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THE BRAZILIAN TAX SYSTEM AS TOOL TO FIGHT INEQUALITY



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## Summary and keywords

This paper aims to analyze the Brazilian tax system and, to this end, seek the principles and objectives of a fair taxation and those present in the Constitution of 1988, focusing on the different entities with tax collection power. A historical analysis is also made starting from colonial Brazil, highlighting the main events that led to changes in the system. Finally, are presented the pros and cons of the current system and possible solutions to efficiently use the tax system as a tool against inequality.

Keywords:

- Inequality
- Income transfer
- Social assistance
- Poverty
- Bolsa Familia
- Tax
- Federal pact
- Constitution

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## Introduction

As the main source of state resources and one of the main means of combating inequality, the Brazilian tax system has been the subject of analysis and studies for years. Nowadays, with the rise of the extreme right wing and the victory of Jair Bolsonaro in the last Brazilian elections, overthrowing the PT that remained more than a decade in power, the need for a change in the tax system has been placed on the agenda.

Not only because it is a source of government resources and because it acts against income inequality, but also because it impacts on the allocation of resources and consumption and competitiveness, changes in the tax structure are highly disputed by representatives of each economic and social sector, making difficult a significant change in its structure.

This work intends to analyze the Brazilian tax system through desk research focusing on the different entities with tax collection power, in order to confirm the main hypothesis; the system has several failures that create a feedback loop and aggravate inequality. It also aims to consider the positive aspects of the system and the negative ones and look for possible solutions as far as possible.

The monograph was divided into five chapters: Current economic and political situation, brief introduction to the theory of the Brazilian tax system, concepts and principles of the Brazilian tax system, inequality and tax distribution and pros and cons of the system and final considerations.

The first chapter will deal with the actual problems that the new government will have to face providing data of the major economic indicators. The second one aims to analyze the Brazilian tax system along its history, starting with the colonial period. The following chapter aims to describe the actual system, its principles established by the Federal Constitution, and the basis of incidence of taxes. The fourth analyzes the income inequality in Brazil and how the tax system deal with it with the tax distribution policies. Finally, the fifth chapter aims to make final considerations about the Brazilian tax system according to what was presented in the paper.

## ABBREVIATIONS

CTN - CÓDIGO TRIBUTÁRIO NACIONAL [National Tax Code]

CF - CONSTITUÇÃO FEDERAL [Federal Constitution]

IBGE - INSTITUTO BRASILEIRO DE GEOGRAFIA E ESTATÍSTICA [Brazilian Institute of Geography and Statistics]

OECD - ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

SINDIFISCO NACIONAL - SINDICATO NACIONAL DOS AUDITORES-FISCAIS DA RECEITA FEDERAL DO BRASIL [National Fiscal Auditors Union Of The Federal Revenue Of Brazil]

IT - INCOME TAX

GDP - GROSS DOMESTIC PRODUCT

WBG - WORLD BANK GROUP

WTO - WORLD TRADE UNION

PBF - PROGRAMA BOLSA FAMILIA

FPE - FUNDO DE PARTICIPAÇÃO DOS ESTADOS [State Participation Fund]

IRPF - IMPOSTO DE RENDA PESSOA FISICA [Individual Income Tax]

IRPJ - IMPOSTO DE RENDA PESSOA JURÍDICA [Tax on Corporate Income]

IPI - IMPOSTO PRODUTOS INDUSTRIALIZADOS [Tax on Industrialized Products]

## 1.- Current economic and political situation

The actual focus of the current situation in Brazil is in the expectation regarding the last presidential election won by Jair Bolsonaro and the problems that the new government has to face. Wrong economic decisions, which sought to grow the economy by stimulating credit, with low interest rates and fiscal stimuli, but in an environment of low confidence and little legal security, has put the country in a vicious circle. The result was the following; population's indebtedness and lack of control in the public accounts (government spending more than it collects) at the same time that the collection has diminished drastically, due to the recession. In order to illustrate and understand this situation the following table shows the main indicators of the country. It is important to emphasize the high Gini index, because the fiscal policy is a corrective tool for it, almost 20 points above the one of Spain for example, which according to data of the World Bank Group (WBG) <sup>1</sup>are 52.8 and 36.2 respectively.

Economic Indicators	Source	Data	Year
<i>GDP</i>	IBGE	US \$ 2.02 trillion	2017
<i>GDP per capita</i>	IBGE	US \$ 9,689	2017
<i>Gini Index</i>	WBG	52,8	2013
<i>Investment rate</i>	IBGE	16% of GDP	2nd 1/4 2018
<i>Tax burden</i>	IBGE	37% of GDP	08/2018
<i>Savings rate</i>	IBGE	16.4% of GDP	2nd ¼ 2018
<i>Inflation</i>	IBGE	2.95%	2017
<i>Workforce</i>	IBGE	105.1 million	09/2018
<i>Minimum salary</i>	IBGE	R \$ 954.00	2018
<i>External Debt</i>	Central Bank	US \$322.121 billion	05/2018
<i>Public Debt</i>	Central Bank	65% of GDP	2017
<i>Public Sector</i>	IBGE	-R\$110.5 billion	2017
<i>International reserves</i>	IBGE	US \$379.4 billion	08/2018
<i>Federal Collection</i>	IBGE	R \$ 1.342 trillion	2017
<i>Direct investments in the country</i>	IBGE	US \$ 3.897 billion	07/2018

Elaborated with data from the WBG

<sup>1</sup> The World Bank Group is one of the world's largest sources of funding and knowledge for developing countries.

Another field that is worth analyzing to have a greater perception of the country is the commercial sector. Although according to the latest data provided by the WTO - World Trade Organization, foreign trade accounts for only a quarter of its GDP, Brazil is among the 25 leading exporters and importers in the world. The trade balance of Brazil is structurally surplus, but has had a downward trend in recent years, due to the decrease in the prices of raw materials, the rise in energy imports and the lower competitiveness of Brazilian products. Brazil's current account balance represents -0.6% of GDP in 2017, compared to -1.3% in 2016. From 2013 to 2015, Brazil posted trade deficits, but the balance has been rebounded since mid-2016, reaching according to estimates to USD 8,000 million at the end of 2017.

Foreign trade indicators	2014	2015	2016	2017
Import of goods (millions of USD)	239.152	178.798	143.474	157.476
Exports of goods (millions of USD)	225.101	191.134	185.280	217.769
Import of services (millions of USD)	85.916	68.921	63.750	66.293
Export of services (millions of USD)	39.047	32.989	33.300	33.677
Commercial balance (millions of USD)	-6.629	17.670	45.037	64.028
Commercial balance (including services) (millions of USD)	-54.736	-19.276	14.590	30.178
Foreign trade (in % of GDP)	24,7	27,0	24,6	24,1

Elaborated with data extracted from the Instituto Brasileiro de Geografia e Estatística

According to the last data provided by the IBGE the countries that Brazil most imported were China, the United States, Germany, Argentina and South Korea while the countries that Brazil most exported were the same changing South Korea for the Netherlands, and Japan. The main products that Brazil exports are iron ore, cast iron and steel; crude petroleum oils; soybeans and derivatives; automobiles; cane sugar; aircraft; beef; coffee and chicken. And on the other side of the balance, the products imported are crude oil; electronic circuits; transmitters / receivers; vehicle parts, drugs; cars, fuel oils; natural gas, electrical equipment and aviation engines.

However, these figures could evolve drastically, for better or for worse, with the uncertainty that supposes of the new government with Paulo Guedes assuming the economic rudder of the largest economy in Latin America after more than a decade of left wing government.



Pablo Guedes presented to Brazilian society several versions of his tax reform plan, that violate the principle of progressivity in the income tax, that principle will be explained later with the other ones.

If the main proposal were approved, the rate of who earns up to 2,800 reais per month would jump from 7.5% to 20%, that is, it would be almost three times higher.

Nevertheless, before seeing the current taxation system, we have to take a look to the past to better understand the roots and the evolution of it along the different periods.

