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# *A COMPARATIVE ANALYSIS OF TAX DISPUTE UNDER STATE ADMINISTRATIVE LAW: SÃO PAULO, BRAZIL AND CALIFORNIA, USA.*

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*"If law is poorly adapted to the economy, expectations conflict, cooperating is difficult, and disputes consume resources. Conversely, if economic law is adapted to the economy, people cooperate with each other, harmonize their expectations, and use resources efficiently and creatively".*

*Robert Cooter*

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## *INTRODUCTION*

Economic growth is a daily challenge to every country in the world. To achieve sustainable economic growth, most economists agree that a given country has to have an open market that interacts with other countries, a government able to implement its macroeconomic policies and a healthy institutional infrastructure. Institutional infrastructure is the collection of institutions that allows economics to run more efficiently, such as a legal system that is competent in preserving the Rule of Law. They are responsible for the "rules of the game" and to insure the enforcement of those rules.

Some of the characteristics that highlight a successful institutional infrastructure include a solid regulatory environment, stable and predictable legal and legislative scenarios, the determination and efficiency within the administration, fiscal and social security reforms, and the control of the corruption. Together, these have an important influence on economic growth.

One of the important aspects that determine the quality of the legal institutional infrastructure of a country is the level of efficiency of its courts; that is, the quality and velocity of their decisions.

A study led by the World Bank[1] stated that the formalism of a legal system is systematically greater in the countries that adopt Civil Law than those countries who adopt Common Law. The formalism of the Civil Law often lengthens the duration of legal disputes. Associated with longer judicial proceedings, there are inefficiency, less judicial consistency, less fairness in judicial decisions and conditions that foster corruption.

Although Brazil is advancing in public administration by reforming social security and the Judiciary, bureaucracy and the delay in the solutions of conflicts by the government institutions are still slowing economic development. The Brazilian Administrative Justice, free and guaranteed by the Constitution, is an interesting option as much for the corporations as for the State, in the resolution of taxation conflicts.

Nevertheless, it has been hindered by the same problems found in the judiciary system. It causes businesses to be insecure, forcing them to keep provisions for judicial losses on their accounting books. It also threatens the State and public interest, as a significant amount of taxes is not collect.

Therefore, it is easy to see the harmful economic effects brought about, in this case, by the undeniable direct relationship between institutions, law and the economy.

The objective of this comparative study between Brazilian and North American administrative solutions in taxation conflicts, specifically between the Sao Paulo State (Brazil), and California (USA), the most economically prominent States in their countries, is to look for suggestions that can increase the effectiveness of the São Paulo State administrative legal system, bringing positive results to its economy.

Chapter 1 describes the instruments the paper will use to reach its objective, showing the development of Law & Economics and Comparative Law, and depicting the relationship between those sciences. Chapter 2 identifies the fundamentals of the Civil Law and Common Law and compares these two major legal systems. Chapter 3 examines the constitutional frameworks and the State taxation systems of Brazil and the USA, and compares them. Chapter 4 analyzes the main procedures of the administrative process in taxation issues from both States and compares them, stressing positive, and negative points. Chapter 5 is an economic analysis of the São Paulo State administrative law that underpins the reasoning for the conclusion.

[1] Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, May 2003, *"Courts", Quarterly Journal of Economics*, World Bank website, July/2004, <http://rru.worldbank.org/Documents/DoingBusiness/ExploreTopics/EnforcingContracts/lexpaper_aug_211.pdf>.

## *Chapter 1*

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# *SEARCHING FOR THE EFFICIENCY OF A LEGAL SYSTEM THROUGH THE ECONOMIC ANALYSIS OF LAW AND COMPARATIVE LAW*

Efficiency - this is what all markets, governments and people are always looking for. Moreover, efficiency is extremely relevant to law. After all, why would society need laws that do not work? "Work", in that case means producing the effects their creators and society want to reach, with the best possible cost-benefit relationship. According to Ugo Mattei, *"from the point of view of a given legal system, efficient is whatever avoids waste; whatever makes the legal system work better by lowering transaction costs; (…) whatever legal arrangement "they" have that "we" wish to have because by having it they are better off."*[2]

Government costs money, and sometimes costs a lot of it, chiefly when the law the state is providing and dealing with is not economically viable. One can easily state that a legal system that takes several years to resolve one case is wasteful, becoming impossible to calculate the cost of that process. The parameters of the cost are lost as times goes by.

São Paulo State is facing this problem in the administrative legal system in tax issues. In some cases, an administrative process can consume years to be resolved. Thus, one can easily consider that the São Paulo State administrative law is not as efficient as it could be.

Certainly, there is not a "perfect legal system", but the Common Law system is clearly market-oriented, as realized in the economic success of countries like the USA, Canada, Australia, New Zealand and the United Kingdom. California has been solving its administrative processes in 18 months in average.

Thus, studying their solutions, comparing the legal systems and doing the economic analysis of our law, we can find original insights that may economically improve São Paulo State legal system.

As stated by Ugo Mattei, *"in using the tools of law and economics together with those of comparative law, the notion of efficiency assume itself a comparative meaning. An institution,*

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[2] *Comparative Law and Economics*, p.145.

*rule, or state of the world is never efficient or inefficient in the abstract or absolute. It may only be so compared with concrete alternatives that may fit better or worse a given context."* [3]

Hence, before we start using them, we will present an overview of those tools.

## *1.1. Law & Economics*

The economic analysis of law or "Law & Economics" is the *'the application of economic theory and econometric methods to examine the formation, structure, processes and impact of law and legal institutions"*[4]

It explicitly considers legal institutions not as given outside the economic system but as variables within it, and looks at the effects that changing one or more of them has upon other elements of the system.

The understanding of growth, institutions and social changes as independent factors deprives them of theoretical and analytical sense.

Institutions matter because they generate and affect technological innovations, the labor process, macroeconomic policies and the competitive pattern, which together explain long-term economic growth and development.

The process of economic growth, and its outspread in different patterns of development, are outcomes not only from the length of positive net GNP and *per capita* rates, but also and ultimately from the institutional arrangement that allows the achievement of decisive structural changes to constitute new forms of growth.

Institutions form the structure of incentive of a society. Douglass C. North[5] theorizes that they are restrictions created by human beings that structure human interactions, and are composed by formal constraints (rules, laws and constitutions), informal constraints (norms of behavior, conventions and self-imposed codes of conduct) and their enforcement characteristics.

Time is the dimension in which the learning process of human beings shapes the way institutions evolve. Institutions provide fixity in the short term and development in the longer term.

Government, as an indivisible and necessary part of the institutional infrastructure, has law enforcement and the supporting of the Rule of Law as its very mission.

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[3] *Comparative Law and Economics*, p.1.

[4] Rowley, Charles K., 'Public Choice and the Economic Analysis of Law', in Nicholas Mercuro (ed.), *Law and Economics*, Boston, Kluwer Academic Publishers, p.125, 1989.

[5] *Economic Performance through Time*, The American Economic Review, volume 84, Issue 3 (Jun. 1994), 329-368.

In fact, the role of government in a free society, as affirmed by Milton Friedman[6], has to be *"to provide a means whereby we can modify the rules, to mediate differences among us on the meaning of the rules, and to enforce compliance with the rules on the part of those few who would otherwise not play the game"*. Moreover, *"does something that the market cannot do for itself, namely, to determine, arbitrate, and enforce the rules of the game"*.

However, government has to have a formal basis to accomplish its mission. Without translation to an appropriate language, the historical process and its attendant social changes will remain abstract. Only when society assimilates those changes and translates[7] them to the language of Law, we can say the learning process has transformed them into rules and norms.

Thus, the Law gives life to formal institutions. Government creates and enforces laws, whereby the economics runs. At this point, we can realize the narrow connection between the Law and Economics.

The current stream of law and economics originated in the United States in the late 1950s and found acceptance amongst the legal community in the 1970s.

According to Richard A. Posner, a founder of the trend, *"the new law and economics began with Guido Calabresi's first article on torts[8] and Ronald H. Coase's article on social cost[9]"*.

Law and Economics has the ambition of applying the economic approach not merely to economic regulation, but to all areas of law.

Many argue that law should be concerned with justice and equity. Nevertheless, the pursuit of justice must be efficient. The economic analysis of law advocates that law is not just a system of coercion but also a system of implicit costs. Legal interpretation should not only concern itself with justice; it should also concern itself with efficiency.

Justice is a "subjective" value, whereas efficiency is an "objective" value. Indeed, there are only a few definitions of efficiency accepted by the established economic paradigm (Paretos', Kaldor Hicks' criterion[10]), and there are as many notions of justice as there are people.

Only when focused on transaction costs, the law will shift the burden to the party in the best position to bear them. Ronald Coase states that when transaction costs are minimal, market actors may

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[6] *Capitalism and Freedom*, p. 25.
[7] Paulo de Barros Carvalho, Curso de Direito Tributário, passim.
[8] *Some Thoughts on Risk Distribution and the Law of Torts*, 70 Yale L. J. 499 (1961).
[9] *The Problem of Social Cost*, 3 J. Law & Econ. 1 (1960).
[10] According to Pareto criterion, a change in the state of the world is efficient when at least one individual is better off after it while no individual is worse off. According to Kaldor Hicks criterion, a change in the state of the world is efficient if the winners compensate the losers (wealth maximization).

reach efficient results by way of bargaining the optimal resource allocation despite the initial distribution of property rights.

This paper wants to shed light over the actual concern of the São Paulo State Administrative Law with the transaction costs of its administrative processes in tax issues, analyzing the effectiveness of this law and how it can be improved based on this analysis. We will have as comparative parameter a Common Law based legislation.

Law & Economics scholars believe that, as all goods have substitutes, legal rules should as well. In such reasoning, *legal transplants*, or the moving of a rule or a system of law from one country to another has been shown, as stated by Ugo Mattei[11], to be the most fertile source of legal development, since most changes in most systems are the result of borrowing.

