



# Fórum Fiscal dos Estados Brasileiros

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## AN ALTERNATIVE TO TAXATION OF GOODS AND SERVICES IN BRAZIL

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2007



Working Program Forum/FGV 2006/07  
Group 1: Partial Result  
Subgroup: Scenario of Tax Reform  
with Dual Taxation

# TAXATION OF GOODS AND SERVICES IN BRAZIL

- Starting from the assumption that a tax reform on goods and services in Brazil is necessary
- Please note that it will not be possible to comment on existing problems in current legislation
- The purpose of this brief presentation is to comment on an alternative to address the issue of taxation of goods and services
- This consists in Dual Taxation or Dual VAT

# DUAL VAT: WHAT IS IT? WHAT'S IT FOR?

- One VAT at the Federal Government level and another VAT at the State Government level
- Replaces (to be discussed): IPI, PIS, COFINS, CIDE, ICMS, ISS?
- Enable enhancement of quality of taxation on goods and services
- To use a phrase: a civilized form of two levels of government in the federative context to use the same tax base with a VAT type tax
- In a word: harmonization ( unless there is an intent to harmonize taxation there is no such thing as Dual VAT

# DUAL VAT: WHAT IS IT? WHAT'S IT FOR?

- Therefore Dual VAT is a step towards harmonizing taxation on goods and services
- One might call it Dual Taxation since tax regimes in Brazil that deviate from the pure concept of VAT are here to stay
- Nevertheless, it is possible to have two harmonized VATs even if they are not perfect VATs
- This converges closely with the proposal by the federal government
- Yet, how did the idea of a Dual VAT come about?

# ORIGIN OF THE DUAL VAT

- Dual VAT in literature (Bird and Gendron) is a perception that VAT type taxes can be collected by the subnational government
- This leads us to an older mode of Dual VAT
- The IPI/ICM in 1967 ( even though with a different model and context **Brazil was the 1<sup>st</sup> Country** to provide a VAT type tax to two levels of government
- the origin, therefore, is not with the FHC Government (PEC 175/95), nor with the Lula Government (Mar/07), nor with the Fiscal Forum of States, nor is it the Canadian arrangement adopted in 1992 (*Good and Services Tax – GST* and *Quebec Sales Tax – QST*)
- Which is an advantage, since if “an old tax is a good tax” perhaps there is room to discuss an alternative to the Dual VAT

# HARMONIZATION OF TAXATION OF GOODS AND SERVICES

This is the key concept of Dual Taxation as it enables:

Movement towards quality of taxation on goods and services

enhanced efficiency to the system

reduced conflicts in the federation achieving unity even in diversity, inherent to federations