## **2. Brief introduction to the history of the Brazilian tax system**

It is common today in Brazil to hear the statement that it is a country that has one of the highest tax burdens. For this reason, it is necessary to analyze the actions developed by the Portuguese tax authorities in the colonial Brazil, and the Brazil Empire, where we will see that today's tax oppression is a legacy of the past.

### **2.1 Colonial Brazil**

The collection of tributes in Brazil begins before the colonization in the pre-colonial period with the exploration of Pau Brazil. Even though it was exploited through the lease to Fernão de Noronha, the Portuguese Crown received 4,000 *cruzados* annually for the assignment of exploration rights. The period from the implementation of the captaincy system to the installation of the General Government (1530-1548), despite the colonization objectives, management structure and treasury was not properly implemented.

From the General Government until the beginning of the Iberian Union (1548-1580), the administration was structured in the following way: a Chief who assisted the Governor General and at the level of the captaincies was created the position of Provider-Minor, that was aided by the tenants, contractors, clerks, porter and custodian of the Customs. It was up to the provider functions such as superintending and supervising the collection of taxes to the Treasury of the Crown, to supervise the production of sugar in the sugar mills, to judge the causes that exceeded the competence of the partial suppliers in Special Counsel or to punish the disloyal employees, applying penalty of prison and send them to the Kingdom. For providers in terms of captaincy, immediate auxiliary Provider-Minor, we have to highlight some functions such as launching in public auction the rents and royal rights to be auctioned or to take accounts annually to the warehouses and receivers of the rents and send the balances to the treasurer based in Bahia.

It is crucial to emphasize that it was not only the slave trade and the sugar that was taxed, other sources of income were passed on to the metropolitan government like

cattle, gold, tobacco, cotton, among others. The Portuguese tax agency charged between 20% and 30% on the leather tanned, in the case tobacco, in some cases even exceeded the gold. In Minas Gerais with the discovery of gold, the Portuguese treasury acted rigidly with the establishment of various taxes.

Until the end of the colonial era (1500-1822), significant changes characterized the fiscal apparatus applied in Brazil. New organs were created, such as the Overseas Council and the Treasury Council. At the level of captaincies, the creation of the Customs, the Intendance of the Navy and the General Warehouses stands out.

The creation of the Overseas Council was a taxation milestone, as it was intended to structure the colonial practices and to tighten the colony as much as possible, through a rigid fiscal policy, with the increase and creation of new taxes and commercial companies, to maintain the monopoly. In this period, taxes consumed a quarter of the total production, dividing it into ordinary and extraordinary (voluntary donations). The first two decades of the nineteenth century were characterized by social, political and economic transformations in the Portuguese colony of America. On the political side, the arrival of the Portuguese royal family in 1808 constituted an important framework in the process of the political emancipation of Brazil. Such event will culminate with independence in 1822. At economic level, the opening of the ports to friendly nations, on January 28, 1808, freed Brazil from the isolation imposed by the colonial status, to determine the end of the exclusive trade with the metropolis and open the country to international trade. The monopoly system begins to be condemned, and free exchange is defended, since the capitalist guidelines imposed the need for an open market without the presence of the monopolies and privileges that characterized the economic policy until then.

To establish the Portuguese court in Brazil, new tributes were created. It was necessary to maintain the bureaucratic apparatus. In this sense, in addition to those already existing, the following taxes were created and applied in all captaincies:

- i. Royal or national subsidies, represented by duties on green meat, raw or tanned hides, cane brandy and coarse wool produced in the country;
- ii. Literary subsidy, for the cost of the masters schools,
- iii. Tax on behalf of the Bank of Brazil (founded in 1812), on each dealer, bookseller and apothecary, store of gold, silver, tin and articles of copper, tobacco, etc., and exempt only stores of barber and cobbler;
- iv. The sumptuary fee, also for the benefit of the Bank of Brazil, on each of four and two-wheeled carriage;
- v. The tax on sugar and distillation operations, higher or lower according to the province;

- vi. The tenth of the annual income of houses and any urban properties;
- vii. The *SISA*<sup>2</sup>, which was a 10% tax levied on the sale of houses and other urban real estate;
- viii. Half-transfer tax, which was a 5% tax realized on the sale of a slave who was rogue black, that is, who have had some profession,
- ix. The new rights, represented by a 10% rate on the salaries of employees in the departments of Finance and Justice.

Portugal sought to place Brazil very well in the dynamics of the colonial system of the mercantilist era, especially as regards the fiscal administration, since in addition to the collection of taxes, it guaranteed the economic activities and possibilities reserved under contracts and monopolies.

## **2.2 Brazilian Empire**

After proclaim the independence on September 7, 1822, it was necessary to organize the administrative machinery, since Brazil was facing a deep economic crisis, due to the increase of imports and the decrease of exports.

The tax system was precarious, since there was no systematization of revenues and expenses and the tributes were poorly distributed. The young nation inherited from the previous period a tax framework that prevented its growth.

The tax table, in the order of importance of the contributions, in the year 1822, was the following:

- i. Customs duties of entry, charged at a rate of 15% on the official customs value of goods of Portuguese and English origin, and 24% on the official value of articles of other origins, excluded both from one or the other wine, liqueurs, olive oil and vinegars, whose import duties were collected in accordance with a special table, included in the permit of April 25, 1818; the duties of entry of slaves and, among other minor contributions, the duties of transfer, coastguard, re-export and anchorage taxes on foreign vessels were also collected at customs;
- ii. Tithes, in which the genres of culture and creation of all the provinces were incurred, and for whose collection, previously made by administrators or by contract of sale, with serious losses and vexation of the taxpayers;
- iii. Export tax represented by the rate of 2% on all goods not subject to any other subsidy or right of withdrawal;

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<sup>2</sup> *SISA (Serviço de Impostos de Sua Alteza)* is the amount charged for real estate transactions, *SISA* meant "His Highness's Tax Service".

- iv. Urban tenth of the annual net income of the buildings, or of the value of the rent arbitrated, in case their owners live in them;
- v. SISA charged at the rate of 10% on the value of all purchases and sales of real estate;
- vi. Green meat tax, consisting of the contribution of five reis in each fresh beef meat;
- vii. Tax on brandy;
- viii. Tax on carriages, shops and boats, also known as the "bank tax";
- ix. Tobacco tax, charged at the base of 400 reis per arroba;
- x. Rights over the slaves, who were sent to the mines;
- xi. reduced transfer tax of rogues slaves that is, "those who are not there purchased by the new black dealers and entering for the first time in the country, transported from the coast of Africa;
- xii. Various contributions, such as postal fees, foreign exchange rates, toll fees, transit charges between provinces, often collected by local authorities.

The Constitution of 1824, which could define the tax spheres, was silent; only in Article 83, which deals with the General Province Councils and their attributions, established: <<Art. 83 - projects can not be proposed or deliberated in these Councils: 3o) On impositions, whose initiative falls within the special jurisdiction of the Chamber of Deputies>>

Article 179 (15), in turn, stated:

<<No one shall be exempt from contributing to the expenses of the State in proportion to its assets.>>

Through the Additional Act of 1834 the general income was made up of the following taxes:

- i. Import duties at the rate of 15% on all goods, with the exception of gunpowder that paid 50% and tea that went on to incur 30%, and some exempt; there were also a number of customs contributions, such as remittance, re-export, expedients, anchorage, storage;
- ii. Export duties, collected on the basis of 2%, 7% and 20%;
- iii. 15% rights in the purchase of foreign vessels;
- iv. Tax on gold mining;
- v. Tax of the root goods;
- vi. Tax on open stores;
- vii. 5% tax on the sale of national vessels;
- viii. Stamp duty of the papers;
- ix. Slave tax;
- x. Additional urban tenth;

- xi. Tithing of the Chancery; old and new employment rights, as well as other fees and emoluments.