Comparative Law is the suited model to use when it comes to analyzing different legal systems; and Comparative Law gain theoretical perspective by using the functional analysis employed in economic analysis of law.

On the other hand, Comparative Law may provide economic analysis with a reservoir of institutional alternatives that are not merely theoretical, but actually tested by legal history.

## *1.2. Comparative Law*

According to Marc Ancel[12], the comparison of laws has remote origins, inasmuch as Lycurgus, in Sparta, and Solon, in Athens, traveled around the so-called "known world" to know the Institutions, before starting to legislate.

In the same way, the decemvirs, the Roman law-makers, used information about foreign laws to write The Twelve Tables, particularly the Greek laws, which were a visible influence in the first written Roman legislation.

Even Plato used comparisons in his book "The Laws" and Aristotle discussed the existing constitutions, notably the Carthage's. But it was Montesquieu, in his "Spirit of Laws" (1752), who found the systematic resource of extracting knowledge from foreign laws, comparing legal institutions (specifically from the Constitutional Law) to reveal differences and suggesting legislative reforms.

[11] *Comparative Law and Economics*, p.124.
[12] *Utilidade e métodos do direito comparado*, p. 19-20.

In 1869, the *Société de législation comparée* (Comparative Legislation Society) emerged in Paris, following the changes brought by the Industrial Revolution, the development of international trade, and the presence of concrete legislations in western societies.

The First Congress of the *Société de législation comparée*, which gathered in Paris in 1900, can be regarded as the birth of modern comparative law, according to H.C. Gutteridge[13].

In its inception, Comparative Law was dualistic, mostly confined to the confrontation between *Civil Law* and *German Law*, as only these two were considered "comparable". As of 1920, the scholars of Comparative Law became conscious about the existence, importance and extension of the *Common Law* system.

The constitution of the "American Foreign Law Association", in 1925, along with the increasing relations between North America, land of *Common Law*, and Latin America, follower of the *Civil Law*, favored the strengthening of comparative studies.

The importance of Comparative Law comes capitally from the fact that when two different systems are surveyed, positive and negative points can be exposed. It turns out to be a useful tool in the reform and improvement of the law and the judicial system, as well as helping to integrate economic systems.

The analysis of a variety of cultures and legal, judicial and economic systems can point out what is elemental and theoretically necessary to a given system. Limiting the subject of study to one specific country Law, it is like asking a biologist to restrict his research to one single species[14].

Jean Rivero[15] argues that exclusively studying one's own homeland Law, turns the jurist into a prisoner of your own Law.

In fact, by comparing different legal systems, we can find perceptions and alternatives to improve our internal legal system. We can also penetrate inside the history, culture and civilization of a nation, as Law is indeed a social product.

Comparative Law is mostly used to compare nations' legal systems in their entirety. However, administrative legal systems are unique. They are systems concerned with (a) the organization of the government and (b) the relationship between the government and people.

Therefore, the content, the meaning and even the definition of Administrative Law can vary from country to country, and this is why comparing Administrative legal systems can be so difficult.

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[13] *Comparative Law*, p. 18.
[14] Marc Ancel, *Utilidades e métodos do Direito comparado*, p. 17.
[15] *Curso de Direito Administrativo Comparado*,p. 38.

Thus, delimiting the scope is the solution when it comes to comparing administrative legal systems.

Brazil and the USA, as republics, have federal administrative law, and each State has a unique administrative law. Therefore, we will focus the administrative solutions in taxation disputes in two States from both nations: São Paulo and California.

## *Chapter 2*

# *LEGAL SYSTEMS ADOPTED BY BRAZIL AND THE USA: CIVIL LAW AND COMMON LAW*

As previously mentioned, in the beginning, Comparative Law was dualistic, restricted to the Napoleonic Code and the German Civil Code.

However, in 1920, comparative scholars turned their focus to a new perspective.

In this novel field, the analysis of the concrete issues were objective and based in the *case law*, a law that get into the legal system based on decisions made by the highest courts: the Common Law system.

And these are the two *"families"*[16] we are going to analyze: the Romano-Germanic family, also known as Civil Law, which is followed in Brazil, and the Common Law family, followed by the USA.

## *2.1. The Civil Law System*

[16] Rene David uses the term *"family"* to facilitate the comprehension and presentation of the various law systems within the contemporary world.

The Civil Law[17] family was born in Europe. It has took shape from the efforts of European universities, who elaborated and developed, since the 12th century, a broad-based legal science, the *jus commune*, fit for the modern world.

The scholars based their study on the *Corpus Juris Civilis*, the most comprehensive code of Roman law, compiled by the order of Byzantine Emperor, Justinian I. The *Corpus Juris Civilis* was an attempt to systematize Roman law, to organize it after 1,000 years of development.

Developed at the same time in the universities of Latin and Germanic countries, this collection of laws was named Romano-Germanic. By 1500, the *Corpus Juris Civilis* had become the basis of legal science throughout Western Europe. The next step, emulating the systematizing of Justinian, was to state these principles in an exact and ordered form.

As of the nineteenth century, the countries who adopted the Romano-Germanic family, following the hallmark of the Roman legal system, emphasized a way to organize their laws: codes.

The *Code Napoléon* (1804), the most famous of such works, had many successors; the most prominent being the German Civil Code (*Bürgerliches Gesetzbuch*, 1900), the Swiss Code (1907) and the Italian Code (1942).

Due to colonization, the Romano-Germanic family conquered many territories. The Spanish, French, Dutch and Portuguese colonies, established in almost uninhabited regions, accepted in such a natural way the juridical concepts that characterize the Romano-Germanic family.

The Romano-Germanic family is characterized by the written organization of its juridical rules; it is also characterized by the systematic assembly of norms and precedents and by the influence of scholarly interpretations of law, the doctrine.

The Civil Law family tends to create a unified legal system by working with conclusions drawn from basic principles with maximum precision. The provisions of the written law bind the Civil Law judge. The traditional civil law decision states the applicable provision from the code or from a relevant statute, and that provision is the basis for the judgment.

Civil Law works by deductible reasoning, where there are three propositions: a major premise – the law; other one, smaller or specific premise – the fact; and the conclusion.

Applying the major premise (law) over the minor premise (fact), the conclusion must appear automatically and logically. The fact has to fit exactly to the norm in order to generate effects in the juridical system.

[17] The term *Civil Law* came from the translation of the Roman term *ius civile*, by your turn derived from *Corpus Iuris Civile*, the compilation of Roman law. To Common lawyers, civil law also means "private/contracts law" or "not

Under the conditions above described, the Brazilian legal system is easily recognized. On the other hand, the USA, as a former colony of England, adopted the Common Law.

## *2.2. The Common Law System*

The origin of the Common Law family is definitely linked to the origins of England. It was in this country that this family was born and evolved, because of the social transformations and the development of institutions.

Roman domination over England lasted four centuries but left no legal legacy. The history of English law begins after the roman domain, when several Germanic tribes – Saxons, Angles, and Danishes – shared England's territory.

Each tribe had its own law, and there was not a "common law" before the Norman conquest.

In 1066, the Normans conquered England. William I, the Conqueror, proclaimed the Angle - Saxon Law operative.

This conquest turned out to be, in fact, a crucial moment in England's history. It brought to the country a strong, centralized power, rich in administrative experience. As the Norman conquest took place, the tribal era vanished and the feudalism began in England.

The making of the *comune ley* or *common law*, the English and general law in all of England, was the exclusive work of King's Bench. This court was named Westminster Courts, after the place it was constituted as of the twelfth century.

Although only the king and the chancellor placed the "high justice", only the King's Bench had the effective ways of coercing witnesses to attend trials and executing decisions.

On the other hand, only the king, along with the Church, could obligate their vassals to take an oath. The King's Bench modernized the process and created the jury. Thus, whereas the other jurisdictions – the Courts of Common Pleas - kept an archaic system of proof, becoming increasingly obsolete, they were able to step ahead. By taking elements from several local customs from England, they built the Common Law.

The Common Law is officially adopted in the US along with the *Calvin's case*[18].

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criminal law".

[18] The judges in Calvin's case (1608) ruled that all Scotsmen born since James I's accession in 1603 were naturalized Englishmen and *vice versa*. The key was the medieval doctrine of *ligeance*, a feudal and personal view of the relationship between each individual subject and the king. The upshot was that the court dismissed the argument that Scots owed loyalty to James' political capacity as king of Scotland, not his natural person, which happened also

The first English people villages in US territory date from 17th century: England established colonies in Virginia (1607), Plymouth (1620), Massachusetts (1630) and Maryland (1632). The English constituted thirteen colonies by 1722, and they needed to know which Law they had to abide by.

A decision in *Calvin's case* gave the answer: the English Common Law was applicable in the colonies. English vassals brought it with them when coming to a place without an established legal system.

After the US Civil War (1861-1865), some states adopted Civil and Criminal Process Codes. However, influenced by David Dudley Field[19], Common Law prevailed, but not exactly in the same model brought from England.

Most of the concepts are the same (ex.: equity, torts, bailment, trusts, etc.) but one difference is relevant: the distinction made by the US, and not by England, between Federal Law and State Law. England ignores Federalism.

In addition, in England there is no Administrative, Labor, Corporation or Bank Law, as we have in the US.

The common Law in US is based on the *judge-made law*. The judge is a law interpreter and, in some moments, a legislator. When there is not a precedent the American judge will say, *"There is no law on the point"*, even though there exists, apparently, a law about that issue. The precedent has to be abided by as law.

Common Law uses inductive reasoning, departing from the examination of particular cases to reach a general proposition. The argumentation in this system is analogical or empirical, working by comparison and similitude of particular cases to achieve a conclusion in a given case. For this reason, overwhelming power is given to the precedents, a definite a source of Law in this system.

