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VAT in a federal structure: the feasibility of implementation of a single, broader-based VAT in Brazil, within the parameters of the EU VAT model

by

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Summary

The Brazilian tax system is known to be very complex. The main reasons to that is presumably the fact that the federalist pact adopted by the Brazilian Federal Constitution gives a considerable autonomy to all federal entities (the federal government, the states, the Federal District and the municipalities) to impose levies. Besides that, the Brazilian tax system is composed by numerous levies, such as taxes, fees, special assessments, contributions and compulsory loans. Naturally, the consumption tax system is not different. Consumption in Brazil is taxed through different levies that are imposed by all federal entities. Therefore, a reform of the consumption tax system is often on the agenda but was never implemented. The European Union, on the other hand, has succeed with the implemention of a general, broadly-based and non-cumulative value added tax that is charged mainly at the destination. This thesis will perform, firstly, an analysis of both Brazilian and European consumption tax system to, finally, critically compare them. The aim is to examinate whether the implementation of a single and broader-based consumption tax in Brazil, within the parameters of the European value added tax, is feasible based mainly on an evaluation of the basis of assessment, the method of calculation, the rate system and the place of supply rule adopted by both consumption tax systems.

Abbreviation list

AG	Advocate General
BRL	Brazilian Real
CJEU	Court of Justice of the European Union
CIDE	Contribuição de Intervenção no Domínio Econômico (Contribution for Intervening in the Economic Domain)
CIF	Cost, Insurance and Freight
COFINS	Contribuição Social para Financiamento da Seguridade Social (Contribution for Social Security Financing)
CONFAZ	Conselho Nacional de Política Fazendária (National Council of Fiscal Policy)
COSIP	Contribuição sobre o Serviço de Iluminação Pública (Contribution for the Public Lighting Service)
EU	European Union
First VAT Directive	First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes
FPE	Fundo de Participação dos Estados (States' Participation Fund)
FPM	Fundo de Participação dos Municípios (Municipalities' Participation Fund)
GATT	General Agreement on Tariffs and Trade
GNP	Gross National Product
IBGE	Instituto Brasileiro de Geografia e Estatística (Brazilian National Bureau of Statistics)
ICMS	Imposto sobre a Circulação de Mercadorias e a Prestação de Serviços de Transporte Interestadual e de Comunicação (Tax on the Distribution of Goods and the Rendering of Communication and Interstate Transportation Services)
IE	Imposto sobre a Exportação de Produtos Nacionais ou Nacionalizados (Export Tax)
IGF	Imposto sobre Grandes Fortunas (Wealth Tax)
II	Imposto sobre a Importação de Produtos Estrangeiros (Import Tax)

IOF	Imposto sobre Operações de Crédito, Câmbio e Seguro, ou Relativas a Títulos ou Valores Imobiliários (Tax on Financial Transactions)
IPI	Imposto sobre Produtos Industrializados (Tax on Industrialized Products)
IPTU	Imposto sobre a Propriedade Predial e Territorial Urbana (Tax on Real Property)
IPVA	Imposto sobre a Propriedade de Veículos Automotores (Tax on Motor Vehicle Ownership)
IR	Imposto sobre a Renda e Proventos de Qualquer Natureza (Income Tax)
IRAP	Imposta Regionale sulle Attività Produttive (Regional Tax on Productive Activities)
ISS	Imposto sobre Serviços de Qualquer Natureza (Tax on the Provision of Services)
ITBI	Imposto sobre a Transmissão de Bens Imóveis "Inter Vivos" (Tax on Real Estate Transfers)
ITCMD	Imposto de Transmissão Causa Mortis e Doação de Quaisquer Bens ou Direitos (Tax on Estates and Gifts)
ITR	Imposto sobre a Propriedade Rural (Rural Property Tax)
MFF	Multiannual Financial Framework
Sixth VAT Directive	Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes
p	Page
pp	Pages
para	Paragraph
paras	Paragraphs
PIS	Programa de Integração Social (Social Integration Program)
TEC	Treaty Establishing the European Economic Community
TFEU	Treaty on the Functioning of the European Union
TIPI	Tabela de Incidência do Imposto sobre Produtos Industrializados (Table of Incidence of Tax on Industrialized Products)
VAT	Value Added Tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

1. Introduction

1.1 Background

The history of intergovernmental fiscal relations in Brazil has been marked by alternating phases of decentralization and recentralization. The period of the dictatorship, from 1964 to 1985, was characterized by strong centralist tendencies, with a clearly dominant role of the federal government in the management of public resources. The democratization process, culminating in the enactment of the 1988 Federal Constitution, was accompanied by a resurgence of decentralization trends, with a high degree of control over revenue sources being conferred to the states (including the Federal District) and the municipalities.[1]

The Brazilian 1988 Federal Constitution foresees, already in its first article, the adoption of the federalist system by the country. The federal government, twenty-six states, a Federal District and numerous municipalities compose the Brazilian Federation, all of them with tax competences assigned constitutionally. The Brazilian tax system is also designed in the Constitution, which sets forth the existence of five different levies that can take the form of taxes, fees, special assessments, contributions or compulsory loans. This has led to the acknowledgement of the Brazilian tax system as a very complex one.

Naturally, the taxation of consumption is not different. Consumption in Brazil is taxed through different levies imposed by all levels of government. The federal government has competence to impose a tax on the sale of domestic and imported manufactured goods, the IPI; two social contributions imposed on imports and enterprises' gross receipts, the PIS and COFINS; and a contribution for intervening in the economic domain, the CIDE-fuel, imposed on the sale and importation of fuels. The states and the Federal District impose a tax on the supply of goods and certain services, the ICMS. Finally, a tax is imposed by the municipalities on the supply of the remaining services not covered by the state ICMS. Such a complex consumption tax system leads, among others, to high costs with compliance and a burdensome administration, preventing the development of the national economy. Due to its numerous flaws, a reform of the Brazilian consumption tax system is constantly on the agenda. However, despite the proposition of numerous constitutional amendments since the promulgation of the 1988 Federal Constitution, not much has been done in that regard.

The Brazilian state tax imposed on the value added, the ICMS, was originally influenced by the then-existing French value added tax (VAT), since the Brazilian tax was implemented before the European Economic Community harmonized their VAT system, and only France had a value added tax effectively in place.[2] France is now a Member State of the European Union and the latter taxes consumption through a general,

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[1] Teresa Ter-Minassian, 'Brazil' in Teresa Ter-Minassian (ed.), *Fiscal Federalism in Theory and Practice* (Washington, International Monetary Fund 1997), p 438.

[2] Victoria P Perry, 'International Experience in Implementing VATs in Federal Jurisdictions: A summary' (2009) American Tax Policy Institute Conference on Structuring a Federal VAT: Design & Coordination Issues, pp 5-6.

broadly-based and non-cumulative value added tax that is taxed mainly at the destination. The tax is furthermore fiscal neutral, which ensures the functioning of the internal market, and consequently the free movement of goods and services within the European Union.

1.2 Purpose

The purpose of this thesis is to determine whether the replacement of the levies currently imposed on consumption in Brazil with a single and broader-based value added tax, within the parameters of the European VAT model as it stands, is feasible based on an evaluation of the basis of assessment, the method of calculation, the rate system and the place of supply rule adopted by both consumption tax systems.

For that reason, I will raise the question whether the introduction of a single and broader-based value added tax in Brazil, within the parameters of the European value added tax, is feasible.

1.3 Method and material

In order to answer the question that have been raised, this thesis will use the traditional comparative law method, by studying the similarities and differences between the tax consumption systems as it stands today in Brazil and in the European Union. Experience in this field has demonstrated that it is adequate to first present the relevant legal provisions without judgment as a basis for a critical comparison.[3]

The analysis of the Brazilian consumption tax system will be based in the constitutional legislation current in force in that jurisdiction, namely the 1988 Federal Constitution and the constitutional amendments as well as in infra-constitutional legislations, that is to say, the legislations hierarchically under the 1988 Federal Constitution, such as complementary laws, ordinary laws, decrees and senate resolutions.

The analysis of the consumption tax system of the European Union will be based on sources of primary and secondary law, such as Treaties, regulations, directives, decisions and communications. Furthermore, the CJEU case law will be utilized to demonstrate the position of the latter regarding the existence of other turnover taxes in the European Union carrying the characteristics of a value added tax.