upholds subnational autonomy to define budget sizes

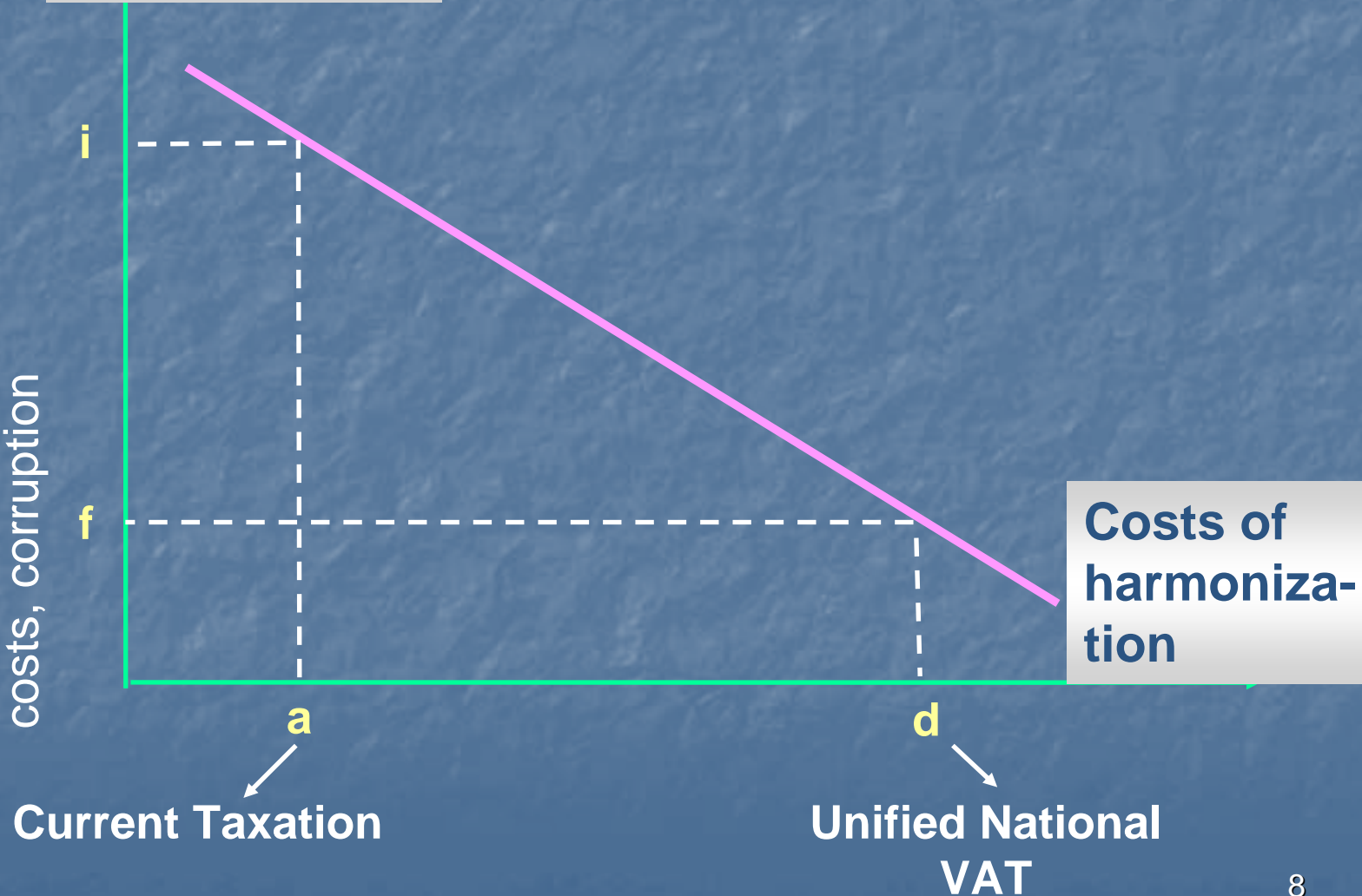
Below is a graphic display of gains that could be achieved through harmonization

# HARMONIZATION OF TAXATION OF GOODS AND SERVICES

**Costs of lack of harmonization**

**a** ( Current Taxation  
**d** ( National VAT

complexity, lack of neutrality, vertical competition, horizontal competition (tax war), delinquency and evasion, high tax admin and enforcement costs, corruption