Common Law is concerned mainly with pragmatic solutions to fit each specific case, giving the doctrine secondary authority.

Civil Law aims to build a juridical pyramid, general, logical and systematic, with a high grade of abstraction. It results in a frame of general and abstract rules, where doctrine has a relevant role in the interpretation of those rules.

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to be king of England. Because ligeance was personal, each subject owed loyalty to James' natural person and in return, James had a duty to protect every subject's right to hold land in each of his kingdoms.

[19] David Dudley Field (1805-1894), controversial American jurist, was a vigorous fighter of legal reform. In 1839, Field had begun his long fight for legal reform through codification. New York's distinction between equity and common-law courts seemed chaotic to him. He believed that the laws ought to be systematized.

Although the American and Brazilian legal systems are different, when it comes to tax legal systems both come close. In the American taxation legal system, the importance of precedents is blended with a intense legislative production, as it is in Brazil. This does not happen with the civil and criminal legal systems in the US, in which decisions are completely *"stare decisis"*[20].

## *2.3. Civil Law v. Common Law: a Brief Comparison*

The Civil Law and the Common Law traditions differ significantly with respect to how judges justify their decisions. Civil Law judges justify their interpretation of a code directly by reference to its meaning, which scholars tease out in lengthy commentaries, and precedents are only subsidiary.

Common Law judges justify their findings of law by reference to precedents and social norms, or *"by broad requirements of rationality presupposed by public policy"*[21].

Civil Law method is taught by reading the codes and arguing from commentaries on them, whereas the Common Law method is taught by reading cases and arguing directly from them.

One cannot generalize about the differences between the two traditions. For example, although the United States is ostensibly a Common Law country, the American states have tried to obtain uniformity in commercial law by a Uniform Commercial Code.

In addition, the American Law Institute, founded in the 1920s, meets periodically to restate the law as it is emerging in the various states. These restatements have a function similar to the codes in Civil Law countries.

Besides differences in the history between the two legal traditions, both apply the law differently. In Common Law countries the lawyers of the litigants bring the arguments, and the judge is not supposed to direct a line of questioning or develop an argument. In this *adversarial process*, the judge acts as a neutral referee who makes the lawyers follow the rules of procedure and evidence. The principle underlying the adversarial system is that the truth will emerge from a vigorous debate by the two sides.

On the other hand, Civil Law judges take an active role in directing questions and developing arguments. In this *inquisitorial process*, the judge is supposed to ferret out the truth. The lawyers respond to the judge, rather than develop the case themselves.

[20] "Doctrine that, when court has once laid down a principle of law as applicable to a certain state of facts, it will adhere to that principle, and apply it to al future cases, where facts are substantially the same." (*Moore v. City of Albany*, 98 N.Y. 396, 410).

Another difference concerns the use of juries. In the Common Law system, the judge was originally supposed to decide questions of law, whereas the jury was supposed to decide questions of fact. In the United States, either party in a dispute usually has the right to a jury trial, although both parties sometimes waive this right and allow the judge to decide matters of fact, as well as matters of law.

The absence of juries in the courtroom is more advanced in Civil Law countries than in Common Law countries. In France as in Brazil, for example, the jury has been used only in the case of murders.

## *Chapter 3*

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# *BRAZIL AND THE USA: STATE TAXATION SYSTEMS AND THEIR CONSTITUTIONAL CONSTRAINTS*

## *3.1. The Brazilian Framework*

Brazil is a federal republic and has had eight constitutions. The first signed in 1824 and the current enacted in 1988.

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[21] Robert Cooter, *Law and Economics*, p.59.

The Brazilian Constitution is a typical Civil Law Code with two hundred and fifty articles and has had forty-five amendments since 1988 until December of 2004. The chapter dedicated to the taxation system describes expressly and minutely the state power to tax and its constraints.

States have autonomy to create their taxation systems, observing the limits imposed by the Federal Constitution, so that the States' Constitutions do not deal with the taxation systems.

Article 155 of the Brazilian Constitution indicates the States power to levy sales tax on goods, on communication services and on interstate and intermunicipal transport services (ICMS[22]); property tax on automotive vehicles (IPVA[23]); gift and inheritance tax (ITCMD[24]) and sundry services or police taxes imposed on specific services rendered by the state.

There are clear constraints on the taxation power of the Federal, State and Municipal governments in Article 150, known as taxation constitutional principles[25]:

- The Enacted-Law Clause (Art. 150, I)
- The Equal Protection Clause (Art. 150, II)
- The Non-retroaction Clause (Art. 150, III, "a")
- The Prohibition Clauses (Art. 150 III, "b" and IV to VI)

### *3.1.1. The Enacted-Law Clause*

The Article 150, I, of the Brazilian Constitution commands that *"without prejudice to any other guarantees ensured to the taxpayer, it is forbidden for the Republic, the States, the Federal District, and the Municipalities:… to claim or increase a tax without a law establishing such claim or increase."*

The purpose of this clause is to ensure that the Executive Power does not create or raise the rate of taxes by decree or any other form of legislation. Only the Legislative Power can enact bills as law, regarding to taxation issues.

[22] ICMS stands for **I**mposto sobre **C**irculação de **M**ercadorias e **S**erviços.
[23] IPVA stands for **I**mposto sobre **P**ropriedade de **V**eículos **A**utomotores.
[24] ITCMD stands for **I**mposto sobre **T**ransmissão **C**ausa **M**ortis e **D**oação.
[25] To facilitate the comparison, it will be used similar definitions to the US constitutional principles, although all these principles are, in the end, prohibitions, restraints to the taxing power of the Brazilian Federal, State and Municipal governments.

### *3.1.2. The Equal Protection Clause*

Article 150, II makes it forbidden for the members of the federation *"to institute unequal treatment for taxpayers that are in an equivalent situation, it being forbidden to make any distinction by virtue of the professional occupation or function performed by them, regardless of the legal designation of the income, instruments or rights."* This clause aims at guaranteeing that every taxpayer has to have the same treatment regarding taxes if in similar situation. However, there are possibilities to classify taxpayers, for example, by ranges of income or values of property.

### *3.1.3. The Non-retroaction Clause*

Furthermore, the Article 150, III, "a" declares that a federation member cannot *"collect tributes…for taxable events that occurred before the effectiveness of the law that instituted or increased them."* This means the law cannot retroact to reach some fact that is anterior to the effective enactment of that law, in order to levy that newly created tax. This clause aims to keep the juridical security of the legal system, in other words, to give predictability to the system and ensure that the government cannot charge the taxpayer for an event that happened yesterday by a tax created, say, today.

### *3.1.4. The Prohibition Clauses*

In addition to the latter command, Article 150, III, "b" states that a federation member cannot *"collect tributes… in the same fiscal year in which the law that instituted or increased them was published."* It means that, when a new tax is created, the federation member can only get the revenue from it in the following year. It explicitly complements the Non-retroaction Clause and has as an objective to give time to the taxpayer to prepare his or her budget for a new tax.

The prohibitions continue, stating that federation members cannot:

- (IV) *"To use tributes for purposes of confiscation"*, although is very difficult for the courts specify the definition of confiscation;

- (V)*"To establish limitations to the traffic of persons or goods by means of interstate or intermunicipal tributes, except for the collection of toll fees for the use of highways maintained by the Government."* This means the state can levy interstate taxes inasmuch as this collection does not create some kind of barrier to the free movement of people and goods. (The command of the Art.152 complements this objective: *"It is forbidden for the States, the Federal District and the Municipalities to establish a tax difference between goods and services of any nature by virtue of their origin or destination*.")

Furthermore, is not allowed (Article 150, VI) to institute taxes on:

- *"a) Property, income, or services of one member of federation by another"*, that brings about a constitutional immunity among the federation members;
- *"b) Temples of any cult"*, creating an immunity that aims to promote all religion cults;
- *"c) Property, income, or services of political parties, including their foundations, of worker unions, and of non-profit educational and social assistance institutions, with due regard for the requirements of the law"*, aiming to ensure the progress of democracy, in the case of the political parties, and relieve the burden on the budget of the unions and non-profit associations
- *"d) Books, newspapers, periodicals, and paper intended for the printing thereof"*, in order to stimulate the written culture of the country.

## *3.2. The United States of America Framework*

Independent states and a central federal government compose the federative structure of the United States of America.

The Constitution of the US, dated from 1787, contains seven articles and twenty-six amendments, from 1791 until 1992. It expressly limits the power of federal government, giving partial autonomy to the states. The Tenth Amendment states, *"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."*

Therefore, the states have received substantial autonomy to implement their own taxation systems, apart from the federal tax system, since they do not conflict with the US constitution.

When a tax dispute arises in a state, first, one must observe the applicability of the rules and precedents within that state; second, if the rules and precedents conflict with the State Constitution and eventually if the rules and precedents disagree with the US Constitution.

Revenue sources employed by the States are excise taxes, income taxes, property taxes, gift taxes, license fees, special assessments and user charges, fines and intergovernmental aid.

The US Constitution has limits and principles that work as a guide to limit the states' taxation power, and the main constitutional limits are:

- The Commerce Clause (Article I, section 8, clause 3);
- The Due Process Clause (Amendment XIV, section 1);
- The Equal Protection Clause (Amendment XIV, section 1);
- The Import/Export Clause (Article I, section 10, clause 2);
- The Privileges and Immunities Clauses (Article IV, section 2, clause 1);

### *3.2.1. The Commerce Clause*

Article I, section 8 and clause 3 of the US Constitution states, *"The Congress shall have power…to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."*

The purpose of this clause is to maintain and develop the idea of a national and international economy. Along with this, it is the notion that the state rules must match that clause in order to do not create barriers to the operations of economy.

Following the basis of Common Law, the notion that the Commerce Clause places a limitation on state taxation power comes from the precedent in the case *Brown v. Maryland* (1827)[26]. In this case, the Court rejected a tax over international trade based upon the Commerce Clause. However, the proper definition of "interstate trade" remained unknown, and only in 1977, with a decision in the

[26] *Brown v. Maryland,* 25 U.S. 419 6 L Ed 678 1827.