Articles, literature, conference and working papers will complement the analysis and the critical comparison of both systems. Besides, an English version of the 1988 Brazilian Federal Constitution available at the Federal Supreme Court's website was used to guarantee that the source can be reviewed.

1.4 Delimitation

The Federalism was introduced in Brazil with the proclamation of the republic in 1889. This thesis will, however, focus on the federalist structure

[3] Konrad Zweigert and Hein Kötz, 'Introduction to Comparative Law' (3rd ed., Oxford, Clarendon Press 1995) pp 4-6.

in force in Brazil since the promulgation of the latest Constitution, the 1988 Federal Constitution.

Regarding the Brazilian tax system, this thesis will focus solely on the consumption levies, namely, at the federal level, the tax imposed on the sale of imported and domestic manufactured goods (IPI); the two social contributions imposed on imports of goods and services as well as on enterprises' gross receipts (PIS and COFINS); and the contribution for intervening in the economic domain imposed on the importation and commercialization of fuels (CIDE-fuel). At the state level, the tax charged on the distribution of goods and the rendering of certain types of services (ICMS). Finally, at the local level, the tax imposed on the services that are outside the scope of ICMS (ISS). The aforementioned analysis will focus merely on the basis of assessment, the rate system and the method of calculation adopted by each levy.

Regarding the European tax, this thesis will exclusively address the character of the European value added tax; the own resources of the European Union system; the VAT rate system; and finally the destination principle.

1.5 Outline

This thesis is divided into five main sections. The introduction is followed by the second chapter, which clarifies how the adoption of the federalist regime by Brazil designed the tax system of the country as it is nowadays, with various different levies being imposed by the three levels of government. It touches upon the federal entities and the system of competence divisions between them; it enumerates the type of levies currently in force in the Brazilian Constitution; and finally, it lists the main limitations to the exercise of tax powers by the federative entities.

The third chapter enumerates the levies imposed on consumption in Brazil, dividing them between the different levels of government to which they pertain, in other words, this chapter will firstly list and explain the levies imposed by the federal government, secondly the tax levied by the states and the Federal District, and finally the tax imposed by the municipalities. The chapter provides mainly the basis of assessment, the rates system and the method of calculation adopted by each levy.

The fourth chapter focuses on the value added tax as it stands nowadays in Europe. The chapter describes the reason behind the adoption of a single and broader-based valued added tax by the European Union as well as provides the concept and the method of calculation of VAT liability. It also refers to the own resources of the European Union system, which utilizes VAT as a revenue source to the EU budget; the VAT rate system; and finally, the destination principle.

The fifth chapter will provide a comparison of both European and Brazilian consumption tax systems, focusing in the fiscal capacity of their taxes; whether they are neutral with regard of competition between Member States, Member States and third countries, and between the Brazilian federal entities; whether the method of calculating the European tax and the Brazilian levies is advantageous in the sense that it avoids cumulativity; and

finally, it will focus in the rates systems. This chapter will be followed by the conclusion of the author.

2. Federalism in Brazil

2.1 The federal entities

According to Article 1 of the 1988 Federal Constitution, the Federative Republic of Brazil is formed by the indissoluble union of the states, the Federal District and the municipalities. In that sense, Article 18 of the aforementioned Constitution is even more specific by stressing that the political and administrative organization of the Federative Republic of Brazil comprises the federal government, the states, the Federal District and the municipalities, all of them autonomous.

As foreseen under its Constitution, Brazil is a Federative Republic composed by autonomous federal entities. The federal entities comprehend the federal government, the twenty-six states, the Federal District,[4] and the municipalities,[5] all of them with tax competences assigned constitutionally. In that way, the 1988 Federal Constitution lays down a complex system of competence divisions between the federative entities. While several functions are exclusively assigned to the federal government,[6] to the states[7] and to the municipalities,[8] many other responsibilities are assigned concurrently to the different levels of government.[9]

2.2 The tax assignment system

The 1988 Federal Constitution also adopts a rigid and detailed tax assignment system. The Brazilian tax system comprehends several levies, namely taxes, fees, special assessments, contributions and compulsory loans.

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[4] The Federal District is neither a state nor a municipality but rather has its own juridical profile. It can impose the taxes assigned to both states and municipalities. However, its competence is restricted by the federal government which, according to Article 21(XIII) and (XIV) of the 1988 Federal Constitution, shall have the power to organize and maintain the Judicial Power, the Public Prosecution and the Public Legal Defence, and the plainclothes police, the uniformed police force, and the uniformed fire brigade of the Federal District, as well as to provide financial support to the Federal District for the carrying out of public services by means of a specific fund.

[5] Of particular interest is the fact that the municipalities have also been granted the status of a federative entity in the 1988 Federal Constitution, differently from other federal constitutions, which typically define the municipalities as creatures of their respective states. According to the Brazilian National Bureau of Statistics (IBGE), in 2013 the number of municipalities across Brazil accounted to 5,570.

[6] Such as national defence, financial sector regulation, currency issuance, energy, mining, foreign relations and telecommunications. See, Articles 21 and 22 of the 1988 Federal Constitution.

[7] Such as natural gas delivery. See, Article 25 of the 1988 Federal Constitution.

[8] In general, local public services, such as public transportation. See, Article 30 of the 1988 Federal Constitution.

[9] Such as health care, social security, education, agriculture, sanitation, housing, natural resource management, law enforcement and environmental protection. See, Articles 23 and 24 of the 1988 Federal Constitution.

2.2.1 Taxes

According to Article 16 of the National Tax Code, taxes are levies unrelated to any specific public service delivery and as such are destined for financing general government activities. Article 145(1) of the 1988 Federal Constitution lays down that taxes are based on the ability-to-pay principle, being graded according to the economic capacity of the taxpayer.

Article 153 of the 1988 Federal Constitution establishes which taxes are to be assigned to the federal government,[10] among others, the tax imposed on the sale of domestic and foreign industrialized products (IPI). Article 155 of the 1988 Federal Constitution lists the taxes assigned to the states and to the Federal District,[11] with the tax imposed on the distribution of goods and the rendering of communication and interstate transportation services (ICMS) being one of them. Finally, Article 156 lists the taxes assigned to the municipalities,[12] with the tax on the provision of services (ISS) under its scope.

2.2.2 Fees

Fees are also considered levies under the Brazilian Federal Constitution. However, differently from taxes, fees are connected to specific governmental actions directed towards the taxpayer and as such based on the benefit principle. According to Article 145(II) of the 1988 Federal Constitution, they are generally assigned to all levels of government.

Furthermore, fees can be assessed either on the exercise of police power or on the provision of specific and divisible public services, rendered to the taxpayer or made available to him. The most commonly enacted fees in Brazil are, among others, sewer fees, water supply fees, waste collection fees, postal service fees and national identification service fees.

2.2.3 Special assessments

Special assessments are also levies under the Brazilian Federal Constitution. As foreseen in Article 145(III) of the latter, special assessments are assigned to all levels of government. According to Article 81 of the National Tax Code, the federal government, the states, the Federal District or the municipalities may levy special assessments to fund its own public work which resulted in a gain in value of real estate. Special assessments are rarely levied in Brazil, presumably due to the extensive list of prerequisites imposed by Article 82 of the National Tax Code.[13]

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[10] The federal government has the power to impose the following taxes: import tax (II), export tax (IE), income tax (IR), tax on industrialized products (IPI), tax on financial transactions (IOF), rural property tax (ITR) and wealth tax (IGF), being the later not yet enacted by Congress.

[11] The states and the Federal District shall impose the following taxes: tax on estates and gifts (ITCMD), tax on the distribution of goods and the rendering of communication and interstate transportation services (ICMS) and tax on motor vehicle ownership (IPVA).

[12] The municipalities are liable to impose the following taxes: tax on the provision of services (ISS), tax on real property (IPTU) and tax on real estate transfers (ITBI).

[13] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 660.

2.2.4 Contributions

Contributions are another type of levy and, in general, fall under the competence of the federal government, the exception being the first paragraph of Article 149 of the 1988 Federal Constitution, which makes a narrow concession to the states, the Federal District and the municipalities, allowing these federative entities to collect social contributions from state and municipal public servants in order to fund their social security schemes.

