There is a great paradox in the Brazilian tax system: although its tax administration is among the most modern in the world, it is nevertheless gargantuan, complex, and imposes high costs on families and businesses in meeting their tax obligations. Resolution of the paradox, however, lies more in improving management of the system than in changing laws. Rather than tax reform, it is essential to have good management.

That is how Everardo Maciel, tax consultant and former Secretary of the Federal Internal Revenue Service (IRS), summarizes his views on Brazil’s tax system. “The tax burden is clearly high in relation to other developing nations, but this is due largely to the political choice of having a generous social security system and universal public health,” he says. That is why the tax burden and social contributions are about 35% of gross domestic product (GDP).

A quite different question is the cost of compliance — what it costs taxpayers in terms of both finances and time to stay current with their tax obligations. Compliance is very expensive even though, driven by public policies implemented since 1995, Brazil is a world champion in using new information and communication technologies in tax matters. The country pioneered sending income tax information over the Internet, prompting Bill Gates in 1997 to say that tax administration in Brazil was an example for the U.S., Canada, and Australia.

“It’s as if we had a Ferrari that despite high speed always comes in last,” Maciel says. Consequently, there is extensive planning and a proliferation of disputes related to tax. “It is common for tax consulting offices to offer taxpayers package solutions, ranging from the opening of legal discussions to using legislative loopholes to reduce the amount of taxes paid.”

The roots of this situation lie in the taxation model Brazil has adopted. Maciel is convinced that “No other country lays out in their constitution a taxation model as analytical and broad as Brazil. [And] one of the dangers of most tax reform proposals is that they would deepen these distortions
and increase the number of tax rules in the Constitution.”

**Growing complexity**

Another factor is that, although taxpayers have access to modern tools, the federal, state, and country mechanisms overlap. Maciel explains that a single tax entity like a company has different identities for the federal government, the state, and the county. And if the company operates in more than one state, such as Rio de Janeiro and São Paulo, it would have additional identities.

The copious number of tax instruments is another flaw in the tax system, according to Maciel. Certain instruments, such as tax substitution and tax withholding, have been misused. “What was to happen in exceptional situations became the general rule,” he says. Also missing is creativity to overcome barriers in relations between the IRS and the taxpayer. For instance, with regard to digital certification authorization for transmitting tax statements over the Internet, Maciel says, “I had to allot a day to do this, introducing myself with a copy of my company’s social contract, in addition to paying US$200.”

Mauricio Tadeu de Luca Gonçalves, a tax accountant who is director of Partwork Associados, adds that a company has about 30 ancillary obligations before the Bureau of Internal Revenues and state and municipal tax bureaus. Besides the annual declaration of income tax, there is the state Information and Analysis Guide (GIA), and the county Electronic Declaration of Services (DES). “This is required for taxpayers to monitor their own activity,” he says.

In Brazil the assumption seems to be that the citizen is dishonest until proven otherwise, as Minister Hélio Beltrão has stated in the past. From this premise was created a tangle of laws to tie the citizen. “Even those who seek to act properly are penalized by the minority who want to escape the rule,” says Amir Khair, a specialist in public finance and consultant.

Unlike the United States, which assumes that people are honest but punishes offenders harshly, in Brazil every time the National Congress, legislative state assemblies, and county councils come up with new laws, they all regulate these measures, issue decrees, and thus elaborate the legislation. “Not even Jesus Christ can keep up with so many details,” Khair says, adding that ultimately the result is to overload the courts.

For a company that hires someone to take care of all this, Luca Gonçalves says, the cost “may represent twice as much as the wages paid.” Although it was a step forward, the National Simple system (a combination of six federal taxes, plus the state taxes on goods and services, and the municipal services tax) failed to provide benefits after the initial changes. In recent years, says Luca Gonçalves, “The rates have ended up being higher, and the rules are not so clear.”

Consultant Carlos Eduardo Rocha

“No other country lays out in its constitution a taxation model as analytical and broad as Brazil. [And] one of the dangers of most tax reform proposals is that they would deepen these distortions and increase the number of tax rules in the Constitution.”

*Everardo Maciel*
Campos, owner of Polimax Brasil, agrees. When he opened the company a few years ago, it enjoyed the benefits of the Simple category, but, he says, “The restrictions introduced by the government and a failure to raise the earnings limits excluded our company. Basically, this was a disguised way to raise taxes.”

Such decisions constrain growth. “It’s not easy to do business in Brazil. Many investors think twice before expanding their businesses because of the headaches and lack of incentives,” Campos believes.