*Complete Auto Transit, Inc. v. Brady*[27] case, the Supreme Court has established the "four-prong test" to evaluate the applicability of the Commerce Clause.

In order for a given state tax to be considered according to the Constitution, regarding the interstate commerce:

- It has to be levied over an operation that has substantial nexus with the levying state;
- It cannot discriminate against interstate commerce;
- It has to be fairly apportioned;
- It has to be proportional to the services rendered by the levying State.

### *3.2.2. The Due Process Clause*

Pursuant to Amendment XIV, section 1 of the US Constitution, *"(…) nor shall any State deprive any person of life, liberty, or property, without due process of law (…)."*

This clause provides protection against the actions of a given state, enacting direct restrictions to them. There is another due process of law clause in Amendment V, but it only applies to the federal government.

*University of North Carolina v. Foy* (1804)[28], where the Supreme Court of North Carolina disqualified state law because it was considered against the *law of the land*[29], is the leading case.

*Mobil Oil corp. v. Commissioner of Texas* (1980)[30] established the two prior assumptions to set the limits of the state taxation power in this matter: (1) nexus between the interstate activities and the levying state and (2) logic relationship between the state-owed revenue and the services rendered by the state, in a clear accordance with the Commerce Clause.

### *3.2.3. The Equal Protection Clause*

*"No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States"* is another command of Amendment XIV. Despite the fact that state

[27] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 281 1977.
[28] *University of North Carolina v. Foy*, 2 Hayw. (N.C.) 310 (1804).
[29] The decision based upon the State constitution, once the XIV came up only in 1868.
[30] *Mobil Oil corp. v. Commissioner of Texas*, 445 U.S. 425, 436-37 (1980).

taxation must abide by the Equal Protection Clause, the states have a wide range of liberty to raise their revenue, classifying property and taxpayers in different brackets, within certain limits.

Usually taxpayers evoke this clause when there are errors in property assessments.

The two most famous cases about this issue are *Allegheny Pittsburgh Coal Co. v. Count Commission of Webster City* (1989)[31] and *Nordlinger v. Hahn* (1992)[32].

However, the Supreme Court has allowed the states to treat differently the taxpayer as in *Lehnhausen v. Lake Shore auto Parts Co.* (1973)[33], stating, *"In taxation, even more than in other fields, legislatures possess the greatest freedom in classification. (…)T here is a presumption of constitutionality, which can be overcome 'only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes'."*

### *3.2.4. The Import/Export Clause*

The Import/Export Clause (Article I, section 10, clause 2) states: *"No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress."*

The concerns of this clause are: (1) to give the federal government exclusive power over the international trade so that ensure the nation speaks in one voice; (2) to assure an important source of revenue to the federal government and (3) to keep the harmony among the states, avoid the seaside states from taking revenue from imports and levy taxes that could impose barriers on the free traffic of goods to the other States.

*Brown v. Maryland* (1827)[34], as in the Commerce Clause, was the inaugural case about this issue, funding the "original package doctrine"[35].

*Michelin Tire Corp. v. Wages* (1976)[36], however, abandoned the original package doctrine. Instead of analyzing the nature of the goods as imports, it examined the nature of the tax to determine if

[31] *Allegheny Pittsburgh Coal Co. v. Count Commission of Webster City*, 488 U.S. 336 (1989).
[32] *Nordlinger v. Hahn*, 112 S. Ct. 2326 (1992).
[33] *Lehnhausen v. Lake Shore auto Parts Co.*, 410 US 356 (1973).
[34] *Brown v. Maryland*, 25 US 419, 6 L.Ed. 678 (1827).
[35] Under this doctrine, as long as the goods retained their status as imports by remaining in their original packages, they enjoyed immunity from state taxation.

it was an "impost or duty". This analysis focused on whether the tax offended or not any of the three enumerated policy considerations underlying the Import-Export Clause.

### *3.2.5. The Privileges and Immunities Clauses*

Article IV, section 2, clause 1 of the US Constitution provides, *"The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States"*.

Challenges to state or local taxing schemes under this clause are rare.

In the *Austin v. New Hampshire* (1975)[37] case, the Court struck down the New Hampshire Commuters Income Tax because it effectively exempted all of the state's own citizens. Reviewing the genesis of the clause, the Court concluded that this taxing scheme would offend "the structural balance essential to the concept of federalism" because it might invite retaliation by other states.

## *3.2. Comparing the Brazilian and the USA Constitutional Frameworks*

The two countries have decided to build their constitutional framework based on federal system, divided into states, and have chosen to give autonomy to the states to establish their own taxation systems.

Both adopt the doctrine of the separation of powers but, in the US, this separation is clearly less than absolute. Michael Asimow[38] cites cases that depict a "formalist"[39] view of the separation of powers. These cases treat the separation of functions as a simple matter of reading the constitutional text.

Asimow also cites cases called "functionalist"[40], which evaluate the situation by asking whether it results in undue usurpation of the core functions of one branch by another branch, or undue interference by one branch with the functions of another.

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[36] *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 96 S. Ct. 535, 46 L. Ed. 2d 692 (1976).
[37] *Austin v. New Hampshire*, 420 U.S. 656 (1975).
[38] *California Administrative Law*, p. 1.
[39] *Clinton v. City of New York*, 524 US 417 (1998).
[40] *Morrison v. Olson*, 487 US 654 (1988).

Brazil's Constitution is very specific regarding the taxation power, indicating exactly which tax the state can impose, whereas the US Constitution leaves the states the choice of which kind of tribute they wish to create.

By doing that, the US constitutional framework allows, for example, the existence of several income taxes around the country[41], which is not possible in the Brazilian system. The States Constitutions in the US have strong importance in the building of the state taxation system, whereas in the Brazilian framework the State Constitutions do not deal with this, building their taxation systems by regulations respecting the Brazilian Constitution principles.

Regarding the constitutional restraints to the taxation power of the states, there are some similarities between the two frameworks.

Both countries use the Equal Protection Clause (see 3.1.2 and 3.2.3), aiming to avoid discrimination in taxation issues, although both accept the existence of different classifications related, for example, to the income range the taxpayer belongs to.

Under the same category of protection is the US Constitution Privileges and Immunities Clauses (see 3.2.5 ). This clause also aims to prevent discrimination between citizens in tax issues.

The Commerce Clause contains another similarity, as the Brazilian Constitution presents, in Articles 150 and 152 (see 3.1.2), the same concern of Article I, section 8, clause 3 of the US Constitution (see 3.2.1), that is, to impede the states from creating taxation barriers to trade.

The command of Article 156, IV of the Brazilian Constitution reinforces this reasoning: "*a resolution of the Federal Senate, on the initiative of the President of the Republic or of one third of the Senators, approved by an absolute majority of its members, establishes the rates to apply to interstate and export transactions and rendering of services.*"

The Due Process Clause is also present in both constitutions: in Amendment XIV, section 1, of the US Constitution (see 3.2.2) and in Article V, section LIV of the Brazilian Constitution which commands, "*no one may be deprived of his or her freedom or assets without due process of law*". Classically characteristic of the Rule of Law, this clause aims to protect people from dictatorial tendencies that can be brought on by a government. When it comes to tax issues this is definitely a strong ally of the taxpayer.

The doctrine that one federation member cannot levy tax on another member exists in both systems. It is in Article 150, VI, "a" of the Brazilian Constitution (see 3.1.4) and has been in the US

[41] All kinds of US State government's collection are at http://ftp2.census.gov/govs/statetax/03staxss.xls .

system since *McCulloch v. Maryland* (1819)[42]: *"If the States may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax patent rights; they may tax the papers of the customhouse; they may tax judicial process; they may tax all the means employed by the government, to an excess, which would defeat all the ends of government. This was not intended by the American people. They did not design to make their government dependent on the States".*

Notwithstanding, comparing the US Import/Export Clause (see 3.2.4) with similar statements in the Brazilian Constitution, one can realize they are similar but in some ways different. The power to levy taxes on international trade belongs to both federal governments; nevertheless, Brazilian states can levy sales tax (ICMS) on imports, respecting all the other constitutional principles.

The main difference one can note in both systems is regarding the Enacted-Law Clause. The Brazilian system is very clear, stating that only the Legislative Branch, through an enacted law, can create taxes.

The US system allows the Judiciary Branch to determine the levy through analogy, supplying the Legislative Branch competence, as decided in *Material Service Corp. v. Department of Revenue* (1983)[43].

In this case, the court stated, although there was not a specific state legislation regarding taxes on transportation, *"the taxpayer was not permitted to separate a 'minimum load charge' collected on the sale of ready-made concrete from the selling price of the concrete, which was taxable under the Retailer's Occupation Tax; the charge was 'an inseparable part of a single transaction' and was essentially a transportation charge for delivering ready-made concrete."* One can perceive how it brings some uncertainty to the tax system.

In addition, the absence of a Non-retroaction Clause (see 3.1.3) in the US Constitution seems to cause certain a lack of legal security, as decided in *Welch v. Henry* (1938)[44]: *"In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation."*

[42] *McCulloch v. Maryland*, 4 Wheaton 316 US (1819).
[43] *Material Serv. Corp. v. Department of Revenue*, 98 III 2d 382, 75 III. Dec. 219, 457 N.E. 2d 9 (1983).
[44] *Welch v. Henry*, 305 US 134, 59 S.Ct. 121 (1938)

In *Usery v. Turner Elkhorn Mining Co*. (1976)[45], we can note the same trend: "*the imposition of liability for the effects of disabilities bred in the past is justified as a rational measure to spread the costs of the employees' disabilities to those who have profited from the fruits of their labor - the operators and the coal consumers.*"

The Prohibition Clauses, contained in Article 150, VI, "b", "c" and "d" (see 3.1.4), are specific constitutional immunities. These specific immunities do not exist in the US Constitution.

