state social insurance contributions were 8.9 percent of GDP in 1991. Therefore, for those authors, total taxes (including social insurance contributions) were 29.5 percent of GDP in 1991.

6- PERSONAL INCOME TAX TODAY IN BRAZIL

6.1 – RATES

Nowadays, there are two different income brackets in Brazilian personal income tax: 15 and 25%. It has changed a little in the past years as summarized in table 03

TABLE 03 – SUMMARIZED RATES OF BRAZILIAN PERSONAL INCOME TAX (1991-1997)

YEAR	RATES		
1991	10%	25%	
1992	10%	25%	
1993	15%	25%	
1994	15%	25%	
1995	15%	26.6%	35%
1996	15%	26.6%	35%
1997	15%	25%	

Source: Adaptation from Receita Federal data

The complete table showed below includes values (in reais) of each different bracket and also values that are able to be deducted.

TABLE 04 – RATES AND BRAKETS – BRAZILIAN PERSONAL INCOME TAX (1991-1997)

1991					
Income brackets				Rate	Deduction
Up to	6.651,79			*****	*****
Above	6.651,79	Up to	22.172,59	10%	665,17
Above	22.172,59			25%	3.991,06
1992					
Income Brackets				Rates	Deduction
Up to	4.571,84			****	****
Above	4.571,84	Up to	14.897,97	10%	457,18
Above	14.897,97			25%	2.691,88
1993					
Income Brackets				Rates	Deduction
Up to	9.198,32			****	****
Above	9.198,32	Up to	17.936,72	15%	1.379,75
Above	17.936,72			25%	3.173,42
1994					
Income Brackets				Rates	Deduction
Up to	7.701,58			****	****

Above	7.701,58	Up to	15.018,08	15%	1.155,24		
Above	15.018,08			25%	2.657,05		
1995							
Income Brackets				Rates	Deduction		
Up to	8.072,85			*****	****		
Above	8.072,85	Up to	15.742,06	15%	1.210,93		
Above	15.742,06	Up to	145.311,36	26,6%	3.038,54		
Above	145.311,36			35%	15.246,56		
1996							
Income Brackets				Rates	Deduction		
Up to	9.779,62			****	****		
Above	9.779,62	Up to	19.069,80	15%	1.466,95		
Above	19.069,80	Up to	176.028,11	26,6%	3.680,87		
Above	176.028,11			35%	18.465,85		
1997							
Income Brackets				Rates	Deduction		
Up to	10.800,00			****	****		
Above	10.800,00	Up to	21.600,00	15%	1.620,00		
Above	21.600,00			25%	3.780,00		

Source: Receita Federal

6.2 – PROFILE OF TAXPAYERS

Federal government, received through Receita Federal 7.61 millions personal income tax filings during the year of 1996. It represented a raise of 16% when compared to the year of 1995.

6.3 – INCOME TAX FILINGS RECEIVED - GEOGRAPHIC DISTRIBUTION

Brazilian taxpayers are concentrated the in southeast and south areas or the country: Southeast area is responsible for 60% of the overall filings received in 1996; South, 18,4% and North; 3,1%.

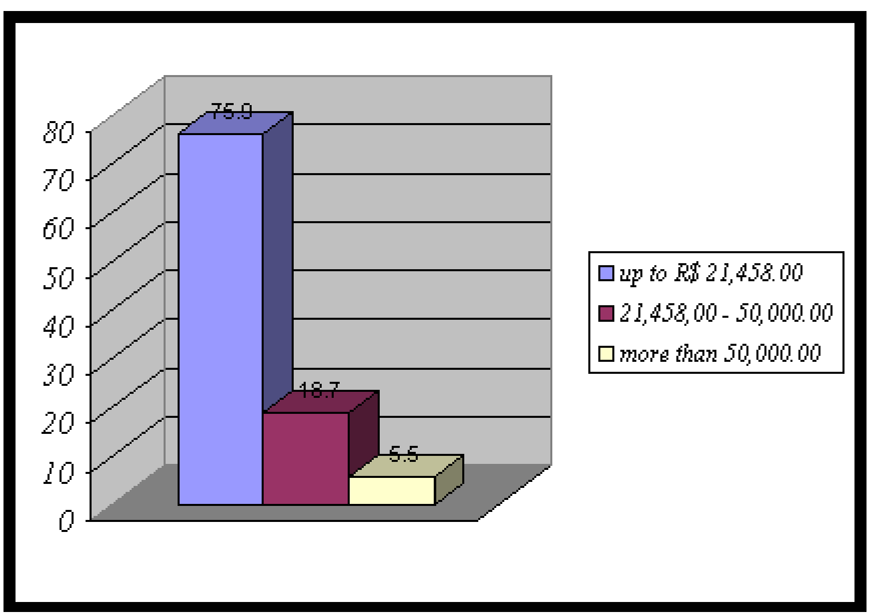
Among the states, 34,6% of the filings came from Sao Paulo ; 13,1% from Rio de Janeiro; 10,3% from Minas Gerais; 8,9% from Rio Grande do Sul; 6,1% from Parana; 3,5% from Santa Catarina and 3,5% from Bahia. The filings delivered in the other states represented 20,5% of the total received.