There are three types of contributions, namely the social contributions,[14] market intervention contributions[15] and contributions on professional and economic categories.[16] Furthermore, the constitutional amendment 39/02 amplified the municipalities and the Federal District competences by adding Article 149-A to the 1988 Federal Constitution which sets forth that the municipalities and the Federal District may establish a contribution to finance the public lighting service which may be charged to the consumer's electricity bill, the COSIP.

2.2.5 Compulsory loans

Finally, according to article 148 of the 1988 Federal Constitution, the federal government has exclusive competence to institute compulsory loans to meet extraordinary expenses resulting from public calamity, foreign war or the imminence thereof, and in the case of public investment of an urgent nature and relevant national interest. This type of levy has not been implemented after the promulgation of the 1988 Federal Constitution, presumably due to its narrow financing goals, its refundable nature and the significant limitation of the complementary law requirement.[17]

2.3 Limits to the exercise of tax powers

Aiming the national coordination of subnational levies, constitutional framers also decided to stipulate certain hindrances to the exercise of tax powers. For instance, the 1988 Federal Constitution prohibits the federal entities to impose levies without a law establishing it (Article 150(I)); to impose taxes on one another's services (Article 150(VI)(a)); precludes the federal governmental to institute exemptions from taxes within the powers of the states, of the Federal District, or of the municipalities (Article 151(III)); and forbids the states, the Federal District and the municipalities to impose discriminatory levies on goods and services by reason of their origin or destination (Article 152).

Complementary laws also play an important role as a limitation to the exercise of the tax powers by the federative entities. For instance, the institution of some levies, such as the compulsory loans,[18] the wealth tax,[19] the residual tax[20] and the contributions laid down in Article 149, are limited

[14] Such as PIS and COFINS.
[15] Such as CIDE-fuel.
[16] Such as the Brazilian Bar Association dues.
[17] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 661.
[18] Article 148 of the 1988 Federal Constitution.
[19] Article 153(VII) of the Federal Constitution.
[20] Article 154(I) of the 1988 Federal Constitution.

to the enactment of a complementary law. This special legislative process, to be passed, requires, according to Article 69 of the 1988 Federal Constitution, approval by an absolute majority of members from both houses of Congress, the House of Representatives and the Senate. The two main complementary laws in force are the National Tax Code[21] and the Fiscal Responsibility Act.[22]

Senate Resolutions are also important when dealing with the limitation of tax powers. By way of illustration, regarding ICMS, the 1988 Federal Constitution foresees that a resolution of the Federal Senate shall establish the rates that apply to interstate transactions (Article 155(2)(IV)) and the minimum and maximum rates for intra-state transactions (Article 155(2)(V)(a) and (b)).

3. Levies on consumption of goods and services in Brazil

In Brazil, consumption is taxed through several levies that are imposed by all levels of government. The most relevant ones are, at the federal level, the tax imposed on the sale of imported and domestic manufactured goods (IPI); the two social contributions imposed on imports of goods and services as well as on enterprises' gross receipts (PIS and COFINS); and the contribution for intervening in the economic domain imposed on the importation and commercialization of fuels (CIDE-fuel). At the state level, a tax is charged on the distribution of goods and the rendering of certain types of services (ICMS). The services that are not subject to ICMS fall under the scope of the municipal tax (ISS).

3.1 Federal levies

3.1.1 IPI

According to Article 153(IV) of the 1988 Federal Constitution, the federal government is the federative entity empowered to institute the IPI.[23] IPI is a tax imposed on transaction involving imported[24] and domestic[25] industrialized goods.[26] No IPI shall be imposed on industrialized products

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[21] The National Tax Code (Law No. 5172/66) was originally enacted as an ordinary law but it is materially a complementary law on the ground that its enactment occurred in 1966 under the scope of the 1946 Constitution, which did not foresee any role for complementary laws. See, Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 694.

[22] Complementary Law No. 101/00.

[23] IPI is further regulated by the National Tax Code and the Decree No. 7212/10, the Regulation of the Tax on Manufactured Products (RIPI).

[24] According to Article 47(I) of the National Tax Code, the IPI taxable base for imported products is the price of the product in foreign currency, converted into national currency, according to exchange rate for that date (Article 20(II) of the National Tax Code) plus exchange fees paid by the importer, import duty, and other import fees for all imports.

[25] According to Article 47(II) of the National Tax Code, the IPI taxable base for domestic products is the value of the transaction which results in the departure of the product from the industrial establishment. In the absence of this value, the taxable base is the wholesale price utilized by the establishment from which the product departed.

[26] According to the sole paragraph of Article 46 of the National Tax Code, an industrialized good is a product that has been subjected to any transformation that changed its nature or purpose, or ameliorated it for consumption.

intended for export, in accordance with Article 153(3)(III) of the 1988 Federal Constitution

Article 153(3)(I) of the 1988 Federal Constitution sets forth that IPI is a selective tax imposed according to the essentiality of the product. Its multiple rates, which can be ad valorem or per unit, thus vary depending on the type of the product and how essential it is, which means that, the more essential a product is to the society, the lower it is the tax rate, and vice versa.[27]

Article 153(3)(II) of the 1988 Federal Constitution sets out that IPI is a non-cumulative tax by establishing that the tax due in each transaction shall be compensated by the amount charged in previous transactions. Therefore, the method utilized to calculate the IPI liability is the tax-credit method, with the amount of the tax due in the previous transaction being credited against the tax due in the subsequent transaction.

IPI is a VAT-type of tax but, in essence, is an excise tax due to its specific imposition on manufactured goods. In that way, one can affirm that no broadly-based VAT truly exists in Brazil at the national level.[28]

IPI is furthermore subject to a revenue sharing system, in accordance with Article 159 of the 1988 Federal Constitution. For instance, the revenue raised by IPI is partially allocated to subnational levels through participation funds such as the States' Participation Fund (FPE) and the Municipalities' Participation Fund (FPM).[29]

3.1.2 PIS and COFINS

As already mentioned in 2.2.4, Article 149 of the 1988 Federal Constitution foresees that, contributions, as a general rule, can only be enacted by the federal government. The same article sets forth three types of contributions,[30] being the social contributions one of them. Social contributions are laid down in Article 195 of the 1988 Federal Constitution.

PIS is a social contribution, mandatory to employers, that finances the Social Integration Program, a savings fund that belongs to employees of the private sector.[31] PIS is charged under two different regimes, namely the non-cumulative[32] and the cumulative.[33]

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[27] IPI rates are laid down in the Table of Incidence of Tax on Industrialized Products (TIPI).

[28] It will be shown later on that, in Brazil, the right to impose a genuine VAT-type of tax is though conferred to the state level.

[29] According to Article 159 (I)(a) and (b) of the 1988 Federal Constitution, 21.5% of the IPI is allocated to the FPE, while 24.5% is allocated to the FPM. In accordance with Article 159(I)(c), 3% shall be remitted for the financing of investments credits to the private sector in the poorest regions of the country (North, Midwest and Northeast). Article 159(III) establishes that the federal government shall remit 10% of the IPI to the states and to the Federal District to compensate them for the loss of revenue entailed by the zero rating of exports of industrialized products.

[30] Social contributions, market intervention contributions and contributions on professional and economic categories.

[31] From July, 1976, PIS was unified with PASEP, a fund with contributions of public institutions of the three levels of government, in behalf of civil servants.

[32] Regulated by Law No. 10637/02.

[33] Regulated by Complementary Law No. 7/70.

COFINS is also a social contribution that funds the social welfare policies, namely health, social security and social assistance. Akin to PIS, COFINS may be imposed either under a non-cumulative[34] or a cumulative regime[35].

Enterprises' gross receipts[36] are subject to the incidence of both PIS and COFINS. Under the non-cumulative regime, PIS and COFINS are generally charged at a rate of 1.65% and 7.6%, respectively, on gross revenue. Tax credits are allowed for expenses strictly connected to the company's business, which may be used to offset PIS and COFINS liabilities. The non-cumulative system makes use of elements of a cash flow tax system, by taking the gross receipts as a starting point and then granting a credit for certain expenses incurred by the business. The method of calculation is hence based mainly on cash inflows subject to certain exemptions and accounts for cash outflows in the form of a credit.[37] Under the cumulative regime, PIS and COFINS are turnover taxes imposed at reduced tax rates of 0.65% and 3%, respectively, but without any tax credits.