# HARMONIZATION OF TAXATION OF GOODS AND SERVICES

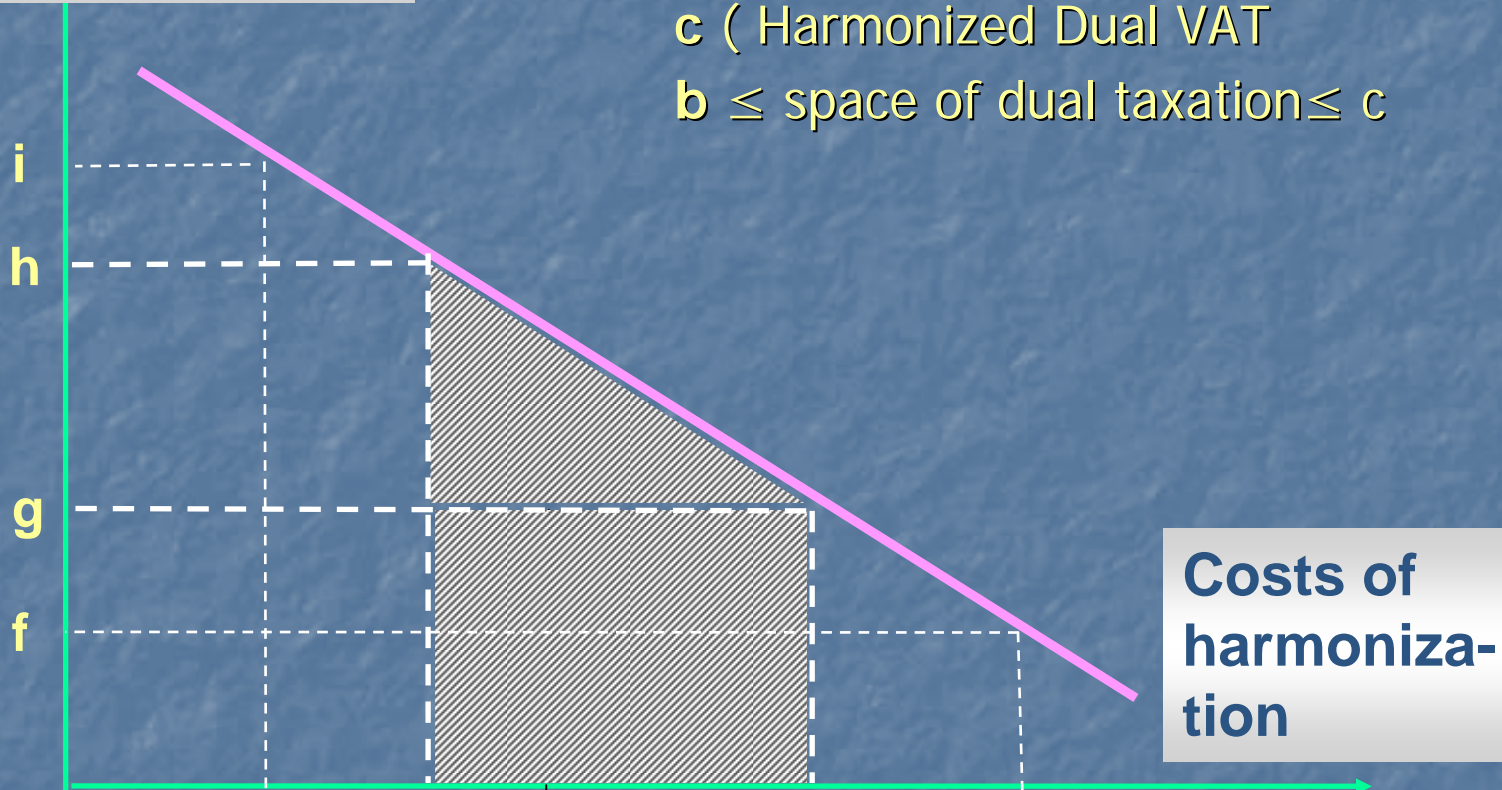
**Costs with lack of harmonization**

a( Current Taxation

d( National VAT

c ( Harmonized Dual VAT

$b \leq \text{space of dual taxation} \leq c$



**Costs of harmonization**

Current Taxation

Dual Taxation

National VAT

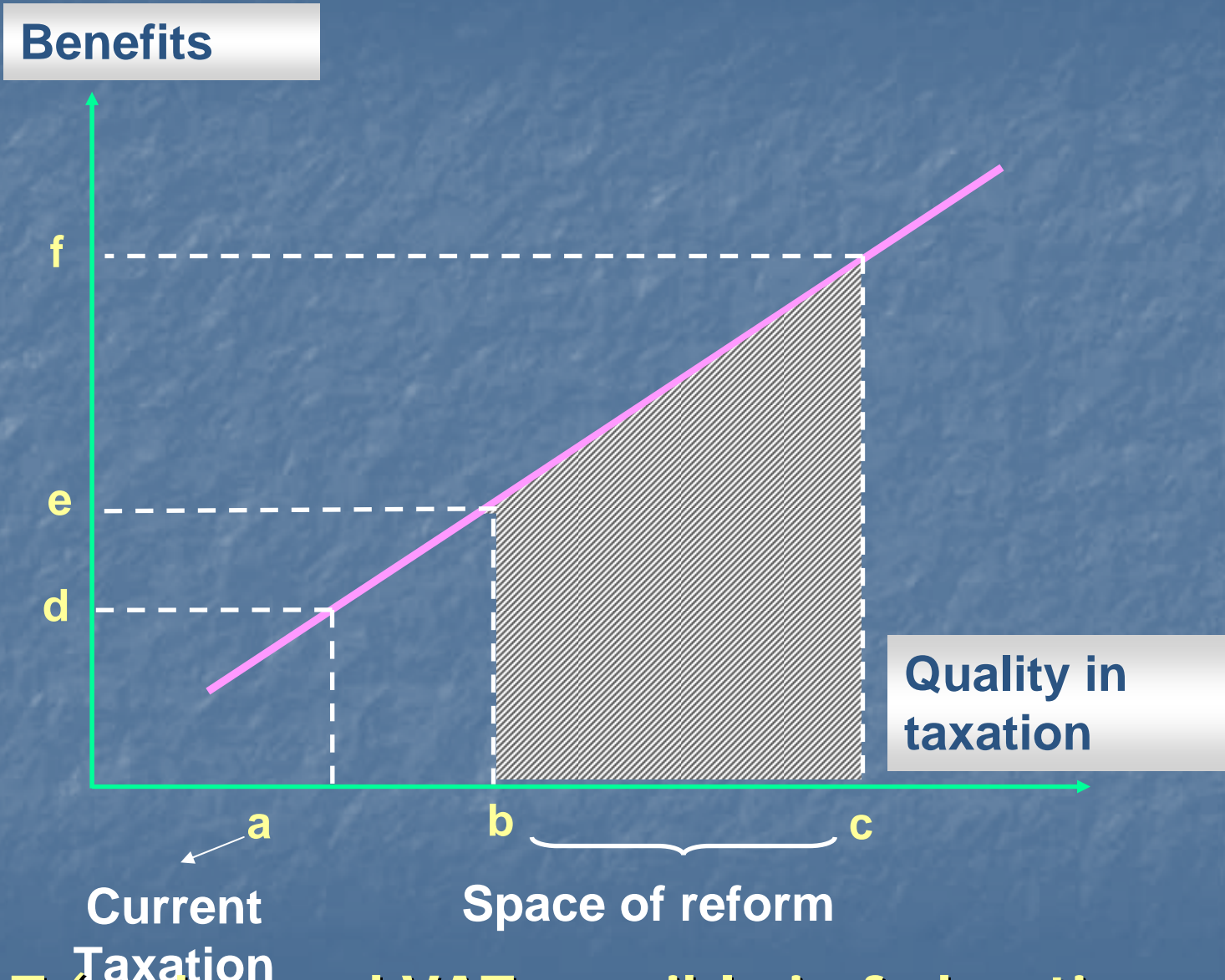
c = Dual VAT ( enhanced VAT possible in federative context 9

# TAXATION OF GOODS AND SERVICES WITH AND WITHOUT HARMONIZATION

- Costs      several dimensions
- Inverse relation      quality of taxation x costs
- Current system      low quality of taxation
- Central VAT      least possible cost
- Dual harmonized VAT ( least possible cost within federative context ( **reference model**
- Reform of taxation of goods and services      space between current system and reference model
- More or less quality of taxation depends on choices between principles of harmonization x autonomy from "b" moving towards "c"

# HARMONIZATION OF TAXATION OF GOODS AND SERVICES

simplification, efficiency in collection, neutrality, citizenship rights, intergovernmental cooperation, legal-institutional stability, federative balance, competitiveness



**C = Dual VAT (enhanced VAT possible in federative context)**

# BENEFITS OF HARMONIZATION IN TAXATION OF GOODS AND SERVICES

- Benefits several dimensions
- Direct relation: quality of taxation ( benefits simplification, efficiency in collection, neutrality, citizenship rights, intergovernmental cooperation, legal-institutional stability, federative balance, competitiveness
- Preserves autonomy of subnational governments to adjust their financial needs
- Dual Taxation facilitates the adoption of the principle of destination

# FINAL NOTES

- Reform of taxation of goods and services should be part of a broader reform
- This is because it automatically results in a discussion on revenue sharing
- At the Fiscal Forum of the States, the perception is that taxation, revenue sharing, regional development, retirement/ welfare, budgetary restrictions... are interlinked issues
- We have seen an alternative to address taxation of goods and services in a federative context
- Time is lacking for us to go into greater detail
- Below is a draft of aspects of Dual Taxation to be made available and discussed at another opportunity