### **2.3 Brazilian Republic**

The Constitution of 1891 sought to establish the competence of the Union and the States on the question of taxes. Article 7 provided that it was the exclusive competence of the Union to decree:

- Tax on the importation of foreign origin;
- Rights of entry, departure and stay of vessels, cabotage trade being free to domestic goods, as well as foreigners who have already paid import duty;
- Stamp fees;
- Rate of federal couriers and telegraphs;

In accordance with article 9, it was incumbent upon States to enact taxes.

- On the export of goods from its own production;
- On rural and urban properties;
- On transfer of properties;
- On industries and professions (stamp duty, contribution of telegraphs and postal services).

We call special attention to one of the taxes that started to contribute, from 1922, to the revenue of the Union and the States, the income tax (IT). The Income Tax was established in Brazil in 1922. However, it should be remembered that the collection of this tax is not in any way a novelty; since the Imperial period, the tax authorities imposed a tax on certain rents, such as taxes on income, subsidies, salaries and dividends. However, it was from the Budget Law no. 4625, dated December 31, 1922, which was << Established the general tax on income, which will be due annually, by any natural or legal person residing in the territory of the country, and will be levied in each case on the net set of income of any origin<sup>3</sup>>>

After the victorious Revolution of 1930, the power was delivered to Getúlio Vargas, who slowly reinforced his personal power, culminating in November 1937 with a coup. Getúlio Vargas ruled without a constitution until the promulgation of the *Carta Magna* of 1934. The country was earning the most advanced constitutional text of its history, establishing the minimum wage, with eight hours of work a day, prohibiting the work of minors under 14 years, paid weekly rest etc.

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<sup>3</sup> AMED, Fernando José. *História dos tributos no Brasil*. São Paulo: Edições SINAESP, 2000, page 250.

In its tax aspects, compared to the 1891 Constitution, there was systematic improvement, in its article 6, it was the responsibility of the Union:

I. Decree taxes on:

- The importation of goods of foreign origin;
- Consumption of any goods other than motor fuels;
- Income and proceeds of any kind, except for real estate rent; transfer of funds abroad;
- Acts emanating from the government, business of its economy and instruments of contract;
- Acts regulated by federal law;
- The Territories.

While in its article 8, it was the responsibility of the States:

I. Decree taxes on:

- Territorial property, except urban;
- Transmission of property *causa mortis*;
- Transmission of property between alive;
- Consumption of explosive motor fuels;
- Sales and consignments made by traders and producers, including the industrial ones, being exempted the first operation of small producer;
- Export of the goods of their production, up to a maximum of ten per cent ad valorem, any additional seals;
- Industries and professions;
- Acts emanating from your Government and business of your economy, or regulated by state law;

II. Charge state service fees:

1<sup>st</sup> - The sales tax shall be uniform, without distinction as to the origin, destination or kind of products;

2<sup>nd</sup> - The tax on industries and professions shall be issued by the State and arranged by the State and the Municipality in equal shares.

And according to the articles 2 and 3, it was competence of municipalities:

- The license fee;
- Urban land and property taxes, levied on the first, in the form of a tenth or an income tax document;
- The tax on public amusements;
- The tax on the rent of rural properties;
- Fees on municipal services.

With the redemocratization, a new Constitution was promulgated in 1946. As far as the taxes were concerned, there was a change in its discrimination in relation to that of 1937.

- The tax of industry and professions that was of exclusive competence of the States passed to the Municipalities (half of the product of this collection went to the Municipalities);
- "Improvement contributions" were instituted for the Union, the States and the Municipalities;
- States and municipalities started to participate in various taxes. Actually, the competence of the taxes was thus discriminated against.

The military government, installed in 1964, had as a priority the accelerated growth, that is, the concentration of income, expansion of consumer credit and the opening of the Brazilian economy to the foreign market. From 1969 to 1973, this tripod made possible the so-called "Brazilian miracle".

In this context, the national tax system began to be composed of direct taxes (which were levied on the income of each taxpayer) and indirect taxes (which are passed on to the prices of the goods). The IPI (Tax on Industrialized Products), created in 1966, whose rate should be proportional to the essentiality of the product, did not in practice occur. For example:

<<Wines were added at a rate of 20%, while beer reached 35%; perfumery and cosmetics had the same taxation as brooms and toothpastes, i.e. 8%; cars did not exceed 20%, while equal rates were attributed to soaps and soaps.<sup>4</sup>>>

In the period of the Brazilian Miracle, credit expanded, bringing consequences to the popular classes, with the increase of money in circulation. Fiscal and foreign exchange incentives were created, allowing the entry of foreign capital and, with this, the exploitation of the national labor force was reduced to very cheap costs.

On January 15, 1985, Tancredo Neves defeated Paulo Maluf in the electoral College. He died shortly thereafter and took over Vice President Jose Sarney, beginning the period known as the New Republic. Trying to balance the economy, in February 1986, the Cruzado Plan was edited, which extinguished the *cruzeiro* and created a new currency, Cruzado. It was in this context that the Constitution of 1988 was promulgated.

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<sup>4</sup> COSTA, Luís César Amad. *História do Brasil*. São Paulo: Scipione, 1999 p.354

The current model is a remnant of this constitution, which, moreover, took as a parameter for its elaboration, with few modifications, the Tax Reform of 1966, created in the midst of the centralizing military regime.

### **3.- Concepts and principles of the Brazilian tax system**

After seeing the historical background of the current system, we can deep in the actual one. But first of all we have to know what it is with clarity. The Tax system is understood as being the organic complex formed by the taxes instituted in a country or an autonomous region and the principles and norms that govern them. Consequently, we can conclude that the Brazilian tax system is composed of the taxes established in Brazil and the principles and norms that regulate such taxes.

The Brazilian tax constitutional system, in view of the norms contained in the text of the Federal Constitution, has obvious characteristics. The main one is rigidity - the Major Law does not give the ordinary legislator the freedom to draw any fundamental trait.

The Federal Constitution defines the field of each of those persons with tax jurisdiction; exhaustion and complexity - traces the Federal Constitution, in the articles destined to the study of the National Tax System, all contours of the system, little relegating to the ordinary legislation. This characteristic is usually considered, by the studies of the Tax Law, as a consequence of rigidity. In fact, some writers claim that the Brazilian tax system is a true subsystem, dealing with aspects of taxation by the state, the powers exercised by it in the tax sphere and the taxpayers' assurances regarding these powers.

#### **3.1 Types of contributions**

Contributions are considered to be all the compulsory pecuniary benefit established by law and charged through a linked administrative activity, which does not constitute sanction of an unlawful act (CTN, article 3). Generating fact is the situation that gives rise to the obligation to pay the pecuniary sum due to the corresponding institutions. All the powers of the federated entities for the imposition of taxes is disciplined in the Federal Constitution. As Hugo de Brito Machado asserts:

*“In the exercise of its sovereignty, the State requires individuals to resources you need. The power to tax it is nothing more than an aspect of state sovereignty, or a part of it. It is important, however, to note that the taxation relationship is not simple relationship of power as some have intended it to be. It is a legal relationship, although its foundation is the sovereignty of the State”<sup>5</sup>*

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<sup>5</sup> Machado, Hugo de Brito. *Curso de Direito Tributário*. 28ª Ed., revista, atualizada e ampliada. São Paulo: Malheiros Editores, 2007, p.90



The national tax system is composed in accordance with article 145 of the Constitution, with the following tributary species:

1. Tax, it is the one that has as a generator a situation independent of any specific state activity relative to the taxpayer (Article 16 of the CTN). In other words, tax is the tribute that is not tied to a direct consideration to who is paying it.  
Tax revenues are not intended to pay for works or services on behalf of those who pay them, but rather to be used to defray the state's general expenses, in order to promote the common good.
2. Fee - Can be charged by the Federal Government, States, Federal District or Municipalities, within the scope of their respective attributions, which has as a generator, the exercise of police power or the actual or potential use of specific public service and dividend provided to the taxpayer or made available to him (Article 77 of the CTN).
3. Contribution of improvement- It is charged by the Federal Government, States, Federal District and Municipalities, within the scope of their respective attributions, with the objective of meeting the cost of public works carried out by real estate valuation, having as total limit the expense incurred and as limit the value of the work resulting for each property benefited (Article 81 of the CTN)
4. Special contributions- These are provided in articles 149 and 149-A of the Federal Constitution, are charged for the cost of parastatal activities and may be: social, intervention in the economic domain and interest of economic or professional categories...
5. Compulsory loan -This one can only be established by the Union, through a complementary law, in cases of: - Public calamity or external war or its imminence, requiring extraordinary resources, that is, in addition to those provided for in the fiscal budget of the Union. - Public investment of an urgent nature and of relevant national interest.