Additional PIS and COFINS for the import of goods[38] and services[39] were enacted by the federal government in 2004.[40] These levies are largely subject to the same non-cumulative assessment system above-mentioned, which means that taxpayers are allowed to offset PIS and COFINS collected on imports against local PIS and COFINS liabilities.[41] In general, the PIS and COFINS rates are 2.1% and 9.65%, respectively, in the case of imported goods, and 1.65% and 7.6%, respectively, in the case of imported services.

Finally, unlike IPI, PIS and COFINS are earmarked to social security expenditures and are not subject to the revenue sharing with subnational governments.

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[34] Regulated by Law No. 10833/03.

[35] Regulated by Complementary Law 70/91.

[36] According to Article 1(1) of the Law No. 10637/02 and Law No. 10833/03, gross receipts encompasses the results from the sales of goods on own account, the price of services rendered, the results from operations on someone else's account (i.e. commissions), and all other receipts from the activity or main enterprise objective of the legal person.

[37] Ernst and Young, 'Experiences with Cash-flow Taxation and Prospects – Final Report' (2015) Taxation Papers Working Paper N. 55, pp 44-5.

[38] In the case of imported goods, the taxable base was originally the CIF value plus ICMS and PIS and COFINS themselves, in accordance with Article 7(II) of the Law No. 10865/04. The latter was, however, declared unconstitutional through Extraordinary Appeal 559.937 RS of the Supreme Federal Court in 2013. Law No. 12865/13 gave, later on, a new wording to the then-unconstitutional Article 7, which now stipulates that, in the case of imported goods, the taxable base is solely the CIF value. Due to the exclusion of the ICMS, PIS and COFINS from the taxable base of the PIS and COFINS imposed on imported goods, the standard rates of the latter were increased in 2015, but the PIS and COFINS rates on imported services kept untouched.

[39] The taxable base for imported services is the service price plus service tax (ISS) and PIS and COFINS themselves, in accordance with Article 7(II) of the Law No. 10865/04.

[40] Through Law 10865/04.

[41] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 665.

3.1.3 CIDE-fuel

CIDE-fuel is a type of contribution for intervening in the economic domain. The competence to institute contributions was assigned to the federal government in Article 149 of the 1988 Federal Constitution.

CIDE-fuel is imposed on the importation and commercialization of oil and oil products, natural gas and its by-products, and combustible ethylic alcohol, to the financing of subsidies for the purchase of fuel, environmental projects, which aim to reduce the effects of pollution caused by fuels, and development of the transportation infrastructure.[42]

CIDE-fuel also observes the principle of non-cumulativity. Therefore, the amount paid at the time of import is credited by the importer to offset the contributions due in subsequent transactions (tax-credit method of calculation).[43]

CIDE-fuel multiple rates are per unit and vary depending either on the cubic meter or the tonne.[44]

Article 159(III) of the 1988 Federal Constitution mandates the federal government to share 29% of the revenues collected with CIDE-fuel with the states and the Federal District, being 25% of the above-mentioned amount shared with the municipalities (Article 159(4) of the 1988 Federal Constitution).

3.2 State tax

3.2.1 ICMS

According to Article 155(II) of the 1988 Federal Constitution, ICMS is under the competence of the states and the Federal District. ICMS is a tax imposed on transactions related to the distribution of goods and to the rendering of selected services, such as interstate and intercity bus and air transportation, and telecommunications. According to Article 155(2)(X)(a) of the 1988 Federal Constitution, ICMS shall not be imposed on exports.[45]

In practice, the ICMS has multiple ad valorem rates, depending on whether the transaction is intra-state or interstate. Whereas states set their own tax rates on intra-state transactions, the ICMS imposed on interstate trade is constrained by national rules.[46]

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[42] CIDE-fuel was created through the constitutional amendment 33/01 that introduced a fourth paragraph in Article 177 of the 1988 Federal Constitution. CIDE-fuel is further regulated by Law No. 10336/01.

[43] CIDE-fuel generates credits in the fuel production chain, but does not generate credits for companies that consume fuel and, for this reason, it is considered a cumulative tax by some people.

[44] CIDE-fuel rates were reduced to 0% since 2012. Nevertheless, in 2015, the federal government, through Decree No. 8395/15, decided to raise the CIDE-fuel rates imposed on gasoline and diesel, which corresponded to an impact of BRL 0.22 increase over the price of the liter of gasoline and BRL 0.15 over diesel.

[45] ICMS is further regulated through several complementary laws. The most important is, though, the so-called Kandir Law.

[46] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 698.

In accordance with Article 155(2)(V)(a) and (b) of the 1988 Federal Constitution, the Senate may establish the minimum and the maximum rates for intra-state transactions. Since no Senate Resolution has been enacted up to this date, each state establishes its own ICMS rate for intra-state transactions, autonomously.[47] The states and the Federal District usually utilize either 17% or 18% as tax rates.[48]

According to the second paragraph of Article 155(IV) of the 1988 Federal Constitution, the interstate rates may also be set through a resolution of the Federal Senate. The interstate rates are thus set centrally, though not uniformly, by Senate Resolution No. 22/89 through a dual-system. A normal 12% rate applies to transactions involving taxpayers located in states of the South and Southeast-bound regions and a 7% rate applies to transactions involving taxpayers located in the poorer states, namely North, Midwest and Northeast-bound regions, as well as for the state of Espírito Santo, despite its location in the Southeast region.

The place where ICMS should be charged can also vary depending on the type of transaction. Intra-state transactions follow the origin principle while interstate transactions are subject to a hybrid origin-destination rule. Previously, interstate transactions (including e-commerce) between an ICMS taxpayer and a final consumer, who was not an ICMS taxpayer, were also subject to the origin principle, with the ICMS being imposed fully by the state where the good or the service supplier was established. However, the constitutional amendment 87/15 amended the wording of Article 155(2)(VII) of the 1988 Federal Constitution, which from 2016 sets forth that all interstate transactions between a taxpayer and a final consumer, regardless if an ICMS taxpayer or not, are to be subject to a part origin, part destination rule.[49] This means that the state of origin shall levy the ICMS at interstate rates, while the state of destination is entitled to collect the difference between such an interstate rate and its internal rate.[50] The

[47] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 696.

[48] Nevertheless, in practice, due to the fact that the ICMS rates are imposed on a tax-inclusive base, the two rates are, in fact, 20.48% and 21.95%, respectively.

[49] ICMS current design for interstate transactions, with its reliance on a part-origin, part-destination model, has been devised in order to reduce the revenue disparity between producing and consuming states, and thus give more revenue to the less developed states. See, Alan Schenk, Victor Thuronyi, Wei Cui, 'Value Added Tax - A Comparative Approach' (Cambridge, Cambridge University Press 2015) p 508.

[50] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 699. The constitutional amendment 87/15 also lays down an apportionment system that aims to gradually transfer the revenue yielded from the tax corresponding to the difference between the interstate rate and the internal rate to the state of destination. In that way, in 2016, 40% of such difference between the interstate rate and the internal rate should go to the state of destination while 60% goes to the state of origin. In 2017, 60% goes to the state of destination and 40% to the state of origin. In 2018, 80% goes to the state of destination and 20% to the state of origin. Finally, in 2019, 100% of the difference between the interstate rate and the internal rate goes to the state of destination.

importation of goods and services is taxed in the state of consumption, in accordance with the destination principle.[51]

ICMS is, regardless of the type of transaction, non-cumulative, in accordance with Article 155(2)(I) of the 1988 Federal Constitution, and subject to the tax-credit method, with the tax due in each transaction being compensated by the amount charged in the previous transactions.

Article 158(IV) of the 1988 Federal Constitution establishes that the states shall assign 25% of their ICMS revenue to the municipalities located in their respective jurisdictions.