The Brazilian Constitution contains all the necessary commands the states have to follow in taxation issues. To the States' Legislative Branches remain the rights to enact laws that create taxes, and to the States' Executive Branches remain the duty to enforce them. At a first glance, it seems to give the system enough legal security. However, it turns all taxation issues into a constitutional matter, which ends up allowing unrestricted reasons for taxpayers to complain, and courts overload as a result.

Given the two constitutional frameworks and guidelines for the state taxation power, we can go into the focus of the analysis: how the taxation disputes are resolved in the administrative law systems in São Paulo, Brazil, and California, USA.

## *Chapter 4*

# *COMPARING STATE ADMINISTRATIVE LAW RESOLUTION IN TAXATION ISSUES: SÃO PAULO, BRAZIL AND CALIFORNIA, USA*

The Rule of Law contains as a principle the right to complain about anything the government is demanding from the people. The first thing one thinks when it comes to complaints is the Judiciary Branch. Indeed, the Judiciary Branch is the shelter for someone who had his or her rights infringed upon.

Notwithstanding, one can first complain directly to the administrative agency which, by delegation of the government, is claiming something. It can range from a mere procedure to a large amount of money, usually taxes.

Every taxpayer can (and sometimes must) ask for an administrative revision after an audit, for example, before suing the government. As an advantage, one can realize that the officials who will

[45] *Usery v. Turner Elkhorn Mining Co*., 428 US 1 (1976)

examine his or her complaint are far more specialized than the average judge regarding that specific matter.

Another advantage: the cost of an administrative appeal is less than a Judiciary suit, as one can even appeal without hiring the services of a lawyer.

The administrative proceedings which aim to resolve the disputes between the taxpayer and the state governments will be the field we are about to explore.

## *4.1. São Paulo Administrative Process*

São Paulo is the economically strongest state in Brazil. Responsible for about a third of the Brazilian GDP, the state annual revenue (not considering the federal government transfers) was about US$15 billion in 2004[46] for a population of about 39 million.

The biggest part (89%) of this revenue comes from the sales tax (ICMS)[47] and consequently most of the disputes arise because of that levy. The right to appeal to the administrative system is guaranteed by the Brazilian Constitution in Article V, LV[48].

The Constitution also contains the principles on how the administrative law system has to work, and the same rules apply as much to the federal government as to all the states.

Respecting those principles, the states built their own administrative process system, which has as an objective the reviewing of the tax debt, formalized after the audits conducted by the Tax Agents.

A taxpayer who disagrees with any São Paulo State government demand in tax issues can reach the Secretariat of Finance of São Paulo State, the administrative agency responsible for the state revenues, and follow the procedure below[49]:

§ After an audit, since the auditor has observed the taxpayer understated its tax assessments, the Tax Agent will formalize a document that shows the amount owed in terms of tax, penalties and interests. This document is the official beginning of the administrative process.

§ The taxpayer has 30 days to pay the debt or appeal, after a notification about that document.

[46] Source: Secretariat of Finance of São Paulo State Official site at: http://www.fazenda.sp.gov.br/relatorio/2005/janeiro/analise_receita.asp (only in Portuguese). The currency exchange rate used in this paper is R$ 2, 80 = U$ 1.00.

[47] For an overview of the State taxation system, see 3.1.

[48] Litigants in court or administrative proceedings and defendants in general are assured to use the adversary system and full defense rights, with the means and remedies inherent thereto.

[49] The presented sequence of procedures is showing only the main steps, leaving aside the formal details.

§ Whether the taxpayer appeals or not, if the debt involved reaches 500 UFESP[50] or more, and it was not paid, there will be a judgment in the first instance.

§ A sole administrative judge makes the judgment on the first instance.

§ If the state loses, the administrative judge must appeal from his own decision to his superior[51], the Delegate of Judgment.

§ If the taxpayer loses, and the debt is less than 2000 UFESP, he also must appeal to the Delegate.

§ The administrative decision handed down by the Delegate to the state and to the taxpayer is final. The difference is the taxpayer can appeal to the Judiciary Branch, while the state cannot.

§ If the debt is over 2000 UFESP, the taxpayer can appeal to the *Tribunal de Impostos e Taxas,* the administrative tax court.

§ Sixteen Chambers constitute this administrative court, each one composed by 6 administrative judges, 3 of them lawyers, 3 of them state officials.

§ After the judgment in one of those Chambers, whoever loses at this stage can appeal to the United Chambers, if it is a matter of law. If the plaintiff or the state loses the case, they cannot appeal when it is a matter of fact.

§ The United Chambers are the collection of all 16 Chambers, employing 96[52] administrative judges to decide ultimately about a process.

The Brazilian taxation system states that once the Tax Agent perceives an understatement or any misconduct related to tax regulation, he is obligated to report and formalize the amount owed. After this formalization, this official statement cannot be modified unless decided within administrative or judicial process.

During the course of the administrative proceeding, discretional power is not given to the Tax Agent. In all instances, an official from the Tax Issues Representatives'[53] Sector represents the interest of the State within the proceedings, but he cannot try to transact the debt or accept any settlement proposal from the taxpayer.

[50] This is a State index (one UFESP = U$ 4.75).
[51] The administrative judges work for the Sector of Judgments, directed by a Delegate who is in charge of this review.
[52] Although the maximum number of judges can reach 96, usually the United Chambers work with 48 administrative judges.

There is a discretional range of power to the Delegate of Judgment, that he can act on, but he cannot transact; only judge the case. In sum, neither the taxpayer nor the State can make transactions after the process has begun. The regulations of the administrative proceedings restrain both.

If the state wins the case, the process must go to the Tax Issues Attorneys' Office because the Secretariat of Finance of São Paulo State, the administrative agency responsible for the administrative process, cannot enforce the collection of taxes directly from the taxpayer after the administrative process: a Judicial Branch judge must hand down the enforcement.

## *4.2. California: an Overview of the Taxation System and Administrative Process in Taxation Issues*

### *4.2.1. The Taxation System*

California is a massive giant in terms of economy. If California were a country, its GDP would be the seventh largest in the world, generating US$ 1.446 trillion (2003) for a population of about 36 million.

In the 2002-2003 fiscal years, the Board of Equalization[54], the taxation administrative agency, collected approximately US$41 billion, with near by US$35 billion generated from sales and use tax[55].

California imposes sales tax on retailers who sell tangible personal property and other goods to customers who would use these items in California, that is, if they were not purchased to be resold to someone else.

Additionally, California imposes a use tax on purchasers who buy tangible personal property that comes from outside the State.

There are special taxes on the distribution of cigarettes, gasoline, and alcoholic beverages. California also imposes fees, income and property taxes.

The US Constitution does not have specific instructions about administrative law.

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[53] This officials are Tax Agents specialized in defend the State in tax administrative issues. They act as administrative attorneys, but they are not State lawyers as the staff of Tax Issues Office Attorneys, whose officials act only defending the State before the Judiciary system.

[54] California has also the Franchise Tax Board, which administrates the State income tax, with a collection around US$ 41 billion (source: Official site at: http://www.ftb.ca.gov/aboutFTB/annrpt/2003/2003ar.pdf ). The Board of Equalization is also responsible for appeals regarding to the income tax.

[55] Source: Board of Equalization Official site at: http://www.boe.ca.gov/annual/table2_03.pdf .

According to Bernard Schwartz, administrative law in the US *"is limited to powers and remedies and answers the following questions: (1) What powers may be vested in administrative agencies? (2) What are the limits of those powers? (3) What are the ways in which agencies are kept within those limits?"*[56]

American administrative law relates more to procedures than to substantive law, more upon the procedures that administrative agencies must follow in exercising their powers.

In California, the term administrative law (also known as regulatory law) refers to the body of law created by the California Executive and Administrative agencies.

The California Constitution establishes or authorizes Executive Departments.

Administrative agencies may be established directly by the Constitution or be created by or have authority delegated to them from the Legislature.

Agencies have quasi-legislative power. Quasi-legislative enactments are generally referred to as *regulations* or *rules*. They also have quasi-judicial power and some may even issue advisory opinions. The terminology for the adjudicatory functions (decisions in disputes) and advisory functions varies from agency to agency, although they are typically referred to as decisions (or opinions) or they may also be called orders (or a variety of other terms).

The California Administrative Procedures Act (California Government Code § 11340 et seq.) outlines the powers and boundaries of the administrative functions, as well as setting up an Office of Administrative Law to oversee the "orderly review of adopted regulations." The Office of Administrative Law has the power to reject proposed regulations that they feel do not meet the standards set out in the *Administrative Procedures Act* (usually on grounds that they do not meet the requirements of notice, necessity, consistency, or clarity).

### *4.2.2. The Administrative Process*

Taxpayers' liability disagreements with California in tax issues must follow these steps[57]:

1. After an audit, if the audit staff determines that the underreported tax is based on taxpayer's negligence, the audit staff may recommend that a 10 percent penalty for negligence be imposed.

[56] Administrative Law, p. 2.
[57] Only the main steps will be stressed.

2. However, if fraud is involved, the audit staff will recommend a fraud penalty of 25 percent of the tax if there is clear and convincing evidence that the taxpayer underreported its tax liability in order to evade intentionally the tax. The audit staff has the burden of proving that the taxpayer committed a fraudulent act.

3. When the auditor completes his or her audit, the results are discussed with the taxpayer who may or may not agree. Taxpayers may also provide additional documentation to refute the results of the audit.

4. The auditor and supervisor can change the liability involved while at the district level. After that, the Petitions Section, the Appeals Division, and the next higher level (the Board of Equalization) would request the change.

5. After the audit has been reviewed and approved by a reviewer, a billing (Notice of Determination) is issued to the taxpayer.