### 3.2 - Basic principles of the Brazilian tax system

Constitutional principles are those embodied expressly or implicitly in the system, whose function is to inspire understanding of the legal rules, informing their meaning and acting as commandments to be followed in the exercise of the right, in accordance with the norms provided for in the Major Law.

The national tax system is subordinated to several principles, which constitute constitutional guarantees to taxpayers, according to arts. 150 to 152 of the Federal Constitution, without prejudice to others, and, on the other hand, constitute limitations to the power to tax. In some sense, it is possible to understand as a limitation to the power to tax everything and any restriction imposed by the legal system of the entities endowed with power. However, the principles are not just limitations of the exercise of tax jurisdiction, but rather an instrument for their adjustment. The principles here, or nowhere, serve as a limitation of something, but as a guideline of certain matter or state of affairs. In the words of Paulo de Barros Carvalho:

*“Belonging to the same stratum of the Constitution, of which mere logical record of a didactic nature, or constitutional subsystem tributary performs the functions of the whole, disposing of the capital powers of the State, in the field of taxation, together with measures to ensure the indispensable guarantees to the freedom of the people, before those powers.”<sup>6</sup>*

In the area of taxation, there are several constitutional principles, to be used as a tributary imposition,

1. Principle of Legality (article 150, I, of the Federal Constitution) prevents taxpayers from requiring taxes (institute or increase) that have not been established by law. Only by law are possible the establishment and increase of taxes. Thus, we can say that the exercise of tax jurisdiction is one of the manifestations of legislative competence. For this reason, we can conclude that tax jurisdiction necessarily implies the competence to legislate.
2. Principle of Isonomy or Tax Equality (article 10, II, of CF), the principle of isonomy stems from art. 5 of the Constitution, which establishes that all are equal before the law, without distinction of any nature.
3. Principle of non-retroactivity (art. 150, III, "a") is forbidden to charge taxes for taxable events that occurred before the beginning of the rule of law that instituted or increased. In fact, this constitutional principle pertaining to fundamental rights, contains provision in art. 5 °, XXXV, of the CF. Thus, events

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<sup>6</sup> Carvalho, Paulo de Barros. Curso de Direito Tributário. 21ª Ed. São Paulo: Saraiva, 2009, p. 157

already duly constituted under the previous aegis, can not be modified by a new law under penalty of making it exterminate the legal security existing between people, the rule is excepted by the National Tax Code that, in art. 112, establishes the retroactivity of the effects of the interpretative laws (item I), as well as of the laws that benefit the taxpayer (item II, and its sub-paragraphs).

4. Principle of Priority (Article 150, III, "b"), as set forth in the aforementioned article, stipulates that taxes may only be collected for a financial year subsequent to the year in which the new law was published, which has created a tax or increased your gathering.
5. Principle of Prohibition of Tribute with Confiscation or Non-Confiscation (article 150, IV, CF), is a tax that, because it is excessively onerous, is felt as a penalty, may be enunciated as the prohibition on the imposition of taxes that are excessively onerous, anti-economic, making the development of economic activities capable of producing wealth impossible. The CF / 88 prohibited its use as an instrument of absorption by the State of the means of production, that is, the prohibition of confiscation tax prevents its use as an instrument to suppress the so-called private sector, and consequent institution of the regime of state economy
6. Principle of Freedom of Traffic (article 150, V, CF), taxpayers may not establish limitations on the traffic of persons or goods, by means of interstate or inter-municipal taxes (CTN, article 9, item III). This does not mean should be all interstate transactions immune to any taxation. What can not be there is the aggravation of the burden by the fact of being interstate, or intermunicipal, the operation. The prohibition of limitations on the traffic of people and goods does not prevent the collection of tolls for the use of roads conserved by the Government.

There are other limitations included in the Art. 151, CF / 88 prohibits the Union from instituting a tax that is not uniform throughout the national territory or that implies a distinction or preference in relation to State, Federal District or Municipality, to the detriment of another, subject to the granting of tax incentives intended to promote the balance of socio-economic development between different regions of the country.

- Principle of geographical tax uniformity (art.151, CF), stems from a greater principle that is the basis of federalism, whereby federated units must be treated equally, in order to ensure the political and economic unity of the country. Tax uniformity is a corollary of the principle of tax equality (article 151, II, CF).

- The principle of uniformity in the taxation of public debt obligations income (CF, article 151, II, first part) can not also tax the income of the state's public debt, Federal

District and municipal bonds, at levels higher than those fix for their own obligations and for their own agents.

- Principle of uniformity in the taxation of remuneration and taxes of public agents (CF, article 151, II, final part), the Constitution also prohibits the Union from taxing the remuneration and proceeds of public agents of the States, Federal District and Municipalities at levels superior to those that fix for their own agents.

- Principle that prohibits the Union from granting State and Municipal Tax Exemptions (CF, art. 151, III) EC No. 1/69 (art.19, §2) allowed the Union, through a complementary law and taking into account the relevant social interest or could grant state and municipal tax exemptions. The CF / 88 prohibits the granting of these exemptions by the Union, again avoiding the possibility of odious privileges, ensuring the prevalence of isonomy.

- Principle of non-discrimination in taxation, by virtue of the origin or the destination of goods (CF, article 152), the states, the federal district and the municipalities are also prohibited from establishing a tax difference between goods of any nature, by reason of their origin or destination (CTN, article 11). This rule is in line with art. 22, VIII, which gives the Union competence to legislate on foreign and interstate trade.

- Principle of Contributory Capacity (Article 145, § 1, CF) is the ability of the person placed in the position of legal tax recipient to bear the tax burden, without the loss of the tax-depleting wealth.

### **3.3 The Federal Pact and the different entities**

As we have seen in the historical background since the Proclamation of the Republic (except Era Vargas between 1937 and 1946) it is important to note that Brazil, in theory, constitutes a Federation. Federation, by definition means the union of states that delegate their sovereignty to the Federal State. That is to say, each Brazilian State were independent of the others in its formation and that, at a certain moment in history, they resolved to unite around a centrality of power.

Since the National Tax Code was enacted in 1966, a system of harmonization of tax competencies was envisaged, where it was sought to attribute to each Federative Entity the competence to legislate and administer taxes under all economic tax categories. Thus, historically, the division of the various tributary species abovementioned (by species and economic category) by the federative entities (Union, States and Municipalities) practically remains unchanged. There are two exceptions to this rule that should be highlighted, both of which demonstrate the process of concentration of the federal tax authority over the other federative entities that we will see below. The first

is related to taxes levied on income, where, since 1993, the exclusive competence over the power to legislate over it has remained with the Federal Government. This was done through Constitutional Amendment 03, which amended Article 155 of the Constitution, excluding from the competence of the States the possibility of legislating and collecting the State Income Tax Additional.

The second exception concerns Contributions in general, except for Improvement. Until 1977, there was a great legal discussion about the legal nature of Contributions - social security, social, union - and this discussion was settled with the promulgation of Institutional Act No. 08/77 and later consolidated with the Federal Constitution of 1988. In this, was reserved the exclusive right of the Federal Government to establish any contributions other than Improvement.

The table below based on the articles 153, 154 and 155 of the CF, facilitates an understanding of the current division of tax competencies and the economic categories on which the taxes provided for in our legislation fall.