3.3 Municipal tax

3.3.1 ISS

Article 156(III) of the 1988 Federal Constitution sets forth both the tax competence and the basis of assessment of IPI by establishing that the municipalities shall have the competence to establish a tax on services of any nature, not included in the ICMS scope.

Complementary Law No. 116/03 contains an annexed list that enumerates the services covered by the incidence of ISS. The list comprehends 40 types of services and several subtypes. Imported services are subject to ISS, in accordance with Article 1(1) of the aforementioned complementary law. The latter also relieves the export of services that have been effectively rendered abroad from ISS in its Article 2(I).

Article 156(3)(I) and (II) of the 1988 Federal Constitution sets forth that complementary law shall set the national standard for ISS through establishing the maximum and minimum ISS rates. In that way, Article 89(II) of the Complementary Law No. 116/03 settles the maximum rate, corresponding to 5%. The ISS minimum rate is 2%.

Finally, ISS is a turnover tax subject to a cumulative regime and as such does not confer any credit for the ISS levies occasionally paid at earlier stages of the service provision chain.[52]

4. General indirect tax on consumption of goods and services in the European Union

4.1. Character of a Value Added Tax

The harmonization of indirect taxes, and especially, turnover taxes, has been present within the European integration project from the beginning. However, it was with the introduction of the internal market policy that the harmonization of VAT law gained primordial position. On one hand, it was made clear by the White Paper[53] that, if the internal market was to be

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[51] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 700.

[52] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 669.

[53] In 1985, the European Commission presented the White Paper for the completion of the internal market. The paper laid down a series of measures with a view to establishing an internal market by 1992, divided under the following three headings: removal of physical barriers; removal of technical barriers; and removal of fiscal barriers. Under the heading

established, a certain level of harmonization of VAT laws would have to be achieved; on the other, Article 14 of the Treaty Establishing the European Economic Community (TEC)[54] clearly confirmed VAT policy as part of the internal market policy by making express reference to it in Article 93 TEC.[55]

Article 113 of the Treaty on the Functioning of the European Union (TFEU), former Article 93 TEC, is the legal basis for the advanced harmonization of turnover taxes within the European Union.[56] The Article currently sets forth that the VAT harmonization is necessary not only to ensure that the internal market is established, but also to hinder that competition is distorted (added with the Lisbon Treaty), by stating that:

> The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.

Before the introduction of the VAT in the 1960s, cumulative turnover taxes, enacted as consumption taxes, were frequently used in Europe. These taxes were levied on gross turnover and presumed to be passed on in the prices of goods and services. They were thus eliminated with the introduction of the First VAT Directive,[57] as they could not exist in a (at that time) Community with a free market.[58]

The preamble to the First VAT Directive established, in a clear manner, the reasons behind the introduction of a common VAT system, by stressing that the harmonization of legislation concerning turnover taxes should make it possible to establish a common market within which there is healthy competition and whose characteristics are similar to those of a domestic market, by eliminating tax differences liable to distort competition and to hinder trade.

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removal of fiscal barriers, the paper contained several measures in the field of VAT. See, Rita de la Feria, ‘The EU VAT System and the Internal Market’ (Amsterdam, IBFD 2009), p 57.

[54] Article 14(1) TEC (current Article 26(1) TFEU) established the following: “The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992, in accordance with the provisions of this Article and of Articles 15, 26, 47(2), 49, 80, 93 and 95 and without prejudice to the other provisions of this Treaty.”

[55] Rita de la Feria, ‘The EU VAT System and the Internal Market’ (Amsterdam, IBFD 2009), pp 38-9.

[56] Ben Terra and Julie Kajus, ‘Commentary – A Guide to the Recast VAT Directive’ (Amsterdam/Hornbæk, IBFD 2016) p 544.

[57] First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes, OJ 71, 14/04/1967, 1301.

[58] Ernst and Young, ‘Experiences with Cash-flow Taxation and Prospects – Final Report’ (2015) Taxation Papers Working Paper N. 55, p 39.

The definition of VAT is currently established by the first article of the VAT Directive,[59] which states that the principle of the common system of VAT involves the application to goods and services, up to and including the retail trade stage, of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which takes place in the production and distribution process before the stage at which tax is charged. However, VAT is chargeable on each transaction only after deduction of the amount of VAT borne directly by the costs of the various price components.

The procedure for deduction is so currently arranged by Article 168 of the VAT Directive, in which taxable persons are authorised to deduct from the VAT for which they are liable, the VAT which the goods or services have already borne and that the tax is charged, at each stage, only on the added value and is finally borne by the ultimate consumer.[60]

The European VAT is therefore a non-cumulative, general, broadly-based tax on consumption levied at all stages of production and distribution process, as well as the supply of services, with a deduction of the tax due in previous stages. In that way, the tax paid on inputs is offset against the tax due on output, in accordance with the tax-credit method.

As supra-mentioned, a common system of VAT required Member States to eliminate and replace all national cumulative multi-stage taxes.[61] The VAT is thus the unique turnover tax currently allowed in the European Union, as foreseen in Article 401 of the VAT Directive:[62]

> Without prejudice to other provisions of Community law, this Directive shall not prevent a Member State from maintaining or introducing taxes on insurance contracts, taxes on betting and gambling, excise duties, stamp duties or, more generally, any taxes, duties or charges which cannot be characterised as turnover taxes, provided that the collecting of those taxes, duties or charges does not give rise, in trade between Member States, to formalities connected with the crossing of frontiers

This provision forbids, consequently, the introduction of other turnover taxes except for the European VAT.[63] Several taxes imposed by Member States have been challenged for violating the one VAT principle prescribed

[59] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L347, 11/12/2006, 1.

[60] Case C-318/96 *SPAR* [1998] EU:C:1998:70, para 23; Case C-295-84 *Rousseau Wilmot* [1985] EU:C:1985:473, para 15; Case C-252/86 *Bergandi* [1988] EU:C:1988:112, para 15; Case C-93/88 *Wisselink and Others* [1989] EU:C:1989:324, para 18; Case C-109/90 *Giant* [1991] EU:C:1991:126, para 12; Joined Cases C-338/97, C-344/97 and C-390/97 *Pelzl and Others* [1999] EU:C:1999:285, para 16; and Case C-475/03 *Banca popolare di Cremona* [2006] EU:C:2006:629, paras 21-22.

[61] Alan Schenk, Victor Thuronyi, Wei Cui, 'Value Added Tax - A Comparative Approach' (Cambridge, Cambridge University Press 2015) pp 492-3.

[62] Ernst and Young, 'Experiences with Cash-flow Taxation and Prospects – Final Report' (2015) Taxation Papers Working Paper N. 55, p 39.

[63] Ernst and Young, 'Experiences with Cash-flow Taxation and Prospects – Final Report' (2015) Taxation Papers Working Paper N. 55, p 40.

in Article 33 of the prior Sixth VAT Directive[64] (now Article 401 of the VAT Directive).[65]

In Case C-475/03 *Banca popolare di Cremona*,[66] the Grand Chamber of the Court of Justice of the European Union (CJEU) ruled that, due to the fact that the regional tax on productive activities in force in Italy, know as IRAP, did not have all the essential characteristics of a VAT, it was a permitted tax, contradicting the conclusions of the Advocates General.[67] The CJEU explained that, whereas VAT is levied on individual transactions at the marketing stage and its amount is proportional to the price of goods or services supplied, IRAP is, in contrast, a tax charged on the net value of the production of an undertaking in a given period. Its basis of assessment is the difference appearing in the profit and loss account between the 'value of production' and the 'production costs' as defined by Italian legislation. It includes elements such as variation in stocks, amortisation and depreciation, which have no direct connection with the supply of goods or services as

[64] Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes, OJ L145, 13/06/1997, 1.

[65] Alan Schenk, Victor Thuronyi, Wei Cui, 'Value Added Tax - A Comparative Approach' (Cambridge, Cambridge University Press 2015) pp 492-3.