6.4 - TAXPAYERS INCOME – GEOGRAPHIC DISTRIBUTION

The distribution of taxpayers, according to different brackets of gross income, bears that in the year of 1996, 75,8% of taxpayers of personal income tax earned annual income of up to R$ 21,458; 18,7% earned between R$ 21,458 and R$ 50,000 a year and only 5,5% had gross income above to R$ 50.000, as Table 05 shows

TABLE 05 – DISTRIBUTION OF TAXPAYERS ACCORDING TO GROSS INCOME

State	Up to R$ 21.458	>R$21,458 - R$50.000	> R$50.000
Distrito Federal	57,1%	31,9%	11,0%
Amazonas	70,7%	21,6%	7,7%
Alagoas	73,4%	19,8%	6,9%
Rio de Janeiro	70,9%	22,2%	6,9%
Exterior	60,1%	33,3%	6,7%
Sergipe	70,6%	22,9%	6,4%
São Paulo	74,4%	19,6%	5,9%
Acre	74,0%	20,3%	5,8%
R. Grande do Norte	73,0%	21,4%	5,6%
Pernambuco	74,8%	19,8%	5,4%
Pará	74,1%	20,5%	5,4%
Ceará	75,9%	18,8%	5,3%
Bahia	74,3%	20,6%	5,1%
Paraíba	75,3%	19,6%	5,1%
Piauí	80,0%	14,8%	5,1%
Maranhão	78,8%	16,5%	4,7%
Espírito santo	76,7%	18,7%	4,6%
Rio Grande do Sul	81,2%	14,4%	4,3%
Mato Grosso	82,4%	13,5%	4,2%
Goiás	80,8%	15,1%	4,1%
Santa Catarina	81,7%	14,3%	4,0%
Minas Gerais	81,4%	14,8%	3,8%
Paraná	81,4%	14,8%	3,8%
Mato Grosso do Sul	80,6%	15,7%	3,6%
Amapá	75,9%	20,5%	3,6%
Rondônia	80,6%	16,2%	3,2%
Roraima	84,1%	13,2%	2,7%
Tocantins	85,3%	11,9%	2,7%
BRAZIL	**75,9%**	**18,7%**	**5,5%**