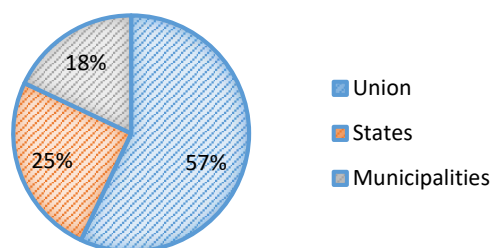
Federative Entities /Generating Facts	Union (Articles 153 and 154 CF)	States (Article 155 CF)	Municipalities (article 156)
Income	<ul style="list-style-type: none"> <li>- Income (IR)</li> <li>-Contribution to Social security</li> <li>- Contribution to Work Accident Insurance</li> <li>- Contribution to Education Salary</li> <li>- Contribution to System</li> </ul>		
Patrimony	<ul style="list-style-type: none"> <li>-Property Tax Rural Property</li> <li>- Great Fortunes</li> <li>-Improvement Contribution</li> </ul>	<ul style="list-style-type: none"> <li>-Transmit Tax Causes Mortis and Donations of Any Nature (Property Tax Vehicles -Improvement Contribution</li> </ul>	<ul style="list-style-type: none"> <li>- Land and Urban Property Tax</li> <li>- Real Estate Transfer Tax</li> <li>- Improvement Contribution</li> </ul>
Economic activity	<ul style="list-style-type: none"> <li>- Industrialized Products Tax</li> <li>- Tax on Financial Operations</li> <li>- Importation Tax</li> <li>- Export Tax</li> <li>- Contr. Social Security System</li> <li>- Social Integration Program</li> <li>- Contr. On Net Income</li> <li>- Contr. of Intervention of the Economic Domain</li> </ul>	<ul style="list-style-type: none"> <li>- Tax on circulation of goods and services</li> </ul>	<ul style="list-style-type: none"> <li>- Tax on Services of Any Nature</li> </ul>

Elaborated with data from the CF

What is seen in the table above is a true concentration of tax policy under the jurisdiction of the Federal Government, to the detriment of States and Municipalities. So, from the point of view of sovereign power, it is easy to conclude that the Brazilian federal pact is a fraud, since the political power to legislate on taxation, the necessary financial resources to defray the expenses resulting from the public policies elaborated under the pact of Constitution, is under the pallium of the Federal Union. Thus we can see that there is a huge concentration of power of the Federal Union over the other federative entities, blocking the independence of sovereign self-determination and, consequently, a better application of public resources and implementation of public policies in response to regional needs.

Although Brazil is a large country divided in 26 states plus the Federal District and 5,568 municipalities, 68% of all taxes collected in Brazil go directly to the federal government, which monthly redistributes a percentage to the states and municipalities.

Taking 2 random years with a bigger margin of the recent ones, we can see that the Federal Union receives the larger part of the contributions. In 2009 were 737,004.43 MR\$, constituting a 69.83% in front of the 25.59% of the states (270,046.37 MR\$) and the 4.58% (48,356.17 MR\$) of the municipalities. In 2015 it ended up like this: 57% of the collection remain in Brasília, 25% in the States and 18% in the municipalities, giving more importance to the municipalities but remaining the biggest part to the Federal Union.



Graph of the % of the collection by the different entities, elaborated with data from IBGE, 2015

#### 4.- Inequality and tax distribution

After seeing how the Brazilian tax system works, and knowing that taxation is used as an instrument of economic policy to face inequalities and making social improvements among other things, we have to take a look on how and why the funds are redistributed,

##### 4.1- Income inequality

The IBGE (Brazilian Institute of Geography and Statistics) has used different methodologies among the last years to calculate the inequality between rich and poor in Brazil. The result, however, reaffirms a national problem: the difference in income persists. This research worked with data collected in 2016, the year the country was in

an economic recession and with unemployment on rise. Due to methodological changes (which further detailed the questions about what Brazilians actually receive in a year), the institute did not compare the data with those of previous years, but according to the IBGE the bad economic scenario affected the Brazilian's income, in words of Cimar Azeredo <<In times of crisis, this inequality is accentuated>><sup>7</sup>

In 2017, the economy returned to show signs of recovery and unemployment fell from 12.8% (quarter ended in July) to 12.2% (quarter ended in October). However, most of the jobs were temporary and with precarious conditions.

In the same year, the average gain of one person included in the group of the richest 1% of the population was equivalent to 36 times of the one of a person in the poorest half of the country.

889.000, is the number of people that make up the richest 1% group, which in 2016 had an average income of R \$ 27 thousand /month.

44.4 million, is the number of people in the 50% group with the lowest income and which in 2016 earned R \$ 747 on average per month, lower than the minimum wage

0.525, is the Gini index used to measure inequality in the country in 2016. The result of 0.525 refers to the real monthly income of the Brazilian, that is, that considers everything that was received (salary, pension and retirement, among other sources).

The average real household income per capita was R \$ 1,242. As with inequality indicators, the North and Northeast still have lower income than in the other regions.

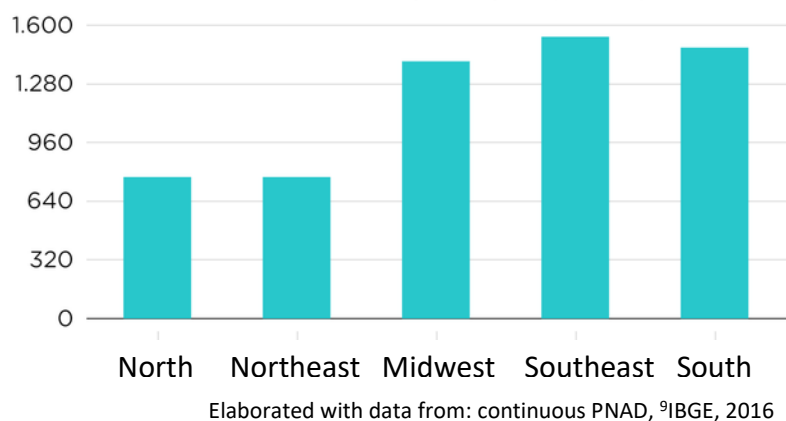
According to IBGE, informal economy helps explain the difference between regions. It also explains the fact that in the North and Northeast there are the largest number of families that depend on income transfer programs, such as *Bolsa Família*<sup>8</sup>. In the

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<sup>7</sup> Azeredo, Cimar. coordinator of Work and Income of IBGE. In an interview with Reuters. 2017

<sup>8</sup> Is a social welfare program of the Government of Brazil that provides financial aid to poor Brazilian families; and if they have children, families must ensure that the children attend school and are vaccinated.

Northeast, for example, 29.3% of the 18.3 million households receive funds passed through the federal program. According to IBGE, the Northeast is the region where the lowest percentage of income from work occurs and, on the other hand, the highest percentage of Brazilians with incomes from "other sources", which includes income transfer. This characteristic gives the dimension of the weight of care resources in family income.



## 4.2 Income transfer

In 2017 the Federal Government was in the red for the fourth consecutive year, registering a deficit of R \$ 124.4 billion, that is, expenses excluding interest on debt exceeded all tax collection in this amount. Despite the bad result, the Government was able to meet the fiscal target, since it had authorization for a diamond of up to R \$ 159 billion. But where has all the tribute money gone?

