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NEF DISCLOSURE

## A MORE ACTIVE SOCIETY COULD HELP SOLVE BRAZIL'S COMPLEX TAX LEGISLATION, WHICH CONTINUES TO SIGNIFICANTLY AFFECT THE COMPETITIVENESS OF THE COUNTRY'S INDUSTRY

Based on the observation that tax reform is still an abstract theme, to the point of giving way to several meanings and interpretations, Fundação Getúlio Vargas' (FGV) São Paulo School of Law created the Tax Studies Nucleus (NEF) five years ago. "The idea is for society to join this debate and become a key player in it, through businesses, universities and press", says NEF's coordinator and FGV professor, Eurico Marcos Diniz de Santi, about the initiative. He says that the nucleus functions like a resonance box of all movements from the different tax administrations.

By combining specialists and collaborators, FGV's challenge is to rebuild this space inside the university, abandon the posture of simply studying the system through books and provide abstract opinions about problems, in order to change its position regarding the relationship between law and development. "The goal is to conduct an analysis of what has been done by the government and what are the reflexes of such measures, through studies and also concrete experiences. In other words, besides being an observatory, we wish to participate in practice and positively interfere in the propositional debate about tax reform", he said about the activities being spearheaded by the University.

In receiving *O Papel* for this interview, Santi provides good examples of how the theme can truly be discussed and suggests viable paths, considering the huge obstacles currently observed. "The tool for this change resides in precisely changing this complex debate into something simpler for society. Build studies that can demonstrate how tax legislation complexity, fiscal war, cumulative taxes and a lack of a business environment reflect on the cost of our products and the competitiveness of our country's industry, to show data and move away from the conventional debate focused on ideological positionings that are favorable for the government and the system."

## *Book demonstrates the difficult environment of accessing the law*

In February, Eurico Marcos Diniz de Santi published the book *Kafka, alienation and deformities of lawfulness* – a social control exercise towards fiscal citizenship, by Editora Revista dos Tribunais. “In these five years of the Tax Studies Nucleus, I noticed that this distressing and desperate feeling cannot be vocalized in words. So, I resorted to the idea of using the perspective of art, cinema, photography and literature to portray this claustrophobic environment that is our tax system,” said the author, from the perspective of someone who studies the system and feels distress towards the existing limitations and bottlenecks.

**O Papel** – In your opinion, are Brazil’s tax laws really complex or are the bottlenecks in another stage of the process, such as in the lack of control over public spending or, yet, lack of transparency?

**Eurico Marcos Diniz de Santi** – The problems in Brazil’s tax system, which create this complexity and a series of other bottlenecks, are divided into several fronts. On one hand, there is the traditional lack of exercise and culture with regards to social control, that is, a fiscal citizenship notion. Throughout our history, this has reflected in a series of governments that offered public goods in the form of assistance programs for the poor (charity), not social rights, which create a political logic of increasing public spending more and more without any social control or efficiency over this spending. It isn’t without reason that the political system always votes in favor to exponentially increase spending. To maintain it, it is necessary to increase the tax load. As a result, the tax system, particularly in the last 50 years, has become extremely complex and fuzzy, making voters not make the connection necessary and not have the logical connection between public spending and tax system. The usual impression is that taxes are paid by companies, but, in fact, all these prices are passed on to goods and the basic food basket. Who’s really footing the bill is the consumer. Today, we have reached the tax load of a first world country, due to a perverse system, a bad quality public service, where those who pay for such service do not know they’re paying for it. This is why we don’t have good quality public transportation, education, healthcare and public safety. There is clearly a paradox in the system and alienation between powers, especially in society, to connect these two systems: public spending and taxation. As a result, the taxation and tax reform theme, always brought up during elections, is never debated in depth – another factor that makes things even worse. In summary, the public machine functions well in collecting taxes, but created a dimension of unsustainable State.

**O Papel** – Where do you find the causes to this lack of society’s understanding about what is being paid and what should be given back as rights?

**De Santi** – This is a historical problem of Brazil, which dates back to our colonial origins and is characterized by a State built from top down, rather than from bottom up, by society. It was a colonization passed on by the Portuguese, an oligarchy, creating a very subservient and passive society in relation to the State. I see this relationship of society’s vassalage in relation to the public spending system and also the tax system as a major problem. This is part of the cultural aspect and, unfortunately, it

contaminates the law. Once this practice is implemented, it follows the strategy of becoming extremely complex in terms of law, creating an obstacle for visualizing the connection between these two universes: taxation and public spending. It’s very difficult connecting these systems and, without it, it is difficult to understand the root of the problem.