6. If the taxpayer is not in agreement with the liability, the taxpayer files a petition for redetermination within 30 days of the date on the Notice.

7. The official appeals process begins when petitioner files a written Petition for Redetermination of such billing. The petition for redetermination is sent to the Section of Petitions of the Sales and Use Tax Department, which handles the beginning of the appeals process.

8. The Petitions Section contacts the taxpayer and tries to resolve the issues that the petitioner brought up in his petition.

9. If the issues are resolved at the district level, and a reaudit is prepared, wherein the taxpayer agrees with the reaudit results, the district will forward the reaudit report and informs the Petitions Section that the issue has been resolved. Based on this report, the Petitions Section would contact the taxpayer to confirm his or her agreement with the reaudit results.

10. If the taxpayers confirm its agreement, a Notice of Redetermination is issued to the taxpayer, which would then have 30 days to pay the liability.

11. However, if the taxpayer does not agree with the reaudit results, or if the issues cannot be resolved at the district level, the matter is referred back to the Petitions Section, which then informs the petitioner that since the matter cannot be resolved at that level, the matter will be referred to the Appeals Division.

12. Attorneys and higher-level auditors who conduct appeals conferences staff the Appeals Division. The conference auditors decide strictly audit issues. The conference attorneys decide legal, and sometimes audit, issues.

13. The conference attorney or auditor analyzes the parties' argument, evidence, and issues his or her decision and recommendation (D&R). Sometimes the D&R would recommend a reaudit, a reduction in the assessment, or no adjustment.

14. The taxpayer may request a reconsideration of the Appeals Division's D&R or the taxpayer may request that the matter be scheduled for a Board hearing.

15. The Board consists of five members, all elected by the people of California. There are four members who each come from four separate districts (California is divided into four districts - one member comes from each district). The other member is the Controller of the State of California.

16. Once a final decision is rendered, a Notice of Redetermination is issued to the taxpayer. The Notice becomes final. The liability becomes due and payable 30 days after the date on the notice of redetermination, unless the taxpayer files a petition for a rehearing within the 30-day period. If the taxpayer files a timely petition for a rehearing, the notice of redetermination is voided.

17. The petition for a rehearing is a request from the taxpayer for the Board to rehear his or her case, because the taxpayer believes the Board made an error of law in reaching its decision, or that there is newly discovered evidence that was not available prior to the Board decision.

18. The petition for rehearing is forwarded to the Appeals Division for review. The Appeals Division then makes a recommendation to the Board whether to grant the petition for a rehearing or not. If the Board denies the rehearing request, another Notice of Redetermination is issued to the taxpayer.

19. In this instance, the taxpayer has no option but to pay the assessment within 30 days of the date on the notice.

One can easily notice that, in this process, the concern in resolving the case is huge and, from the beginning, staff is involved in trying to resolve the case.

The taxpayer has to appeal to the Board of Equalization to try to relieve or reduce the tax liability or has his or her claim for a refund of the protested tax payment denied before filing a suit in court to try to recover the taxes that he or she has paid to the Board.

The process of filing a petition for redetermination, having an appeals conference, having a Board hearing, and having the claim for a refund denied is called the "administrative remedy". A taxpayer has to exhaust his administrative remedies before he can take his case to court. The taxpayer cannot file a suit in the Judiciary court unless he has paid the tax liability first.

### *4.2.2.1. The Administrative Power to Enforce the Collection*

After the Board makes a decision, a Notice of Redetermination is issued to the taxpayer for the unpaid liability consisting of tax, interest and penalty (if any), and the taxpayer is required to pay the liability in full within 30 days of the date of the Notice.

If the taxpayer fails to pay the liability on time, the tax, interest, and penalty becomes immediately due and payable. If the taxpayer fails to pay the liability when it is due and payable, a 10 percent penalty for failure to timely pay the determination is imposed. This penalty is 10 percent of the unpaid tax liability.

If the taxpayer was required to place a security (like a bond, cash, insured bank deposits) to insure compliance with the sales and use tax law, the Board may sell the security at a public auction in order to recover any tax or amount of liability required to be collected.

The Board may also notify the taxpayer's creditors not to transfer any bank deposits, personal property in the creditor's possession, or personal property under control of the bank.

Additionally, the Board may file a lien against taxpayer's credits, or other personal property, which may be auctioned off. The Board may also garnish taxpayer's wages to effect the collection of unpaid liability.

If all these steps fail to pay off all the liability, then the Board may ask the court of law to help in bringing about taxpayer's compliance.

### *4.2.2.2. The Settlement Sector*

Once the taxpayer can present, in all instances of the process, a proposal to settle the dispute, the Board of Equalization also has a Settlement Section, headed by an Assistant Chief Counsel, a high-ranking attorney who reports to the Board's Chief Counsel.

During the appeals process, a petitioner may request to have his liability settled i.e., reduced without going through the appeals process. This process is similar to bargaining: taxpayer will offer to pay a certain percentage of the liability, and that offer may be accepted or rejected. The purpose of this settlement process is to cut short the appeals process. However, the offer must be reasonable and must have a basis.

The cases are assigned to an attorney if the case involves legal issues and to an auditor if the case involves audit issues. The attorney or auditor has latitude in the review and in the recommendation for approval or rejection.

A committee consisting of the Supervising auditor and supervising attorney as well as the Assistant chief counsel then reviews the recommendation. If the case is politically sensitive, or the reduction is over US$300,000, the matter is discussed with the Chief Counsel and the Executive Director of the Board of Equalization. There is no set percentage deemed acceptable, as each case is evaluated on its own merit.

The case is also evaluated for litigation risks (what is the likelihood that a taxpayer will file a suit in court and what costs will be incurred in defending such suits - this is very subjective like an educated guess, but based on prior cases).

Once the approval of the recommendation is made, the auditor or attorney contacts the taxpayer and informs him or her that the settlement proposal is either rejected or accepted. If the Settlement Section finds that there is no room for reduction, because the taxpayer has already been given all the benefit of reductions, but wanted more reduction without basis, the offer would be rejected.

If rejected, the attorney or auditor will inform the taxpayer of his right to make a counter proposal. If no counter proposal is made, the settlement offer is officially denied and the case proceeds with the appeals process.

If the recommendation to accept the settlement offer is approved, the case is referred to the Attorney General's (AG) office of the State of California for comments, because the statute requires the AG's comment.

After the Attorney General makes his or her comment, the recommendation is then presented to the five elected members of the Board of Equalization for approval during a closed session of the Board hearing (there is no hearing where the taxpayer argues his or her case).

If the Board denies a recommendation, the settlement case is referred back to the Settlement section for further investigation. If a settlement is not reached, then the taxpayer proceeds with the appeals process.

If the Board approves the recommendation to accept the settlement proposal, the taxpayer is informed of the Board's decision and the settled liability is billed, and the taxpayer has 30 days from the date of approval to pay it.

### *4.3. Comparative Analysis of both Administrative Processes*

By analyzing the São Paulo State administrative process, one can realize the administrative law, as applied in Brazil, although it is based on the Civil Law, does not follow the administrative system used in France, where the administrative judge decision is final. Conversely, the Brazilian administrative law, as its American counterpart, is subject to judicial review.

The main difference one can notice from the two presented administrative processes is the empowerment of the staff involved.

While the California audit staff can deal with the liability before the taxpayer, since in the district level the auditor and the supervisor have discretionary power to change the liability, the São Paulo audit staff does not have the power to negotiate: once the liability is documented, there is nothing to do but wait for the end of the administrative or judicial process.

Even after the district level, the procedure of the Petition Section, the second instance in California administrative process, is contact the taxpayer and try to resolve the issue. São Paulo does not permit any consideration on this sense.

São Paulo administrative process follows the structure of the Judiciary Branch. Indeed, it is almost a copy of that system, although the objective is to review the Tax Agent assessment. The process does not admit settlement proposals[58], only installment payments predicted by law.

The California last instance has five administrative judges while the São Paulo administrative court can have as many as 96 judges. After the final decision, the California tax agency can enforce the collection, which is not possible for the São Paulo State who has to reach the Judiciary Branch enforcement.

A procedure that deserves some criticism is that which indicates that the meeting of the Board of Equalization, where the evaluation of the settlement proposal occurs, is not public. Every kind of procedure in São Paulo State administrative process must be public, binding Brazilian Constitution rule.

However, there is a rule in California administrative process that states, *"If the Board Members approve the proposed settlement and the reduction of*

[58] São Paulo State offers, after the audit and within 30 days before notification, a 50% discount over the penalty; within 30 days from the first instance decision a 35% discount over the penalty and a 20% discount over the penalty after the last decision and before the official inscription as an outstanding debt with the State. The problem is that some penalties can reach 150% of the tax owed and the option for installment payments are accrued at a 2% rate per month, turning the debt hard to receive due the high final amount.

*tax in the settlement exceeds US$500, certain information*[59] *about the settlement will become a matter of public record, which will be available for review for one year at the office of the Board's Executive Director"*, that is, the meeting is not public but the results are.