The Government raised in 2017 R \$ 1.34 trillion in taxes, but passed to States and Municipalities R \$ 228.47 billion, remaining to spend R \$ 1.11 trillion. Expenses excluding interest on debt were R \$ 1.27 trillion and divided as follows:

- 1) Social Welfare Benefits (INSS) = R \$ 557.23 billion
- 2) Personnel and Costs (salaries and pensions of federal employees) = R \$ 284.04 billion
- 3) Other compulsory expenses (such as credit, unemployment insurance, LOAS, etc.) = R \$ 185.19 billion
- 4) Other expenses = R \$ 252.54 billion

Only social welfare and personnel expenses totaled R \$ 841.25 billion, equivalent to 66% of all expenses. This is because the income differences among the Brazilian regions abovementioned underline the need of a good income transfer policies in a country that

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<sup>9</sup> *Pesquisa Nacional por Amostra de Domicílios Contínua* – PNAD, National Continuous Household Sample Survey in English, is a study that intends to analyze the quarterly fluctuations and the evolution, in the short, medium and long term, of the workforce, and other information



is one of the most efficient countries in the collection of taxes, but it is the last one putting in application of this money in benefits and improvements of the quality of life of the population. The evolution of the Human Development Index (HDI) is inversely proportional to the forcefulness with which the Government treat the taxpayer. This disparity is highlighted by the Brazilian Institute for Planning and Taxation (IBPT), in its eighth edition of IRBES, the Society's Return on Welfare Index. According to this study, currently Brazil is the 15th place among the 30 countries with a higher tax burden. But in the analysis of the volume of taxes on the Gross Domestic Product (GDP) and the HDI, the country falls to the last position. According to IRBES, the countries that best distribute their tax burdens are Ireland, the United States and Switzerland. Brazil, in the last position, is below Uruguay (10th place) and Argentina, in 18th place. Since the first edition of this study, Brazil appears as the last one, with a very high tax burden, but even Cuba surpasses it when analyzing the application of these resources for the benefit of the citizen. IRBES notes data from institutions such as the United Nations Organization and Organization for Economic Cooperation and Development. According to study coordinator and president of the IBPT, João Eloi Olenike, the study reveals that the country needs to spend better the money it takes from the taxpayer and invest in the quality of life of the citizen. In analyzing the figures released by IBPT, the political scientist and professor at the State University of Londrina (UEL) Clodomiro Bannwart, says that the gulf between what Brazil collects and what invests in the citizen reflects the lack of commitment of the politicians with the promises made during the electoral process. He focuses on the proposals of the last elections, and that there is no commitment from the candidates with these promises, and that the people do not have sovereignty, that is, they do not have the control to know if this candidate will comply with these promises, they are merely formal to win votes because there is no mechanism with penalty if they decompile those proposals. In words of the professor Fernando Zilveti;

<<We have the highest tax burden in our history, but we have not been able to close the accounts in the blue or offer a quality return to the population. It is the realization that resources are misused. By charging government spending cuts and rejecting new taxes to carry out the fiscal adjustment, the society is asking the state to reduce its size>><sup>10</sup>

However, we have to put the focus on how is made the distribution among the states. The calculation is made from the State Participation Fund (FPE). The 1988 Constitution says that the National Treasury must hand over to the states three taxes collected:

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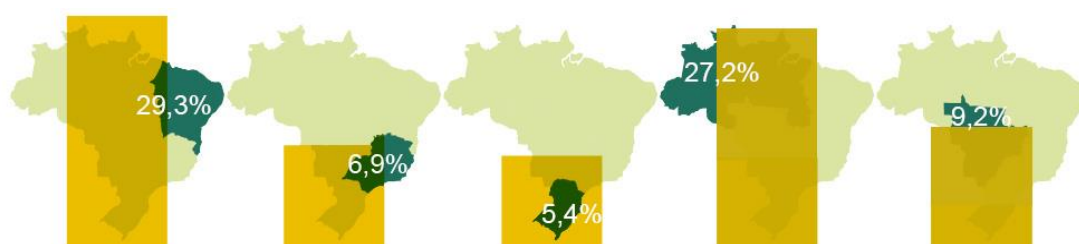
<sup>10</sup> Zilveti, Fernando, in an interview in podcast format for *rádio* CBN, 2017

Individual Income Tax (*IRPF*), Income Tax on Corporate Income (*IRPJ*) and Tax on Industrialized Products (*IPI*). The logic of the apportionment is intended to alleviate regional inequalities and promote socioeconomic balance in the different corners of the country. In practice, in order to calculate the value of the portion that each federative unit must receive, the total amount is multiplied by the individual coefficient of each state - the largest portion is destined to the least developed, those with more inhabitants and lower per capita family income. Of the 26 states plus the Federal District, 11 are federal taxpayers, that is, they pay a lot more than they receive back, while another 15 are recipients, that is, they receive more federal resources than they sent in taxes to the Union. Paying States are mostly in the Midwest / South / Southeast of the country, with exceptions of Pernambuco and Amazonas.

The other States are recipients and receive almost 400% more resources from the Federal Government than they paid in taxes by their own.

### 4.3 Bolsa Familia Program

Another tool that can be taken as an indicator is the *Bolsa Família*, described in *The Economist* as an "anti-poverty scheme". According to the data from IBGE, of the 69.2 million households in Brazil, 14.4% receive funds from it.



Elaborated with data from IBGE, 2017

According to the survey, the proportion of homes in the Northeast that received *Bolsa Família* was 29.3%, which represents almost one in three households. This proportion was also high in the North region (27.2%). The ratio was lower in the Midwest (9.2%), Southeast (6.9%) and South (5.4%). Maranhão was the federation unit with the highest proportion, 38.53%. The lowest was Santa Catarina, 3.46%. Through a series of comparative data, research has shown that *Bolsa Família* is, in fact, focused on lower-income families, as is their goal. The households with the presence of the social program had a mean per capita income of R \$ 311 (already including the benefit), well below the R \$ 1,466 of households without the program. In homes with *Bolsa Família*, there are an average of 4.8 people. For those who do not receive income from the program, the average is 3.4 people.

In general, there is a virtually consensus that the PBF fulfills one of its objectives - to promote the immediate alleviation of poverty through the direct transfer of income to the family. Dozens of articles studied confirm this contribution of the program. The contribution of the Bolsa Família Program to poverty reduction has also been confirmed by data from the National Household Sample Survey (Pnad) and the Institute of Applied Economic Research (Ipea). The 4th National Report on the Follow-up of the Millennium Development Goals indicates that extreme poverty fell from 12% in 2003 to 4.8% in 2008. According to Soares et al. (2010), the Bolsa Família Program is responsible for 21% of the reduction in the Gini Index.

Many studies along the years since the application of this income transfer plan such as those carried out by the International Bank for Reconstruction and Development (IBRD, 2006), the Institute for Economic and Agricultural Research (IPEA, 2011) and the Getúlio Vargas Foundation (FGV, 2005). Brazilian Institute of Geography and Statistics (IBGE, 2008), show a decline in poverty and social inequality in Brazil. Overall, studies credit such changes to currency stability, recent declines in unemployment, and Income Transfer Programs for their expansion and greater focus on the poor.

During these years, analyzing the financial impact of the program, were made different studies, the main one, conducted by IPEA (2011) found that 56% of spending on government social programs is returned to the public coffers through tax collection. The report says that the largest multiplier of Gross Domestic Product - GDP and household income belongs to the BFP. For each R \$ 1.00 spent on the program, GDP will increase by R \$ 1.44 and household income by 2.25%, after having covered the whole cycle of income multiplication in the economy. The report concludes that the PBF generates more economic benefits than it costs and this benefit is twice as great as the benefit generated by the payment of interest on public debt (IPEA, 2011).

Study done by the economist João Rosinke<sup>11</sup> (2011), shows that public policies of redistribution of income help in the economic and social development of the country. These actions help the economy in times of crisis and serve as tools to maintain the level of consumption. The authors point out that, for the economy of some municipalities, the Bolsa Família Program represents a significant part of the local economy and concludes that, from an economic point of view, the results are positive, given that it has increased the propensity to consume of Brazilian society and contributed to reduce income inequality among families.