**Gargantuan tax system**

Another aspect of the tax issue is excessive bureaucracy. Luca Gonçalves points out that, when a business is being opened, it must register with the Board of Trade, the Notary, the IRS, the state government, the county, Health Surveillance, and a variety of other government departments, depending on the activity. Corporations must publish their balance sheets. Then there are tax obligations. Today in Brazil there are 66 types of taxes, a maze of over a million laws, and every three minutes one of them is updated. “It’s a patchwork; tax laws are not replaced, but only one or two paragraphs of a particular law are changed,” Luca Gonçalves says.

This situation can overwhelm even a competent tax and accounting department. “Besides having someone do everything right, it is essential to have someone else reviewing it. If you stay only in the hands of an accountant or tax expert, details may be missed due to the vast volume of information and statements that companies have to deliver,” says Marcelo Lico, a partner at Macro Auditoria e Consultoria, an auditor and consulting firm serving small and medium enterprises.

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“From a technological standpoint we are super advanced, yet most tax professionals are still not prepared to generate the information correctly.”

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“The pursuit of an efficient tax system also involves the devolution of power in the civil service.”

*Silvia Helena de Alencar Felismino*

With knowledge gained in 22 years in this area, Lico has no doubt that Brazilian tax technology is among the world’s best. “Nowadays, almost everything is electronic. The Public System of Digital Bookkeeping should be fully implemented next year and will tie together all the federal, state, municipal, and social security data, allowing more effective cross checking. It all started when electronic invoicing became increasingly widespread here,” he says.

This gargantuan tax system, Lico says, may complicate the daily lives of taxpayers, but as
an electronic supervision system it makes life easier for public tax administrators, who are short of staff. The previous manual process was susceptible to errors and fraud. “From a technological standpoint we are super advanced, yet most tax professionals are still not prepared to generate the information correctly,” he warns. For example, there are 27 different state laws for the VAT on Goods and Services (ICMS).

Following all these tax issues is no longer a job for accountants alone. “The trend is for companies to have a high-level tax expert to monitor it all,” Lico says. “Incorrect information can generate a fine and require the company to argue its case in administrative and judicial proceedings.” He also sees the demands increasing for individuals, who can now fall into the IRS net when information in various fiscal databases is cross-checked.

Silvia Helena de Alencar Felismino, president of the National Sindireceita, the union of IRS tax analysts, points out another taxpayer difficulty: “Importers and exporters can become victims of the poor definition of responsibilities between inspectors and tax analysts, the two top-level careers in the IRS.” Turf struggles between two civil servant career paths can disrupt clearance of goods at customs. “Tax analysts cannot complete customs clearance, as they used to do. Yet the final part of this process depends on a tax auditor to sign documents,” Felismino says. A possible model solution, she points out, comes from the Treasury of Bahia state, which expanded the powers of its tax analysts, resulting in an average increase of 36% in VAT collections. “An efficient tax system involves the devolution of power in the civil service,” she concludes.

**Is tax reform possible?**

If there is consensus on the need for simplification, why does it not happen? Although it has been one of the main tax reform proposals put forward for discussion in recent years, the 27 different state laws for VAT on Goods and Services (ICMS), the main state tax, have still not been unified. Expert on public accounts Amir Khair points out that “As much as the federal government works for unification, changing the ICMS is changing what is the source of 83% of state government revenues. Any change represents a threat of lost resources, and the natural reaction of state delegations in Congress is to stand firm against any attempt to change.”

The result is a “Frankenstein” tax system. Khair explains, “This has nothing to do with this or that government or with political parties. It is an issue related to the federation agreement, and the division of responsibilities and tax revenues between the federal government, states, and municipalities.” He advocates adoption of new alternatives like the National Simple system that makes taxes cheaper for micro and small enterprises; it is “a pragmatic measure of simplification,” that does not require constitutional amendments. “It’s a misperception to think that simplifying the tax system will reduce the tax burden. It is more likely that the rates will rise and the tax burden will increase,” Khair concludes.

Everardo Maciel, tax consultant and former IRS Secretary, also believes that, “it’s a waste of time to carry on this debate. Most of our tax blockages do not need constitutional amendments. And rebuilding the tax system from scratch would create unnecessary chaos.” He does not deny the existence of problems, but believes that to solve them, “just drop what is not working and keep what is.”

Silvia Helena de Alencar Felismino, National Sindireceita president, also advocates simplification and has some good words to say for the repealed Provisional Contribution on Financial Transactions (CPMF): “This type of tax is perfect to check tax evasion. Not that I want the CPMF back as it was, but it could be restored with only a symbolic rate to facilitate supervision.”