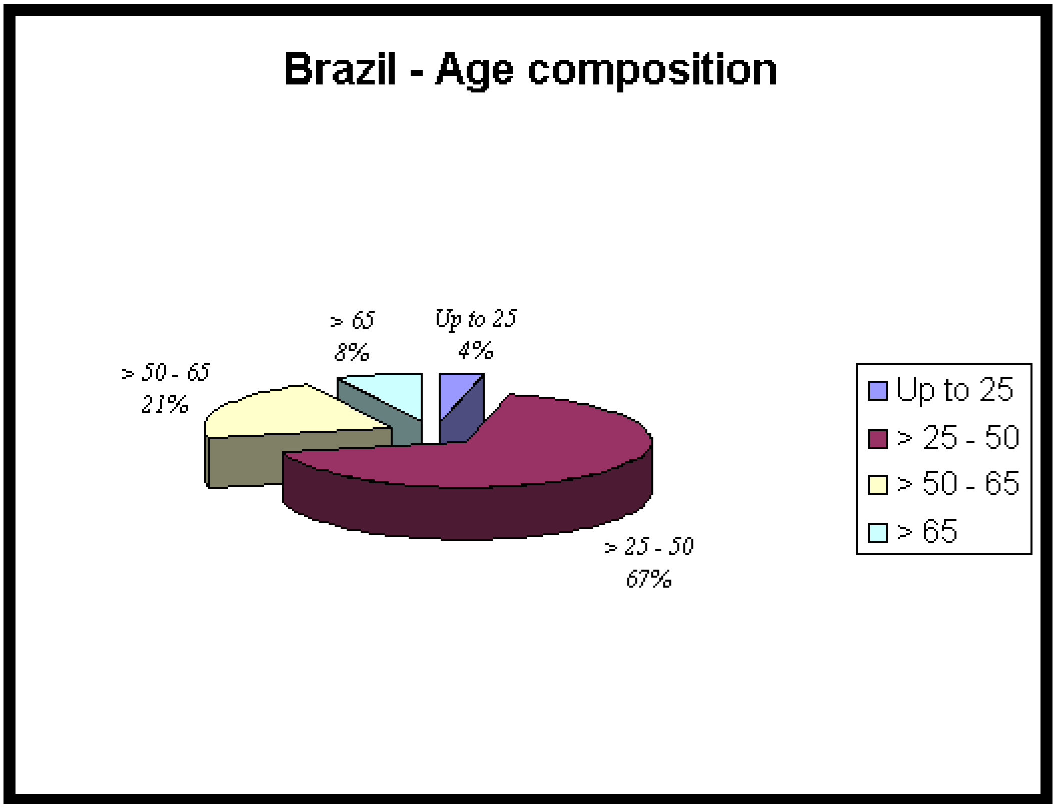


6.5 – AGE COMPOSITION

The distribution of Brazilian taxpayers according to their age shows that 67,7% are adults, with ages between 25 and 50 years old, 20,8% are mature adults, with ages between 50 and 65 years, 7,5% are elderly (more than 65 years) and only 4% are youth, under 25 years.

TABLE 06 – AGE COMPOSITION

state	Youth up to 25 years	Adult >25 a 50	Mature > 50 a 65	Elderly > 65 years	Total 100%
Amapá	7,0%	76,6%	14,4%	2,0%	14.377
Santa Catarina	5,5%	73,3%	17,0%	4,2%	263.739
Tocantins	5,5%	76,1%	14,9%	3,5%	17.009
Mato Grosso	5,4%	75,6%	15,4%	3,6%	75.153
Roraima	5,2%	81,3%	11,3%	2,3%	10.943
Paraná	4,8%	70,2%	19,2%	5,8%	464.315
Goiás	4,6%	70,7%	19,1%	5,6%	155.100
Federal District	4,5%	71,3%	19,8%	4,1%	223.019
Rondônia	4,4%	82,3%	11,8%	1,6%	35.168
Amazonas	4,3%	74,5%	16,8%	4,3%	49.060
Mato Grosso do Sul	4,3%	69,6%	19,5%	6,6%	76.957
Minas Gerais	4,2%	69,2%	20,0%	6,5%	785.784
Rio Grande do Sul	4,2%	67,6%	21,1%	7,1%	675.213
Ceará	4,1%	67,5%	21,2%	7,1%	152.262
Maranhão	4,1%	70,9%	19,6%	5,4%	59.720
São Paulo	4,0%	68,2%	20,5%	7,3%	2.634.645
Espírito Santo	3,8%	71,5%	19,0%	5,6%	131.198
Sergipe	3,6%	70,6%	19,2%	6,3%	43.605
R. Grande do Norte	3,5%	68,9%	20,7%	6,8%	63.697
Piauí	3,5%	69,3%	20,6%	6,6%	45.071
Alagoas	3,5%	69,4%	20,1%	7,0%	47.781
Paraíba	3,4%	66,5%	22,8%	7,4%	67.248
Acre	3,4%	74,0%	19,1%	3,5%	12.621
Pernambuco	3,3%	64,7%	23,7%	8,2%	180.233
Pará	3,2%	70,3%	20,7%	5,8%	96.811
Bahia	2,9%	68,6%	21,2%	7,3%	232.093
Rio de Janeiro	2,8%	58,5%	25,3%	13,3%	995.597
Exterior	0,5%	69,3%	26,7%	3,5%	2.947
BRAZIL	**4,0%**	**67,7%**	**20,8%**	**7,5%**	**7.611.366**



7 – PERSONAL INCOME TAX AND TAX REFORM IN THE UNITED STATES

7.1. – HISTORICAL BACKGROUND

In many instances throughout history, war proved to be an important factor in revolutionizing the fiscal system of a country. The civil war was no exception. Tariffs, which had been the principal form of federal taxation until 1861, proved to be an inadequate revenue source for a government with seceding southern states.