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<sup>11</sup> Rosinke, João G. Efeitos sociais e econômicos para o desenvolvimento local através das contribuições do Programa Bolsa Família no município de Sinop-MT in the period from 2004 to 2009. Revista Interações, Campo Grande, v. 12, n. 1, p. 77-88

However, in a study made by the economist Maria C. Ferreira<sup>12</sup>, point to the fact that federalism plays a double role in promoting the welfare society. It can on the one hand support intergovernmental policies and programs, such as the successful case of the PBF against extreme poverty, but on the other hand, may induce small municipalities to make less effort to raise tax revenue and improve the quality of life of the population. Another weak point is the so called "feast today, famine tomorrow", despite the program stimulates the consume in addition to the reduction of the extreme poverty, according to the IBGE, the north and the northeast, the two main beneficiaries of the program, present a bigger economic slowdown regarding to the GDP, -4,6% while the national mean was -3,3%, maintaining similar figures the following years.

## 5.- Criticisms and final considerations

Since the enactment of the supreme law, began the flood of criticism, both by physical and legal persons. The first critic it has to do with complexity of the system; there are more than 3000 federal tax rules and thousands of standards of the 26 States, Federal District and the 5564 Municipalities.

According to Maria Lucia Fattorelli Carneiro<sup>13</sup>, President of UNAFISCO NACIONAL, <sup>14</sup>

<<The National Tax System has not fulfilled its redistributive function, but has always been a highly regressive and income-generating system. Taxation in Brazil mainly affects work and consumption, while capital income and wealth are not taxed according to the capacity of their holders. Contrary to the developed countries where most of the revenue comes from taxes on income and wealth, in Brazil about two-thirds of the taxes come from taxation on consumption, even for products intended for basic survival, such as food, medicines and personal care products. >>

She also criticizes, the rapid growth of the amounts collected through contributions, created after the CF / 88 and not always shared with the states and municipalities, <<generating serious distortions and wounding the federal pact.>>

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<sup>12</sup> Ferreira, Maria C. Evaluation of the Brazilian Family Grant Program: a quasi-experimental study in the State of Rio de Janeiro. *Revista Psicologia: Reflexão e Crítica*, Porto Alegre, v. 25, n. 4, p. 719-729, jan. 2012.

<sup>13</sup> Attorelli, Maria Lucia, *A Proposta da Reforma Tributária*, Unafisco Sindical, 05.09.2003.

<sup>14</sup>Unafisco - National Association of Tax Auditors of the Brazilian Federal Revenue Service - is the national association that represents the Federal Revenue Auditors.

Study of the Economic and Social Development Council - CDES<sup>15</sup> concludes that the STN is unfair and perverse, with five interrelated problems:

- Regressivity and poorly distributed tax burden:

The CDES records that Brazil has moved in a direction contrary to fiscal justice. The principle of equity has not been observed in taxation and in the distribution of resources collected. Thus, in 2004, people who received up to 2 minimum wages committed 48.8% of their income with the payment of taxes, while those with incomes greater than 30 minimum wages only accounted for 26.3% of income. Injustice also occurs in the high share of indirect taxes (IPI, ICMS, COFINS, ISS, II) (incidents on production and consumption) in total collection (15.6% of GDP or 46.1% of total collected). These taxes do not have transparency / visibility, spreading the belief that the most needy population would not pay taxes. As a result, compensatory policies are seen as favoritism or blessings. Meanwhile, direct taxes levied on income and property (*IR, IPTU, IPVA, ITR, ITBI, ITCD*) account for only 8.2% of GDP or 24.0% of the total burden.

- Low social return in relation to the tax burden.

The STN is also unfair because the social return is low. Injustice is also translated into higher taxation of labor in relation to capital, the large number of taxes, the persistence of cascading taxes, excess taxation on the payroll, the enormous bureaucracy, the inefficiency of the mechanisms for exempting exports and investments. It is also unfair because the distribution of the product collected to the federated entities does not comply with equity. The CDES records comments and conclusions from studies conducted by CNI, the Ministry of Finance, IFAP and the World Bank. According to the CNI, 74% of the exporting companies affirm that the STN damages the competitiveness of the national products and for 44% of them the accumulation of credits affects the decision to export. Data from the Ministry of Finance indicate a stock of unsettled credits of ICMS, COFINS, PIS of 1.3% of GDP, concentrated this value in the sectors exporting and capital goods. According to the data provided by Ipea - *Instituto de Pesquisa Econômica Aplicada* (Institute of Applied Economic Research), <sup>16</sup>in Brazil a standard company spends 2600 hours per year to collect its taxes on sales, salaries and profits, against less than 500 hours per year in most of the economies with which the country

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<sup>15</sup> Conselho de Desenvolvimento Econômico e Social – CDES, *Indicadores de Equidade do Sistema Tributário Nacional, Relatório de Observação Nº 1*, Brasília, junho de 2009.

<sup>16</sup> CDES, *Indicadores de Equidade do Sistema Tributário Nacional, Relatório de Observação Nº 1*, Brasília, junho de 2009, página 27.

competes in the world market. The bureaucracy deriving from the STN consumes 7.0% of the administrative time of the Brazilian companies against 4.1% of the Latin American ones. There are also problems stemming from legal uncertainty, caused by frequent changes in legislation and excessive demands, linked to ancillary obligations. Simple requires no less than 6 fiscal or accounting books in addition to other ancillary obligations.

- Productive activity and job creation are discouraged by taxation.

The high taxation on payroll (from 42.3% to 50.8% of wages) leads to informality, reducing the possibility of investments in labor qualification, which impairs productivity. It also detracts wages and causes unemployment.

- The federal pact is inadequate in relation to its tax responsibilities, responsibilities and territoriality.

As it is abovementioned, the Federation must comply with the principles of subsidiarity and equity. Public policies should preferably be implemented by municipalities (local sphere). Every citizen is entitled to the same level of public services (equity).

The STN is characterized by federative inequity, that is, there is no correlation between the needs of resources and the transfers actually carried out.

There is no correlation between the intergovernmental transfers per capita and the HDI of the municipalities, in 2007 for example, the highest per capita budget of Brazilian municipalities was 10 times higher than the lowest before intergovernmental transfers. After the transfer, the difference becomes 41 times higher. That is, transfers are aggravating disparities rather than mitigating them. There is no correlation between the intergovernmental transfers per capita and the HDI of the municipalities.

- There is no tax consciousness

Citizens do not feel enthusiastic about paying taxes. There is no awareness that these are necessary to meet the burdens of the state. Taxpayers often fail to comply with their tax obligations and fail to oversee the fulfillment of their tax obligations by other citizens. All this is a consequence of a series of mistakes, among which we can mention the embezzlement of public money, the lack of visibility regarding the sources and applications of resources, the low social return, reflected in the lack of attendance to the priority needs of society, the worsening of inequalities between people and regions and deficiency in the simple and accessible information on the STN.

All in all, the main criticism, has to do with the inefficiency as a corrective tool of the persistent inequality. Analyzing the tax collection in Brazil, by taxation bases (consumption, income, wealth, payroll and financial operations), we can see which sectors have contributed more with the financing of the State. The tax rate is very concentrated in consumption (15.2% of GDP in 2008), followed by income (7.8%) and payroll (6%), while taxation on financial operations (0, 7%) and on equity (1.1%) is very low. That is, recent tax reforms have accentuated an anomaly in Brazil: increasing taxation on consumption over income taxation, aggravating inequality or, at least, not allowing a greater reduction of income inequality. If we look at what happens in other countries compared to Brazil, we find the following: those with higher income per capita tend to tax income more than consumption. The collection of social security taxes is very important in the countries with the highest income (probably due to the higher life expectancy), becoming the main source of income in Germany, France, Spain and Japan.

### **5.1 Possible improvements**

The possible solutions go through the collection of taxes and the distribution of these. Following the logical order, we have to start with the collection process; one tax that could help to improve the inequality situation in Brazil, is the tax on great fortunes. This tax, although foreseen in CF / 88, article 153, item VII, until today, after more than 20 years of its promulgation, has not yet been instituted. The measure depends on complementary law. This is a direct tax, ideal to promote redistribution of income and its implementation is justified especially in a country like Brazil, marked by huge social differences, tenth country with the worst income distribution in the world. Several countries have already adopted this type of tax, including France, Germany, Switzerland, Spain, India, Sweden, Finland, Iceland, Norway, Denmark, Luxembourg and Austria, with rates ranging from 0.5% to 5.0 %.