[66] A reference for a preliminary ruling related to the interpretation of Article 33 of the Sixth Directive made in proceedings brought by Banca popolare di Cremona against the decision of the Revenue Agency Office of Cremona that refused to reimburse the regional tax on productive activities (IRAP) paid in 1998 and 1999. IRAP, a tax imposed in each region of Italy and collected by the central government, was introduced in 1998 by Legislative Decree No 446/1997 (ordinary supplement to the GURI No 298/1997, 'the legislative decree') to replace a regional income tax, a tax on corporate dividend distributions, a net worth tax, and a payroll tax dedicated to a national health program. According to Banca popolare di Cremona, the legislative decree was not consistent with Article 33 of the Sixth Directive. The Cremona Regional Tax Court decided to stay proceedings and refer a question to the CJEU for a preliminary ruling. By its question the national court sought to ascertain whether Article 33 of the Sixth Directive precluded the maintenance of a charge to tax with the characteristics of the IRAP. The CJEU answered the question in the negative.

[67] On 17 March 2005, Advocate General Jacobs delivered his Opinion, concluding that a national tax with the characteristics of the IRAP was prohibited by the Sixth Directive. Nevertheless, because such a result would require the reimbursement of large sums of tax levied contrary to European law, seriously disrupting regional funding in Italy, and because the Commission appeared to have contributed to the Italian government's belief that IRAP was compatible with European law, he recommended that the CJEU fix a temporal limitation on its ruling. Moreover, he proposed a new approach to such a limitation, perhaps, although giving a ruling pursuant to which IRAP must be found unlawful, nonetheless fixing a future date before which individuals could not rely on that unlawfulness in any claims against the State. On 14 March 2006, Advocate General Stix-Hackl, who was assigned to the case following Advocate General Jacobs' retirement from the Court on 10 January 2006, delivered her Opinion, the second one in the case. She agreed with Mr. Jacobs that IRAP possesses the essential characteristics of VAT, in terms of generality of application, proportionality to price, the fact that it is charged at each stage of the production and distribution process and the fact that it is imposed on the value added to a supply at each stage with a mechanism for deduction of that tax paid at previous stages – provided that the ratio between the amounts paid by a representative sample of business in IRAP and VAT is substantially constant. It is for the national court to determine whether this is so having regard to IRAP's characteristics. If it is so, IRAP would be prohibited by the Sixth Directive. See, Ben Terra and Julie Kajus, 'A Guide to the European VAT Directives – Introduction to European VAT' (Amsterdam/Hornbæk, IBFD 2014) pp 1562-3.

such. In those circumstances, IRAP could not be considered proportional to the price of goods or services supplied.[68]

The CJEU also noted that a tax levied on production in such a way that it is not certain that it would be borne by the final consumer, is likely to fall outside the scope of Article 33 of the Sixth Directive. The CJEU explained that, whereas, through the mechanism of the deduction of tax laid down by Articles 17 to 20 of the Sixth Directive, VAT taxes only the final consumer and is completely neutral as regards the taxable persons involved in the production and distribution process prior to the stage of final taxation, regardless of the number of transactions involved. First, a taxable person cannot ascertain exactly the amount of IRAP already included in the purchase price of goods and services. Second, if, in order to pass on the burden of the tax due in connection with his own activities to the following stage in the distribution or consumption process, a taxpayer could include that burden in his sale price, the basis of assessment would then include not only the value added but also the tax itself, with the result that the IRAP would be calculated on an amount based on a sale price incorporating, in anticipation, the tax to be paid. The CJEU added that, in any event, even on the assumption that a taxable person liable to IRAP selling to final consumers will take account, in fixing his price, of the amount of the charge included in its general expenses, not all taxable persons have the possibility of thus passing on, or passing on in full, the burden of the tax. From all the foregoing considerations, the CJEU concluded that, according to the legislation concerning IRAP, the tax is not intended to be passed on to the final consumer in a way that is characteristic of VAT.[69]

The CJEU then referred to its ruling in Dansk Denkavit and Poulsen Trading, in which it held that a tax which was levied as a percentage of the total sales effected and services provided by an undertaking during a specified period, less the purchases of goods and services by that undertaking during that period, to be inconsistent with the harmonized system of VAT. It observed in that case that the tax at issue was comparable, in essential respects, to VAT and that notwithstanding differences it retained its character as a turnover tax. However, IRAP differs in that respect from the tax which was the subject of the above judgment in so far as the tax in that case was intended to be passed on to the final consumer. That tax was levied on the same basis of assessment as that used for VAT, and it was collected in parallel with VAT.[70]

4.2 Own resources

Based on the own resources decision of 21 April 1970, which replaced the financial contributions from the Member States by the (at that time) Community's own resources, the budget of the European Union should include, in addition to customs duties and agricultural levies, revenue arising from the value added tax by applying an uniform rate of tax to an assessment basis, which is determined in an uniform manner from Member States according to the Union rules. With the current uniform rate of call of

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[68] Case C-475/03 *Banca popolare di Cremona* [2006] EU:C:2006:629, para 30.
[69] Case C-475/03 *Banca popolare di Cremona* [2006] EU:C:2006:629, paras 31-5.
[70] Case C-475/03 *Banca popolare di Cremona* [2006] EU:C:2006:629, paras 36-7.

the VAT resource fixed at 0.30%, and a maximum assessment basis capped at 50% of the Gross National Product (GNP) of the Member States, basically, this 0.30% can be considered as an additional levy, an European tax, on behalf of the Union, in addition to the rates applied by the Member States in their behalf. Nevertheless, the European rate is hidden within the national rates.[71]

The legal basis of the own resources of the European Union budget is Article 311 TFEU, which lays down that:

> The Union shall provide itself with the means necessary to attain its objectives and carry through its policies.
> Without prejudice to other revenue, the budget shall be financed wholly from own resources.
> The Council, acting in accordance with a special legislative procedure, shall unanimously and after consulting the European Parliament adopt a decision laying down the provisions relating to the system of own resources of the Union. In this context it may establish new categories of own resources or abolish an existing category. That decision shall not enter into force until it is approved by the Member States in accordance with their respective constitutional requirements.
> The Council, acting by means of regulations in accordance with a special legislative procedure, shall lay down implementing measures for the Union's own resources system in so far as this is provided for in the decision adopted on the basis of the third paragraph. The Council shall act after obtaining the consent of the European Parliament.

The VAT Directive also refers to the own resources of the Union in its preamble, among others, in recital 8:

> Pursuant to Council Decision 2000/597/EC, Euratom, of 29 September 2000 on the system of the European Communities' own resources, the budget of the European Communities is to be financed, without prejudice to other revenue, wholly from the Communities' own resources. Those resources are to include those accruing from VAT and obtained through the application of a uniform rate of tax to bases of assessment determined in a uniform manner and in accordance with Community rules.

The Council adopted on 7 June 2007, Decision 2007/436/EC, Euratom on the system of the European Communities' own resources, which established the uniform rate of call of the VAT resource at 0.30%. The Decision took effect in 2007 and provided, furthermore, that Austria, Germany, Sweden and the Netherlands benefited from reduced VAT rates of call during the period of 2007-2013.[72]

On 28 May 2014, the Council adopted three legislative acts[73] forming the own resources package related to the EU's multiannual financial framework

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[71] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 1315.
[72] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 1316.
[73] Council Decision 2014/335/EU, Euratom laying down the main provisions relating to the European Union's own resources system and setting up the different categories of revenue; Regulation (EU) No. 608/2014, laying down implementing measures for the own resources system; and Regulation (EU) No. 609/2014, establishing the methods and procedure for making available the budget revenue.

(MFF) for the period 2014-2020. The three acts will only enter into force when the own resources decision has been approved by every Member States in accordance with their respective constitutional requirements. They will then apply retroactively as from 1 January 2014. According to the new own resources rules, a reduced VAT rate of call of 0.15% will apply, for 2014-2020, only to Germany, the Netherlands and Sweden.[74]

4.3 Rates

The VAT Directive lists three types of rates, namely the standard rates, the reduced rates and special rates. The standard rates are laid down in Articles 96 and 97 of the VAT Directive, which sets forth that Member States must apply a standard rate but can decide the percentage applicable within the terms of the VAT Directive. Furthermore, the rate must be the same regardless of the type of transaction. Until 31 December 2015, the minimum level of the standard VAT rate was 15%. No maximum limit was established.