SKOWRONEK - 1982, pointed out, that the war was the most remarkable episode in state development. The war had brought national military conscription, a military occupation of the South, a national agency for former slaves, a national income tax, national monetary controls, and national citizenship.

A rather vague revenue law passed by congress in 1861 committed the north to the use of an income tax. It was strengthened in 1862 when the levy was made mildly progressive. After the usual administrative difficulties associated with introducing a new levy, the income tax proved to be a substantial source or revenue. Because funds were needed to finance the war, rates were increased and made more progressive in 1864. During the postwar period, Congress increased the personal exemption, made the tax proportional, and twice reduced rates.

Individual and groups who favored redistributing income from higher to lower income classes strongly supported retaining the income tax. Opponents cited its detrimental effect on saving, capital formation, risk taking, and economic growth. The opponents of the income tax finally won the debate, at least temporarily, when congress permitted the tax to expire in 1872. Advocates of the progressive individual income tax did not give up. Over the next twenty years, they introduced sixty-six separate bills in Congress to reestablish the levy. Finally, in 1895, the house and senate passed an act that taxed all forms of individual and corporate income.

The revenue act of 1913 imposed an income tax which rates varied from 1% to 7% for individuals, depending upon the individual’s income level.

The federal income tax became a "mass tax" on individuals during the early 1940s, because of the necessity to finance the revenue needs of the federal government during word war II. In 1939, less than 6% of the US population was subject of the federal income tax, whereas by 1945, 74% of the population was taxed.

7.2 - MAIN FEATURES OF THE TAX STRUCTURE IN THE UNITED STATES

Taxes are levied in the United States by the federal, state and local governments. The federal and state governments have independent taxing powers and each government imposes its own taxes.

Taxes on income, differently from Brazil, are imposed by the federal government, most state governments and some local governments.

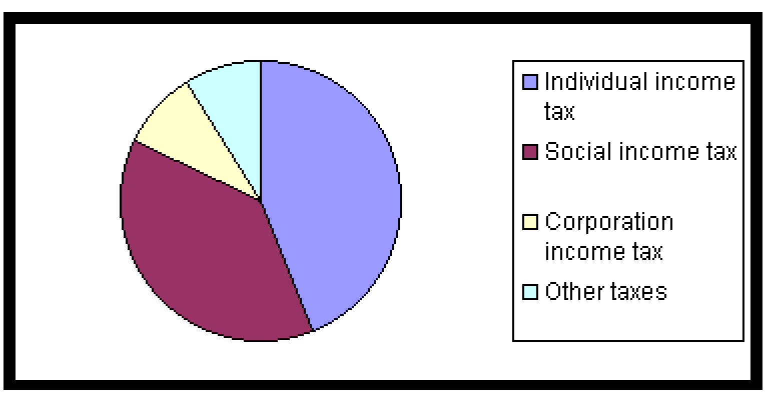
At the federal level, the personal income tax is the most important revenue source. The federal government also levies a social security tax, which applies to both employees and employers and a variety of excise taxes (taxes on alcohol and tobacco, gasoline and other fuel taxes and telephone, for instance).

At the state level, the general sales taxes have traditionally been the largest source of revenue, and at the local governments the property tax remains the predominant form of tax revenue.

The importance of federal personal income tax in the United States can be observed in table 07, that shows the percentage of different federal taxes in the total collected by federal government.

TABLE 07 – FEDERAL REVENUES - %

FEDERAL REVENUES	1981	1986	1991
INDIVIDUAL INCOME TAX	***48%***	***45%***	***44%***
SOCIAL INCOME TAXES	***30%***	***37%***	***38%***
CORPORATION INCOME TAXES	***10%***	***8%***	***9%***
OTHER	***12%***	***10%***	***9%***



Source: Council of Economic Advisors, Economic Indicators, 1992

7.3 - FEDERAL PERSONAL INCOME TAX IN THE UNITED STATES

There are, nowadays, in the United Sates, five different income brackets in the federal income tax, as summarized bellow.