**O Papel** – Is this obstacle one of the factors still hindering the awaited tax reform in Brazil?

**De Santi** – It is necessary to understand that it refers to the reform of a system planted in the Constitution, which is very extensive in terms of tax material and extremely complex. To make changes, we need to discuss the Constitution and its application, but this discussion becomes truly very complex. When we talk about transparency, it does not refer to laws, but the transparency of the three systems and their connection: taxation, public spending and budget. Additionally, a key factor that holds Brazil back is a confidence crisis, not only among citizens, taxpayers and government, but also between governments. In the last tax model that was proposed by the Constitution of 1967, Brazil ended up dividing responsibilities between the Union, 27 States and 6 thousand municipalities. Historically, the country has always been divided into these three units, which had varying degrees of importance at given moments. The fact is that, with the model adopted, a system was created where in a given tax generating factor, taxation occurs in three spheres: Union, States and municipalities, many times, creating conflicts among one another. In practice, every time a reel of paper is produced, the company that sells this good must pay IPI (a federal tax), PIS and COFINS (also federal, but earmarked for social welfare), ICMS (for the States) and, many times, ISS (for municipalities). More than three forms need to be filled out and submitted to more than three controls and interpretations of countless distinct regulations in order to sell one reel of paper. These legislations fight with each other and are contradictory between one another, generating monumental litigation. When we think about reforming the system, it is necessary to face all problems that stem from this federative structure that involves 6 thousand municipalities, 27 States and Union, at the same time that no one wants to relinquish their taxation authority. The Union is scared of giving in on account of its responsibilities, the States don’t want to lose the capacity to exercise their fiscal policy and practice the so-called fiscal war, and municipalities are not interested in losing their existing main tax. At the same time, companies and taxpayers are scared about changing the system, since any change points to an increase in tax

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load. When in doubt, fiscal authorities are never open to conduct a reform to simplify and make the system more transparent and rational. The objective is always to collect more taxes. Therefore, and for good reason, society reacts in a negative manner to any tax reform proposal.

**O Papel** – In your opinion, what are the most serious obstacles in the current tax structure and what negative effects do they cause to industry?

**De Santi** – The main effect for industry, without a doubt, is the lack of competitiveness that stems from the tax load. In an expensive tax system, goods are expensive, which factor affects internal and external competitiveness, thinking we live in a free trade environment. A technical problem is the cumulativeness of taxes in the production and commercialization chain. Another problem we find in this type of inadequate system, which works with the Union, States and municipalities, is a lack of capability for unburdening investments in production. The absence of a business environment coupled with legal uncertainty is another problem for setting up a company. There's no rational system to encourage entrepreneurship.

**O Papel** – Do these negative impacts affect both players that only do business in the domestic market and those that do business abroad?

**De Santi** – Certainly. We tax exports, thus losing external competitiveness, and burden internal circulation, increasing prices in the domestic market. Normally, the business logic is to create external taxes to prevent the sale of imported products. But this only ends up being a way of investing in the system's inefficiency, since the problem is not in the imported product, which is cheaper than the one produced locally. And Brazilian price are not necessarily expensive due to inefficiencies in production procedures or technological deficits, but mainly due to a tax system that effectively burdens the production chain.

**O Papel** – What advancements (or attempts) have you seen in terms of tax reform in recent years?

**De Santi** – An important advancement, which is allowing for a series of positive things, refers to the Law of Transparency - Complementary Law #131/2009, a movement that started in the beginning of the Dilma administration. The law of access to information exercises an important leading role in the sense of advancing public transparency, revealing how much public servants earn and the size of the public spending. It is a comprehensive and important movement in this direction. Going back a bit time, during the FHC era, the Law of Fiscal Responsibility had already created responsibility rules for public spending. It was the first step towards transparency. Other than that, what we see are movements that simply end up worsening

tax legislation. Few measures oppose this logic, since the main objective tends to be tax revenues for the Union, States and municipalities. However, our system is so bad that the perspective is to improve since it can't get any worse.

**O Papel** – In what directions do you envision improvements? What do you believe will actually occur and what is the most difficult to be negotiated and isn't expected to come off the paper so soon?

**De Santi** – The ideal path would be the creation of a single national tax, which would eliminate all other taxes pertaining to the three current spheres. But it is highly unlikely that the Union will waive its IPI, PIS and COFINS taxes, and that States will waive their ICMS tax, and municipalities waive their ISS tax in favor of creating a single base for simplifying taxation nationwide. However, efforts are being made to discuss and find a solution to the fiscal war, or yet, seek a federative coordination in States. At present, there are projects by the Union to re-discuss PIS and COFINS and bring them to the same calculation base and logic of non-cumulativeness as ICMS. There is also a current discussion regarding tax on large fortunes, which to me does not seem like a good solution, but has reflexes on the tax over donations and the transmission of estates. Discussions are already going on about these issues, which points to a positive perspective in relation to society, which is beginning to come together to propose and become a key player in tax reform discussions.

**O Papel** – Looking at international taxation examples, what countries could serve as reference for Brazil?

**De Santi** – Each country has its own tax system and it is very difficult to compare one another. However, it is possible to see that it is unviable to have a system the size of ours with such a large number of competencies. We see a federative structure like this, with so many municipalities, in India, which is a terrible example for Brazil. We also have an example of this type of federalism in Canada. The country serves as an excellent example of governance, since it coordinated the entire state legislation in order to then have a national legislation. Another good example is Germany, where practically only the Union collects taxes and shares it between States and municipalities. Such practice makes the system much more efficient than having thousands of machines working simultaneously, supervising, requesting information and filling out all sorts of forms, and sharing revenues. Chile is another excellent example in terms of creating a good business environment and having significant concern towards transparency, as well as unified taxes. In Australia, we see another positive example of tax administration. There is a chamber that brings together taxpayers and tax authorities to discuss the tax system and public policies, giving an example of democracy. ■