The second rate foreseen by the VAT Directive is the reduced rate outlined in Articles 98 to 101 and Annex III. According to Article 98(1) of the VAT Directive, Member States can have up to two reduced rates. Article 99 of the VAT Directive establishes that the minimum level of the reduced rates must be 5%. Article 98(2) of the VAT Directive sets forth that the reduced rates may only be applied to the supplies of goods and services listed in Annex III[75] and not to electronically supplied services. Finally, Articles 102 to 105 allow the application of reduced rates to gas, electricity, district heating, the importation of works of art and certain transactions in Austria,[76] Cyprus[77] and Portugal.[78] Those provisions have no time limitation.

The final and third rates listed in the VAT Directive are called derogations due to the fact that they deviate from the normal rules. Articles 109 to 122 of the VAT Directive foresee transitional derogations which will be applied until the adoption of definitive arrangements. Those provisions set forth that Member States are authorized to maintain various measures concerning reduced rates which existed prior to 1991, or which were agreed on with the accession of countries to the European Union. Therefore, they are not open to all countries. They allow, in certain cases, rates lower than 5 percent

[74] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 1318.

[75] Annex III foresees the application of reduced rates to foodstuffs for human and animal consumption; supply of water; pharmaceutical products; medical equipment; transport of passengers and their accompanying luggage; supply of books on all physical mean of support; reception of radio and television broadcasting services; window-cleaning; admission to sporting events; use of sporting facilities; hairdressing; et cetera.

[76] According to Article 104 of the VAT Directive, Austria may use a second standard rate, lower than the corresponding rate applied in the rest of the country but not less than 15%, for transactions carried out in Jungholz and Mittelberg.

[77] According to Article 104a of the VAT Directive, Cyprus may apply one of the two reduced rates provided for in Article 98 to the supply of liquid petroleum gas (LPG) in cylinders.

[78] According to Article 105 of the VAT Directive, Portugal may, in the case of transactions carried out in the autonomous regions of the Azores and Madeira and of direct importation into those regions, apply rates lower than those applying on the mainland. Portugal may also apply one or two reduced rates to the tolls on bridges in the Lisbon Area.

(either as super reduced rates or as zero rates), or reduced rates for categories not included in Appendix III.[79] Article 110 establish four cumulative conditions to which Member States shall observe when applying reduced rates lower than the minimum, namely that the lower reduced rates or exemptions with deductibility (zero rates) must be applied in accordance with the EU law; for social reasons; and for the benefit of final consumer if the exemption or reduced rate was applied at 1 January 1991.

On 7 April 2016, the European Commission adopted an Action Plan on VAT towards a single European VAT area. The Action Plan proposes, among others, options for a modernized policy on European rules governing VAT rates. According to the Commission, the current VAT rates policy does not fully take into account technological[80] and economic developments and, as a result, the VAT Directive is becoming obsolete. Moreover, the VAT rates policy was designed over two decades ago with the aim of arriving at a definitive VAT system based on the origin principle. Since then, VAT has increasingly developed into a system based on the destination principle. The rules on rates, however, have never been adjusted to reflect this logic. Finally, given the long time-lags for adopting changes in European legislation, Member States find themselves in breach of the rules. Therefore, a reform giving more freedom to Member States would enable them to take the tax policy decisions they want more rapidly, while relieving the European Union of unnecessary litigation.[81]

On the other hand, the Commission affirms that devolving full rate-setting power to Member States might generate an erosion of VAT revenues, as individual sectors would claim a more favourable treatment. In the long run, this might shrink the tax base, going against the European Union's economic policy recommendations. Furthermore, greater decentralisation might result in an increase in complexity, creating additional costs for businesses and generating legal uncertainty.[82]

Two main options were outlined by the Commission. In the first option, the minimum standard VAT rate of 15% would be maintained. The list of goods and services that can benefit from the application of a reduced rate would be reviewed in the context of the transition to the definitive system and then at regular intervals. Under this option, all currently existing reduced rates, including derogations, legally applied in Member States would be maintained and could be included in the list of optional reduced rates available to all Member States, ensuring equal treatment.

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[79] Copenhagen Economics, 'Study on Reduced VAT Applied to Goods and Services in the Member States of the European Union – Final Report' (2007), p 40.

[80] Such as the case of e-books and electronic newspapers, which cannot benefit from reduced rates available for physical publications.

[81] European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an Action Plan on VAT, Towards a Single EU VAT Area - Time to decide, COM(2016) 148 final, Brussels 2016, p 11.

[82] European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an Action Plan on VAT, Towards a Single EU VAT Area - Time to decide, COM(2016) 148 final, Brussels 2016, p 12.

According to the Commission, the second option would be to abolish the list of reduced rates and allow the Member States greater freedom on the number of reduced rates and their level, while still constrained by European legislation and the European Union's economic governance framework. To prevent unfair tax competition in cross-border shopping, one possible solution could be to prevent the application of reduced rates to high-value goods and services, in particular easily transportable items. To ensure the overall consistency and simplicity of the rates system, the total number of reduced rates allowed by Member States could be limited. Also under this option all currently existing reduced rates, including derogations, legally applied in Member States would be maintained, the possibility to apply them could be made available to all Member States. Finally, the minimum standard VAT rate would be removed.[83]

4.4 The destination principle

Besides the adoption of a system of value added taxation that excludes any other form of turnover tax, the European Union also adopted the destination principle (in principle VAT is to be paid in the state of use) as bases of the harmonization of turnover taxes due to the fact that principle make it possible to determine the exact amount of tax on a product at every stage of production and trade, and to clear exactly that amount upon exportation. Through this system, the possibility for Member States to hide export subsidies in arbitrary refunds upon exportation is eliminated.[84]

The destination principle taxes goods where they are consumed, refunding the tax on export goods and imposing tax on imports. Application of the destination principle leads to compensation in the form of a surcharge on imports, not exceeding the internal tax on corresponding domestic products. The imported products cross the border "tax-free" since on exportation the tax already borne by the article in the country of production has been refunded. The advantage of the destination principle is that all products bear the same tax burden when finally sold to the consumer in a particular country.[85]

Within the European Union, most goods are taxed in the Member State where they are acquired by consumers, in accordance with the destination principle. Articles 110 to 112 TFEU permit the application of border tax adjustments in intra-Community trade. However, the completion of the internal market required that such adjustments should be abolished; at least, adjustments should no longer be made based on formalities at the (internal) borders.[86]

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[83] European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an Action Plan on VAT, Towards a Single EU VAT Area - Time to decide, COM(2016) 148 final, Brussels 2016, pp 12-3.

[84] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 544.

[85] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 1313.

[86] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 1313.

The European Union also applies the destination principle vis-à-vis third countries. The destination principle is recognized in the General Agreement on Tariffs and Trade (GATT). Article III of the latter forbids discriminatory treatment of imported goods, but allows a charge to be levied upon imported goods which is equivalent to an internal (indirect) tax imposed on like domestic products. Article XVI forbids subsidizing exports by tax methods, but allows a refund of the indirect taxes actually charged. The Contracting Parties to GATT may impose compensatory taxes on imports and may exempt or remit indirect taxes on exports. However, there is no requirement for them to do so because the GATT rules are permissive rather than mandatory. Member States of the European Union are, as Contracting Parties, subject to the GATT rules in their trade with non-Member States. Therefore, application of border tax adjustments for indirect taxes, including VAT, is permitted with respect to external trade by all the Member States.[87]

5. Feasibility of application of the EU VAT model in Brazil

5.1 Fiscal feasibility

Firstly, the European VAT is an efficient revenue yielding, since its basis of assessment is broad and its coverage is very extensive, with its burden being spread over the widest possible range of goods and services. Therefore, even a low VAT rate can raise significant revenue.[88] Besides, as mentioned in 4.1.1, the revenue raised from European Value Added Tax is even utilized to finance the budget of the European Union. An uniform rate of 0.30% (except for Germany, the Netherlands and Sweden) is currently applied to an assessment basis, which is determined in an uniform manner from Member States according to the Union rules. The maximum assessment basis is currently capped at 50% of the Gross National Product of the Member States. The adoption of the own resources system is conditional to a decision of the Council, which shall only enter into force after the approval of the Member States.

In Brazil, due to the fact that the overall levies imposed on consumption by the federal government are inefficient revenue yielding, the latter has to rely on other levies that are non-shared sources to fulfill its budget, such as PIS and COFINS. The same logic applies to the states (including the Federal District) and the municipalities, which not only rely on the ICMS and ISS, respectively, but also depend on intergovernmental transfers to finance their budgets.