TABLE 08 - SUMMARIZED INCOME TAX RATE SCHEDULE (FEDERAL PERSONAL INCOME TAX)

summarized INCOME TAX RATE SCHEDULE - %				
15	***28***	***31***	***36***	***39.6***

Individuals may file under four different rate schedules, applying to different forms of household composition. The most widely used schedules are for married couples filing jointly and for single individuals. There is a rate schedule for married couples filing separately and another rate that applies to heads of households (generally used by unmarried individuals with a dependent child).

The complete tax rate schedules are showed on tables 09, 10, 11 and 12.

TABLE 09 - TAX RATE SCHEDULE - SINGLE (FEDERAL PERSONAL INCOME TAX)

If taxable income is	But not over	The tax is	Of the amount over
0	***24,000***	***15%***	***0***
24,000	***58,150***	***3,600.00 + 28%***	***24,000***
58,150	***121,300***	***13,162.00 + 31%***	***58,150***
121,300	***236,750***	***32,738.50 + 36%***	***121,300***
263,750	**********	***84,020.50 + 39.6%***	***263,750***

TABLE 10 - TAX RATE SCHEDULE - MARRIED FILING JOINTLY (FEDERAL PERSONAL INCOME TAX)

If taxable income is	But not over	The tax is	Of the amount over
0	***40,100***	***15%***	***0***
40,100	***96,900***	***6,015.00+28%***	***40,100***
96,900	***147,700***	***21,918.00 + 31%***	***96,900***
147,700	***263,750***	***37,667.00 + 36%***	***147,700***
263,750	*********	***79,445.00 + 39.6%***	***263,750***

TABLE 11 - TAX RATE SCHEDULE - MARRIED FILING SEPARATELY (FEDERAL PERSONAL INCOME TAX)

If taxable income is	But not over	The tax is	Of the amount over
0	***20,050***	***15%***	***0***

20,050	***48,450***	***3,007.50 + 28%***	***20,050***
48,450	***73,850***	***10,959.50 + 31%***	***48,450***
73,850	***131,875***	***18,833.50 + 36%***	***73,850***
131,875	*********	***39,722.50 + 39.6%***	***131,875***

TABLE 12 - TAX RATE SCHEDULE - HEAD OF HOUSEHOLD (FEDERAL PERSONAL INCOME TAX)

If taxable income is	*But not over*	*The tax is*	*Of the amount over*
0	***32,150***	***15%***	***0***
32,150	***83,050***	***4,822.50 + 28%***	***32,150***
83,050	***134,500***	***19,074.50 + 31%***	***83,050***
134,500	***263,750***	***35,024.00 + 36%***	***134,500***
263,750	*********	***81,554.00 + 39.6%***	***263,750***

7.4 – STATE INCOME TAX IN THE UNITED STATES

Only seven states do not impose an individual income tax in the United Sates. In most instances state income taxes are progressive and based upon an individual's federal adjusted gross income (AGI). Some states also allow a deduction for federal income taxes in their computation of taxable income.

States income tax rates have increased significantly in the past 20 years. Thirty-three states now have rates of 6% or higher.

8. – CONCLUSION

Tax reform is able to raise additional revenue by many different forms: Governs can introduce a value-added tax (VAT), increase income tax rates, enforce the existing income tax more effectively or, in an extreme way, abandoning the attempt to tax income progressively and replacing income tax with a consumption tax.

As the efficiency costs of taxation are potentially large, governs must decide between a system that only take in account the costs and other that also is concerned about how it can affect the distribution of welfare.

In Brazil's case, redistributional issues should be admitted and the progressive personal income tax, in this context, should be reformulated.

A few weeks ago, Brazilian federal government announced changes in its fiscal policies that include a raising of 10% in the federal income tax rates. It was, in my opinion, something that can be understood as an urgent way to help diminishing the current account deficit and deal with the global crisis that began in Asia and spread around the world.

An effective income tax reform should be put in practice by broadening the tax base and introducing a rate schedule that could start at a lower level than today (10%, for example) and rise by steps of 5% at a maximum rate of 40%.

Of course, the effects on savings should be carefully studied, and the new legislation should be able to incentive save by raising the amount of deductibility allowed.

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