# DIMENSIONS OF THE REFORM

- Reference Model      where we want to go
- Operational aspects    requirements to achieve the idealized model
- Transition              care to...
- get there              to the idealized model
- not get lost along the way
- reduce uncertainty/ insecurity/ loss
- proper increments over time

# REFERENCE MODEL – GUIDELINES AND CHARACTERISTICS OF DUAL TAXATION

- Both taxes inciding on same base
- Broad base includes services
- Better yet if the Calculation base is the same or quite similar
- Deductive indirect method debits - credits
- Both taxes only record consumption
- credit for goods of use and consumption of company and for fixed assets (asset: unburden or provide credit)
- Principle of destination in transactions as in the rest of the world exports unburdened and imports taxes at the same bracket (load) as applied to national goods and services

# REFERENCE MODEL – GUIDELINES AND CHARACTERISTICS OF DUAL TAXATION

- Within Brazil, tax factors should not constitute an obstacle for free circulation of goods and services
- Principle of destination to allocate revenues from state VAT collection model for fiscal adjustments at borders is an operational issue 'mitigated' boat
- Fewer brackets requirements for VAT to function
- Federal and State governments preserve autonomy to set brackets predetermined space and margins
- **Autonomy linked to the possibility of defining budget size**



# REFERENCE MODEL

## GUIDELINES AND CHARACTERISTICS OF THE DUAL VAT

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# REFERENCE MODEL - DIFFICULTIES

- Coexistence of differentiated regimes
- National 'Simples' Tax
- Tax Replacement
- Manaus Free Trade Zone
- Municipal taxation on services (ISS) or alternative source
- Size of brackets
- explanation of tax burdens and fiscal citizenship
- makes simplification difficult
- Calibrating brackets even if correct, will affect sectoral burden

# REFERENCE MODEL - DIFFICULTIES

- Vertical competition on higher consumption bases delimiting space for each VAT?
- Model for fiscal agreement at interstate borders accumulation of credit
- Losses from tax war and development policies tax war that uses interstate brackets as an instrument will end, a regional development policy would have to be established
- Compensation for losses to reduce insecurities

# OPERATIONAL ASPECTS AND TRANSITION

The major part of taxation reform of goods and services is in the transition and operational aspects

Convergence of legislation and regulations

Approximation of tax regimes (example: replace taxation in two VATs)

Convergence of tax calculation bases

Accommodating and calibrating brackets

Principle of destination for allocating revenue and operational model for fiscal agreement at interstate borders

Tax benefits      how to resolve losses from tax war, including to render adoption of the principle of destination feasible?

# OPERATIONAL ASPECTS AND TRANSITION

- Administrative integration:
- accessory obligations
- records
- surveillance
- administrative proceedings
- consultations; interpretation; conflict resolution
- Alternative for transition
- implementation by segments / activities?
- Progressive harmonization of bases before adoption of Dual VAT?

# LACK OF HARMONY IN CURRENT TAXATION OF GOODS AND SERVICES

- Many taxes on the same item operation, legal act, business deal...
- Differentiated regime for each tax
- Differentiated regime for each tax
- Single phase and multi-phase
- Cumulative and non-cumulative
- "Cumulativity" in non-cumulative taxes (use/consumption, asset, exportation)
- Different calculation methods to obtain non-cumulativity: deductive direct method (non-VA bracket); deductive indirect method (debits – credits)
- Regimes: normal, National "Simples", Tax Replacement (TR)
- Lack of harmony in TR hypotheses and taxes submitted to regime/ states that apply
- Different forms and terms for appropriation of credits (example: fixed assets)

# LACK OF HARMONY IN CURRENT TAXATION OF GOODS AND SERVICES

- ICMS tax war
- Brackets hidden inside and outside
- Multiple nominal brackets and infinite effective brackets
- Taxes are part of calculation base of other taxes, at times simultaneously
- On the operational plane, triplication of efforts
- surveillance
- “accessory” obligations
- payment terms
- records
- information systems.
- consultations
- administrative proceedings
- We could spend the day on examples...