In the following table, there is a sample of prominent cases resolved by the Settlement Sector from June 30, 2004 through March 22, 2005:

*Table 1*

| ***Settled Cases*** | ***Amount in Dispute (US$)*** | ***Total Amount agreed (US$)*** | ***Percentage of discount after settlement*** |
|---|---|---|---|
| Euro-Concepts, Inc | 109,334.00 | 104,477.00 | 4% |
| Thermo VolteK Corp | 96,861 | 92,000 | 5% |
| Static Control Components | 292,713 | 250,000 | 15% |
| Trimont Land Co | 168,973 | 160,000 | 5% |
| Linquist & Craig Hotels and Resorts, Inc | 153,262 | 124,000 | 19% |
| Farzad Essapour | 242,042 | 215,000 | 11% |
| Carruthers Equipment Co | 192,235 | 96,500 | 50% |
| Aqua Mansa Properties Inc | 105,660 | 90,000 | 15% |
| Carl Karcher Enterprises Inc | 2,954,575 | 2,808,709 | 5% |
| CKE Restaurants Inc | 1,185,023 | 1,100,835 | 7% |
| Pacific Building Care | 210,016 | 160,000 | 24% |
| Process Software Corp | 161,526 | 95,000 | 41% |
| Consolidated Electrical Distributors Inc. | 1,285,476 | 592,200 | 54% |
| Cadillac Plastics Group Inc | 1,207,764 | 750,000 | 38% |
| Union Bank of CA | 531,208 | 485,000 | 9% |
| MacDermic Colorspan Inc | 221,754 | 170,000 | 23% |

[59] The public record will include the following: the names of the taxpayers who are parties to the settlement; the total amount in dispute; the amount agreed to in the settlement; a summary of the reasons why the settlement is in the best interest of the State and, when applicable, the Attorney General's conclusion regarding the reasonableness of the settlement.

| | | | |
|---|---|---|---|
| Petroleum Helicopters | 143,148 | 114,000 | 20% |
| **TOTAL** | **9,261,570.00** | **7,407,721.00** | **20%** |

Source: Public Records from BOE Settlement Sector.

By analyzing the figures above, one can notice that California has had good results in settle the state debt, as preserving 80% (average) of the debt after the settlement.

## *Chapter 5*

# *ECONOMIC ANALYSIS OF THE SÃO PAULO ADMINISTRATIVE PROCESS LAW*

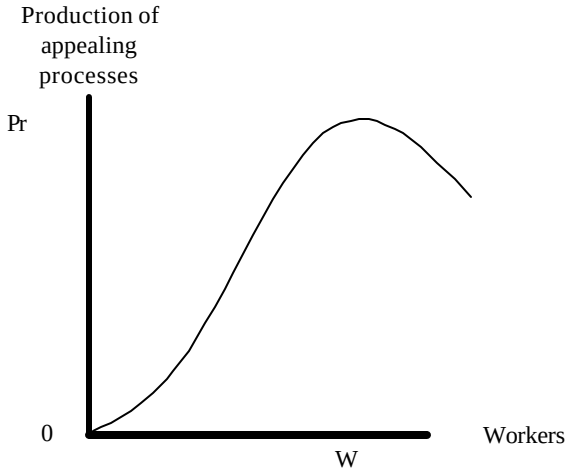
## *5.1. Decreasing the Demand for Appeals without Social Costs*

Achievable without fees and without the lawyers' support, the objective of the São Paulo State administrative law in tax issues is to afford wide access to all taxpayers.

Nevertheless, given the limits of labor and the typical public sector budget restraint, the outcome has been process overload, delays and backlogs.

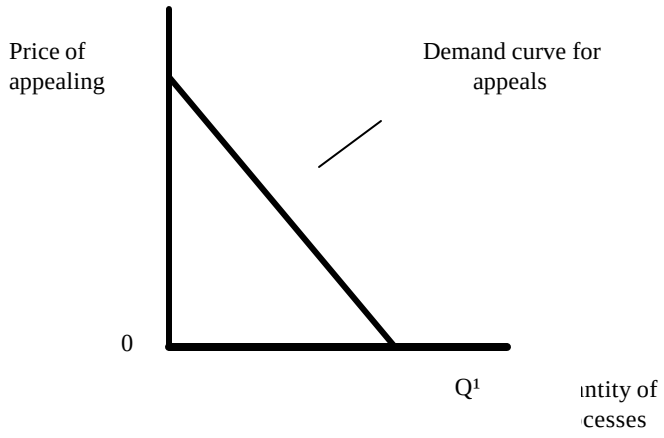
The first restraint that can be graphically shown is the *production function* of the administrative staff in charge of the process. The public budget is fixed at least for, say, a year, then, in that period, let us suppose the government can increase the number of officials in the administrative staff due to the increasing number of appeals being filed.

Production (*Pr*) is increasing as the government adds one more worker to the staff; however, as they cannot increase, for example, the number of desks and computers, there will be a certain number of workers (*W*) from that point, the production will decrease. As there is not enough, for example, space or tools to produce, the addition of one more worker instead of helping the production, will disturb that. Graphically:

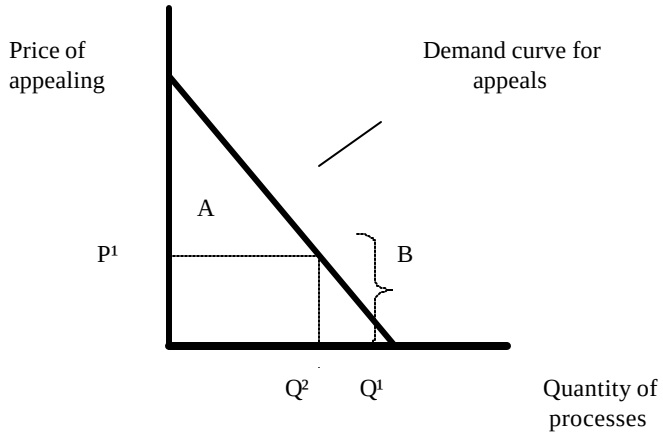



Facing these restrictions, the way to improve production has to be by training the staff, making them technically stronger, increasing the individual productivity and effectiveness.

Additionally, the main economic assumption one can make within the São Paulo State administrative process is that *appealing is free*. Graphing the demand curve of this situation, we have:




The scenario as shown in $Q^1$ is, the demand for appealing is the highest we can have, once appealing is free (price = 0). Therefore, a change in the price of appealing will affect the demanded quantity, shifting from $Q^1$ to $Q^2$, as follows:




However, if the government sets a price to appeal, there will be the following outcomes:

1. *High social costs*, since appealing will became unaffordable to the less wealthy taxpayers[60] (B).

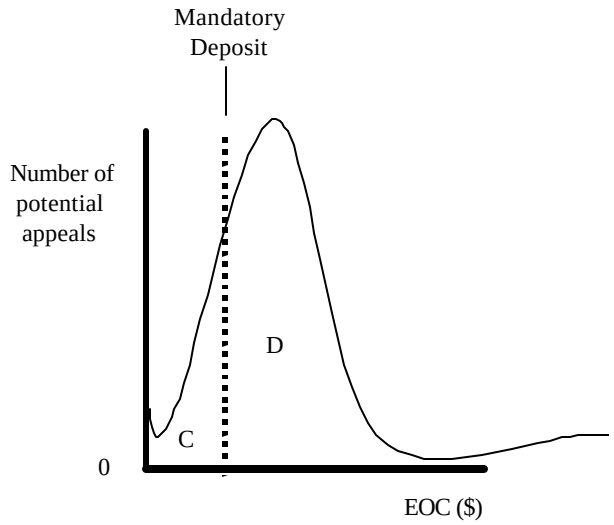
2. A considerable surplus (A) is still left to the wealthiest taxpayers, keeping the pressure over the demand.

Thus, better than set a price to appeal is set an amount as a mandatory deposit, a percentage of the debt, refundable in the end of the process. The government keeps the appeals free of specific fees and the demand for administrative processes goes down, since some taxpayers will now evaluate more carefully the expected outcome of the claim (*EOC*).

Since every administrative process initiates with an assessed understatement and the objective of the process is to review that assessment, we can assume that, to each tax issue in dispute, the *EOC* will increase while this issue is "new" for the audit staff.

In a given point, the taxpayer can expect a maximum *EOC* from the process. As the cases begin to repeat, the audit staff becomes aware o this issue and then, when the audit staff formalizes an understatement and the taxpayer appeals, the *EOC* is decreasing, as that formalization is stronger in its fundamentals.

By setting a mandatory deposit (*MD*), the taxpayer included in the C area will not appeal because *EOC* < *MD*, diminishing the demand for appeals and consequently the number of processes.




## *5.2. Taxpayer's Liability and the Judiciary*

Regarding taxes, the legal environment found in Brazil is, on one hand, the government imposing one of the highest tax burdens in the world and, on the other hand, the taxpayer eager to avoid that burden.

It would not be so different from other countries if the taxpayer were not backed by a tax legal system that allows him or her to go before courts without paying the liability first, even after losing on the administrative level, and a tax legal system that does not have a strong structure of debt enforcement.

Moreover, since the Brazilian Constitution contains the fundamental rules of the tax system, several tax issues can reach the Brazilian Supreme Court, leading some processes to the maximum extent possible.

Additionally, as stated by Eduardo Buscaglia and William Ratliff[61], *"the belief is growing that the judicial sector in developing countries is ill-prepared to foster private sector development within a market system. (…)Increasing delays, backlogs, and the uncertainty associated with expected court outcomes have diminished the quality of justice from Mexico to China"*.

Another negative point about the Brazilian judicial system is the procedural formalism. There is not a culture of bargaining. Paradoxically, because of the process overload, the judges do not stimulate

[60] This is assuming that often a minor amount of debt refers to less wealthy taxpayers (smaller businesses).

the settlement, as it has to be stimulated. They are not trained to persuade the litigants to settle, then, there is no choice but to follow the procedures to reach a decision.

As stated in the World Bank (see reference) study, *"ceteris paribus' higher procedural formalism is a strong predictor of longer duration of dispute resolution. Higher formalism also predicts lower enforceability of contracts, higher corruption, as well as lower honesty, consistency, and fairness of the system"*.