The reasons that Olavo Nery Corsatto<sup>17</sup> give for the implementation would be justified by:

- The asymmetry and perversity of the distribution of income and wealth in Brazil;
- The need to promote fiscal justice;
- The amount of taxpayers, limited and small, facilitating the collection and control of the tax;
- To serve as a subsidy for the control of IR and other taxes on equity.

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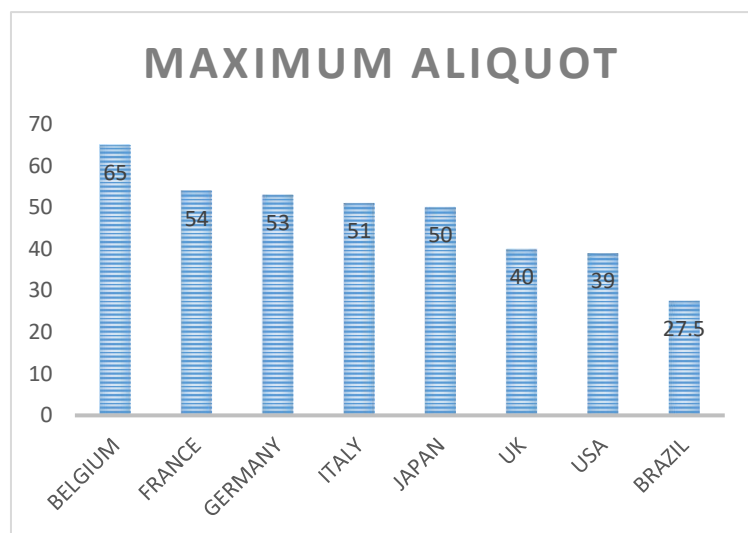
<sup>17</sup> ORSATTO, Olavo Nery, tax on great fortunes, april/june 2000, Senado Federal.

- Its usefulness in combating tax evasion, which would give it fiscal justice;
- Of its institution to give effect to a constitutional provision.

Another possible measure is to increase the number of aliquots and their progressivity in *IRPF*. A study made by Price Waterhouse Coopers justifies it., involving 26 countries in Europe, Asia and the Americas, including Brazil, revealed that the *IRPF* has 5 income ranges and rates that range from 12.6% to 42% 2%. Brazilians range from 7.5% to 27.5%. The OECD <sup>18</sup>carried out a constant survey of the following graph, which indicates the maximum rates of income tax in different countries.

The IR, as an instrument of redistribution of income is very poorly used in Brazil. Among Brazilians, *IRPF* tax revenues reach 1.6% of GDP or 4.7% of the total tax burden against 10.0% of GDP and 26.5% of the total tax burden in the OECD.

Another improvement that could be made has to do with tax evasion. According to a study of Tax Justice Network<sup>19</sup>, Brazil ranks second among the five countries identified in it, with 39% "shadow economy" – just below Russia in this category - and a tax evasion equivalent to 13.4% of its GDP .In short, only the United States surpasses the Brazilian economy that resigns some US \$ 280 billion dollars annually in evasion.



Elaborated with data from elaborated OECD

<<All Brazilian offshore engineering is growing clearly and is beginning to come to light: one example is the large-scale scam to the treasury through the widespread corruption of public officials in actions and lawsuits against non-compliant taxpayers that was discovered recently and that -according to some

<sup>18</sup> OECD - Substantiation of the Tax Reform.

<sup>19</sup> Is an independent coalition of researchers and activists concerned about the alleged harmful effects of tax evasion, tax competition and tax havens.



sources- would have a global volume even higher than the cases of corruption in Petrobras>><sup>20</sup>

The social problems arising from tax evasion are also known. It reduces tax revenues, subtracts resources for education, health, safety and sanitation, impedes social projects, implies illicit enrichment of the evader, unfair competition with honest taxpayers, damages the country's economy, generates corruption among other serious losses.

For the effective fight against tax evasion, the fiscal administration must be strengthened, modernized and preserved from political influence.

Sanctions should be applied strictly to evaders. In some cases this requires a legislative change, such as in the device that allows the evader to exempt himself from the criminal penalty by paying the tax. (Law no. 8137/90, article 2, subsections III and V).

Another solution passes through setting up new criteria for the distribution of resources collected between Brazilian states and municipalities. The CF / 88 determines the transfer of funds collected between the entities of the Federation. The Union transfers resources to States and Municipalities. The States, in turn, pass on to the municipalities. These transfers have served to increase inequalities, especially among Brazilian municipalities, when the constitutional legislator intended the opposite. (CF, Title I, Two Fundamental Principles, Article 3 - They are Fundamental objectives of the Federative Republic of Brazil: III - Eradicate poverty and marginalization and reduce social and regional inequalities). The resources must correspond to the expenses of the federated entities. A strong, democratic and just Federation must obey the principles of equity (any citizen is entitled to a minimum of public services) and subsidiarity (privileging the local spheres of government) and is not what is happening. The most striking figure according to IBGE appeared in 2007, the country's highest municipal per capita budget was forty-one times larger than the lowest, considering transfers. With the withdrawal of these intergovernmental transfers, this proportion dropped to 10.

However, the political measures that are gaining ground, are the ones presented in Bolsonaro's political roadmap that have the approval of the IMF. In words of Krishna

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<sup>20</sup> Gaggero, Jorge founding member of the TJN in Latin America and researcher of CEFID-AR, in an interview with BBC

Srnivasan<sup>21</sup>, <<For now what we have heard of reforms, are going in the right direction.>>

Brazil's President-elect Jair Bolsonaro is analyzing three models of reform for the tax system: a gradual adjustment program, the application of a value added tax or a broader plan that includes a tax on financial transactions. The main one, the VAT was embraced during the campaign by the two candidates who competed in the second round: Fernando Haddad and Jair Bolsonaro. However, it is a regressive tax since it imposes the same burden on both the highest income and the poorest. The objective, said by the president's government team, is to achieve at least a fiscal adjustment of 5% of GDP. Assume that this way you can transform the current deficit, 2% of GDP, into a surplus of 3%.

Hence, it is obvious that there is a need to reform the fiscal system, that is even seconded by the two extremes of the political spectrum, in order to achieve a more equal society and enforce the federal system, complying with the principles of subsidiarity and equity.

According to Kyle Pomerleau<sup>22</sup>, director of the Center for Quantitative Analysis of the Tax Foundation, Estonia has the most efficient and competitive tax system in the OECD and the rest of the world. It has a flat tax of 20%, so that this section is the only one that is applied in the IRPF, from a minimum exempt. In addition, this income tax only applies to labor income, not to income from capital. Secondly, Estonia also has a flat tax of 20% on Corporate Tax, which is also paid only when there is a distribution of dividends, leaving reinvestments of profits free of taxation.

On the other hand, Ireland has a unique system. Estonia is probably the most coherent system, but Ireland has the most aggressive in terms of Corporate Tax. Its tax model is perfectible in many aspects, but in business taxation they have adopted 12.5%, which has generated billions of investments. In addition, they have a reduced rate of 6.25% applied to the benefits generated by patents.

Therefore, Brazil, in addition to the measures abovementioned, it could also have a reform such as the one of Ireland with the patents to attract a large number of investors, and benefit from the money that comes with them. Such measures and a continuous

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<sup>21</sup> Krishna Srivasan, deputy director of the IMF's Western Hemisphere Department after presenting the regional report on Latin America at the Inter-American Dialogue Studies Center

<sup>22</sup> POMERLEAU, Kyle in a conference at the Europe Liberty Forum of ATLAS Network about the tax landscape in the United States and other OECD countries.

fight against corruption could lead to substantial improvements in both the short and long term. What would also mean an improvement in the country's endemic problems such as high crime rates and could restore confidence in politics and the financial system to a citizenship that feels disregarded.

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