IPEA[62] has polled that 90.8 % of the São Paulo State entrepreneurs have named the performance of the judicial system[63] as bad or very bad

Nevertheless, when the issue is taxes, entrepreneurs enjoy using the judicial system frequently, because they rely on the delay of the system to postpone their liabilities, as stated in the same IPEA research as follows:

***Frequency which private sector appeals to judiciary system to postpone liabilities [%]***

| Judicial Expertise | Very often | Often | Less often | Never or almost never | Do not know/did not answer | Without opinion |
|---|---|---|---|---|---|---|
| Labor | 25.4 | 18.6 | 20 | 18.8 | 12 | 5.3 |
| ***Federal Tax Courts*** | ***51.3*** | ***23.5*** | ***6.1*** | ***1.8*** | 11.9 | 5.5 |
| ***State Tax Courts*** | ***44.7*** | ***27.8*** | ***8.0*** | ***1.3*** | 12.3 | 5.9 |
| ***Municipalities Tax Courts*** | ***40.1*** | ***25.9*** | ***11.9*** | ***2.4*** | 13.4 | 6.3 |
| Commercial | 24.8 | 34.5 | 16.5 | 3.1 | 14.2 | 6.9 |
| Industrial Property | 8.1 | 17.5 | 29.3 | 9.2 | 27.8 | 8.1 |
| Consumer Rights | 8.6 | 17.5 | 33.5 | 21.3 | 13.4 | 5.7 |
| Environment | 8.1 | 17.9 | 29.8 | 20.0 | 17.9 | 6.2 |

[61] Law and Economics in Developing Countries, p.56.

[62] IPEA stands for **I**nstituto de **P**esquisa **E**conômica **A**plicada (Applied Economics Research Institute).

[63] Armando Castelar Pinheiro, *Direito e Economia num mundo globalizado: cooperação ou confronto?*[Law and Economy in a globalized world: cooperation or confront?], July 2003, IPEA website at www.ipea.gov.br/pub/td/2003/td_0963.pdf (only in portuguese).

The likelihood of the government losing track of its credit is huge if it leaves the judicial procedures to take care of it. To government, it is better to resolve tax issues within your dominion, as soon as possible.

Comparatively, the following table will show an abstract of the path taken by the tax issues processes in California [64]:

***BOARD OF EQUALIZATION***
***ADMINISTRATIVE AND SUPERIOR COURT TAX DISPUTE RESOLUTIONS***

| Fiscal Year | **2001-02** | | | **2002-03** | | | **2003-04** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **BOE** | **FTB** | **Sum** | **BOE** | **FTB** | **Sum** | **BOE** | **FTB** | **Sum** |
| **Tax Determinations Formally Disputed** | 2,653 | 11,910 | 14,563 | 1,954 | 10,633 | 12,587 | 2,004 | 10,047 | 12,051 |
| ***Cases Resolved by Franchise Tax Board Staff*** | | ***9,047*** | | | ***8,376*** | | | ***7,176*** | |
| ***Cases Resolved by BOE Staff*** | ***2,280*** | ***2,142*** | ***4,422*** | ***2,156*** | ***1,560*** | ***3,716*** | ***1,612*** | ***2,182*** | ***3,794*** |
| **Cases Decided by the Board** | 1,297 | 721 | 2,018 | 1,383 | 697 | 2,080 | 935 | 689 | 1,624 |
| Calendar Year | **2002** | | | **2003** | | | **2004** | | |
| ***Suits Filed in Superior Court*** | ***20*** | ***17*** | ***37*** | ***12*** | ***19*** | ***31*** | ***23*** | ***8*** | ***31*** |
| **Suits Won** | 11 | 8 | 19 | 9 | 8 | 17 | 9 | 8 | 17 |
| **Suits Settled** | 7 | 5 | 12 | 11 | 5 | 16 | 6 | 3 | 9 |
| **Suits Lost** | 0 | 2 | 2 | 3 | 1 | 4 | 2 | 3 | 5 |
| **Total Suits Closed** | 18 | 15 | 33 | 23 | 14 | 37 | 17 | 14 | 31 |

As depicted above, most cases do not reach the Judiciary; the staff resolves them. In addition, the effect of the obligation of paying the liability before appealing to the Judiciary is clearly perceived, as the number of cases that reach the Judiciary is minor.

[64] Source: Office of Acting Board Member Betty T. Yee. ( http://www.boe.ca.gov/members/yee/index.htm )

The following table shows a comparative snapshot with data from the World Bank study where we can observe the delay in judicial procedures in Brazil is greater than in Common Law countries. Note that Canada, as considered along Québec, its Province that adopts Civil Law, comes after Brazil in number of days to resolve a dispute.

| ***Delay of judicial procedures*** | | |
|---|---|---|
| *Country* | *Number of procedures* | *Number of days* |
| Australia | 11 | 157 |
| ***Brazil*** | ***25*** | ***566*** |
| Canada | 17 | 346 |
| New Zealand | 19 | 50 |
| United States | 17 | 250 |
| United Kingdom | 14 | 288 |

In order to complete the economic reasoning, important economic data has to be emphasized: the stock of processes and the amounts involved. In February 2005, 6% of the processes have detained 66% from all the debt involved in administrative processes.

## *CONCLUSION*

The amount involved in administrative processes in São Paulo is huge, reaching about US$ 5.35 billion, that is, 35% of the revenue in 2004.

The excessive formalism carried by the Civil Law ends up feeding bureaucracy, here understood as a rigid sequence of procedures to be followed, with small or no space for discretion, the search for efficiency turns out to be a hard task within the Brazilian public service.

Efficiency to a taxation agency has to be, in short, to collect and allocate tax money with low costs for society.

The data is clear in showing the appeal to the Judiciary as a postponement strategy often used by the taxpayer. The response of the government has to be pushing to settle the disputes before that appeal, that is, within the administrative process.

As the smallest part of the administrative appeals concentrates the biggest amount in debt, good economic results can be reached without too much investment in settlement. After all, there is about US$ 3.5 billion of debt concentrated in about 600 processes.

The economic analysis shows that natural budget constraints limit the production of processes, which strengthens the argument to have a very technically prepared team in order to reverse the tendency of lowering the production.

Additionally, from the economic analysis of São Paulo State administrative law, one can extract that lowering the demand of administrative processes by fixing a mandatory deposit to appeal, the government could reduce production costs without increasing the social cost involved, and then reallocate budget, for example, to upgrade the technical knowledge of the staff and improve the processes production.

The Brazilian Federal government already imposes a mandatory deposit in its administrative process and, after some disputes, the Brazilian Supreme Court considered that procedure according to the constitution.

Besides the narrow limits imposed by the Brazilian law, the same regulation[65] used to offer amnesty can be used to empower the São Paulo State Tax Agent to act with discretion, at least after the formalization of the taxpayer understatement, to reach the settlement.

The level of professionalism of the public servant has been growing notably in the past years and supervised discretion has become perfectly acceptable.

One can argue that, if the taxpayer has the choice of settling, why pay taxes when they are due. Firstly, the settlement as proposed in this paper does not mean total remission of the debt. The due tax never could be remitted. The penalty and the interest involved in the debt could be, in an extension that would allow the taxpayer to pay for his or her debt.

Furthermore, the government would be in charge of the acceptance of the settlement proposal. This system would not create an uncontested right to settle to the taxpayer.

Second, practice shows that the honest entrepreneurs do not want to be involved in outstanding debt with the government, paying their taxes when due, avoiding any extra charge. Even with enough

[65] The Brazilian Tax Code, in its Article 171, states that the law can permit, under certain conditions, to the creditor and the debtor in tax issues celebrate transaction to resolve a dispute. The same law will indicate the authority in charge of that transaction; and the Article 172 states that the law can authorize the administrative authority to concede, by written statement based on law, total or partial remission of the tax debt.

conditions to postpone the liabilities, as shown in the latter chapter, most taxpayers do not neglect to pay taxes; otherwise, the system would totally collapse.

The same rationale applies in the case of amnesty: although it occurs virtually every year in São Paulo, not all taxpayers wait for that remission to pay their tax liabilities.

Third, practice shows that it is not because there are so many extra charges over understatements and postponements that the bad taxpayer will pay taxes when due. According to the proposed system, the bad taxpayer would be punished faster, as the load of processes involving good taxpayers will decrease.

Moreover, the collection of the outstanding debt from judicial procedures contributes only with 0.6 % of the total revenue, revealing large room to be explored regarding collection procedures.

The California administrative process presents a framework of a settlement sector (see 4.2.2.2) which has showing good results in recovering state debt (see table 1), and the same framework can be used by the São Paulo State staff. The discretion to settle has to be always overseen by a superior within the staff hierarchy, avoiding the excessive concentration of power.

Regarding the core of the legal systems, the São Paulo State Administrative Tax Court already uses the binding precedents within the administrative process, as an example of legal transplant from the Common Law tradition, which enables the reception of other institutes to improve the efficiency of the system.

Another important movement towards efficiency would be abolishing the judgment without appeal (see 4.1, item 3), which is an excessive care with the taxpayer who did not show enough interest in looking for his or her possible rights.

The installment plan framework also has to be reviewed, as the level of extra charge imposed makes the accomplishment difficult for the taxpayer. It has been observed that most taxpayers involved in installment payments fail before reaching the last installment, and the participation of this kind of collection in the total revenue is around 0.7 %.

Concisely, to improve the administrative process in taxation system, this study suggests as important steps:

- *Abolish the judgment without appeal.*
- *Impose a mandatory deposit to appeals.*
- *Create a Settlement Sector, empowering the Tax Agent to settle the dispute, with grades of supervision.*

§ *Create a more flexible and affordable method of settlement.*

Public service managers may react to the demand for greater efficiency by reviewing processes, the use of technology, the design of jobs and working practices. In other words, they may adopt a strategic approach and consider how they can deliver more using the same level of resources, distributing equity with a high level of efficiency.

The macroeconomic outlook shows Brazilian credit ratings being constrained by a large general government debt burden, external vulnerability and structural economic weakness. Brazil has to improve its credit rating in order to attract solid investments, needed for economic development.

Strengthening its institutional infrastructure and its collection power by efficient laws and staff, São Paulo State, as responsible for a third of GDP, collaborates decisively to the evolvement of the Brazilian society by improving Brazil's potential of sustainable economic growth.

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