The main fiscal transfers between the federal government and the subnational levels are made through two constitutional mandated funds, the FPE and the FPM, that rely on compulsory shares of the federal tax imposed on imported and domestic industrialized products (IPI)[89], as already mentioned in 3.1.1. These Brazilian intergovernmental transfers were created for the purpose of promoting fiscal equalization by financing public

[87] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 1313.
[88] Ben Terra and Julie Kajus, 'Introduction to European VAT (Recast)' (Amsterdam/Hornbæk, IBFD 2016) pp 256-7.
[89] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 682.

spending in poorer subnational governments, where revenue mobilization is low.[90] Therefore, an uniform and neutral apportionment of the Brazilian levies, such as how it is designed in Europe, is not ideal due to the unequal situation of the different regions of Brazil.

However, intergovernmental transfers have been facing several criticisms in the last years mainly because the system of division of the tax revenue adopted by the existing funds apparently failed to effectively mitigate regional inequalities.[91] The coefficients of distribution adopted by the FPE for instance have even been judicially challenged in many occasions in the Federal Supreme Court.

5.2 Neutrality of competition feasibility

The European VAT is also designed to be neutral with regard to competition between Member States and also between Member States and third countries. Due to the fact that most of the transactions are taxed in the country of destination, all products, domestic or foreign, bear the same tax burden when finally sold to the consumer.

As mentioned in 4.4, the adoption of the destination principle make it possible to determine the exact amount of tax on a product at every stage of production and trade, and to clear exactly that amount upon exportation.[92] Application of the destination principle leads to compensation in the form of a surcharge on imports, not exceeding the internal tax on corresponding domestic products. The imported products cross the border "tax-free" since on exportation the tax already borne by the article in the country of production has been refunded.[93]

As mentioned in 3.2.1, Brazil introduced new rules for interstate transactions (including e-commerce) between an ICMS taxpayer and a final consumer who is not a taxpayer. The reason behind the new rules is that the state ICMS is governed by an interstate council, the CONFAZ,[94] which, in theory, is responsible for the national coordination of the ICMS rates and tax bases. However, in practice, CONFAZ allows a substantial degree of "free play", by granting individual states a considerable degree of flexibility in setting their own tax bases and rates, hindering national tax coordination efforts and creating ample room for harmful interstate tax competition

[90] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 681.
[91] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 685.
[92] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 544.
[93] Ben Terra and Julie Kajus, 'Commentary – A Guide to the Recast VAT Directive' (Amsterdam/Hornbæk, IBFD 2016) p 1313.
[94] CONFAZ, the National Council of Fiscal Policy, was established in 1975 and is composed by each state secretary of finance and the Federal District counterpart as well as by a representative of the federal government, who chairs the council and coordinates its debates. See, Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) pp 705-6.

practices,[95] such as what the doctrine refers to as being a “fiscal war” between states. Under this practice, state governments grant ICMS exemptions and tax rate reductions to national or international firms as a political and fiscal strategy to attract them to their jurisdictions, encouraging fiscally induced mobility and undermining competition.[96] This phenomenon was aggravated by the increase of online sales in the last years, with e-commerce companies located in the North, Northeast and Midwest regions not being able to compete with companies established in rich producing states such as São Paulo and Rio de Janeiro.[97]

Aiming a more equitable tax collection, the ICMS is now apportioned between the state of origin and the state of destination. Nevertheless, the new rules oblige companies to be registered in each state where they have costumers, increasing even more the costs on taxpayers for information and compliance, especially for small and medium size entrepreneurs. Due to the fact that ICMS is charged both in the state of origin and in the state of destination, two invoices have thus to be generated and to accompany the product (allowing the control by the border tax office). Brazil still has frontier controls and, even after the introduction of the electronic invoice by the country, a printed version of a document providing a “key”, which will permit the access by the border tax office to the electronic invoice, is still necessary. Besides, the electronic invoice is restricted to certain IPI and ICMS taxpayers and to certain type of invoices.

Regarding the municipal tax, there is still a constant debate regarding the place of supply of ISS. The law is very unclear and the jurisprudence is disparate regarding that subject. This has led to many companies being often subject to double taxation, that is to say, being taxed in the local where the supplier is established and where the service is provided.

5.3 Non-cumulativity feasibility

Another feature of the European tax is that VAT is easier to calculate. The tax is based on the tax-credit method, which allows taxpayers to pay VAT after each sale and claim a refund after each purchase. The tax liability is attached to the transaction, making it legally and technically easy to follow.[98]

On the other hand, the Brazilian consumption tax system has proven to be extremely complex, leading to high costs on taxpayers for information and compliance, and a burdensome administration for the public sector.[99] For

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[95] Flávio Rubinstein, ‘Brazil’ in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 707.

[96] Flávio Rubinstein, ‘Brazil’ in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 704.

[97] Harmful intergovernmental tax competition practices have also been adverse outcomes of the ISS assignment to the municipalities, with many companies settling down in certain municipalities with the exclusive aim of benefiting from lower ISS rates. See, Flávio Rubinstein, ‘Brazil’ in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 669.

[98] Alan A Tait, ‘Value Added Tax – International Practice and Problems’ (Washington DC, International Monetary Fund 1988) p 5.

[99] Celina Souza, ‘Brazil's Tax System: The Dilemmas of Policy Reform’ (Fondation canadienne pour les Amériques Working Paper FPP-05-02, 2002) p 5.

instance, IPI, PIS and COFINS (under the non-cumulative regime), CIDE-fuel and ICMS, akin to the European VAT, are calculated under the tax-credit method, with the tax paid in previous transactions being credited against the tax due in the following transaction. The difference is that the method adopted by the Brazilian levies is more distortive. The levies imposed on consumption in Brazil are not creditable against each other, resulting in an aggregate cumulative effect between the various consumption taxes assigned to all three levels of government.[100]

ISS, on the other hand, is a turnover tax levied under a cumulative regime and as such does not allow any credit for the ISS occasionally paid at earlier stages of the service provision chain, causing a detrimental cascading effect. Furthermore, the cascading effect is reinforced by the fact that PIS and COFINS can also be levied under a cumulative system, and thus do not allow credits.

Under the non-cumulative regime, the other issues with regard to PIS and COFINS are the complexity of assessment by taxpayers as well as the high level of uncertainty concerning the interpretation of some legal provisions, such as what may be considered as "input" in a concrete situation, leading to an imposition of a high compliance costs on the taxpayer.[101] It is also argued that the high rates in force under the non-cumulative regime may render the latter more costly than the cumulative regime.[102]

5.4 Rates

As explained in 4.1.2, the rates structure under the European VAT Directive is a multiple-rate system, leaving Member States significant freedom to establish their own rates structure such as the level of the standard rate, whether to apply one or two reduced rates, et cetera. This freedom results in VAT rates structure within the European Union remaining highly discrepant, differentiated, and complex.[103] The lack of convergence of the rate structure causes significant economic distortions from the perspective of businesses such as increased compliance costs, distorted competition and hindrance to intra-community trade.

The difficulty establishing the VAT rate applicable to a determined supply in another Member State amplifies companies' compliance costs, which decreases economic efficiency. The engagement in the most basic business transaction in another Member State entails extensive study of the rates applicable in that State, and in many situations, the utilization of external tax expert advice, creating a significant additional financial burden.[104] By increasing the compliance costs, the lack of harmonization of VAT rates

[100] Flávio Rubinstein, 'Brazil' in Claudio Sacchetto and Gianluigi Bizzioli (ed.), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (Amsterdam, IBFD 2011) p 669.

[101] Ernst and Young, 'Experiences with Cash-flow Taxation and Prospects – Final Report' (2015) Taxation Papers Working Paper N. 55, p 90.

[102] Ernst and Young, 'Experiences with Cash-flow Taxation and Prospects – Final Report' (2015) Taxation Papers Working Paper N. 55, p 99.

[103] Rita de la Feria, 'The EU VAT System and the Internal Market' (Amsterdam, IBFD 2009) p 131.

[104] Rita de la Feria, 'The EU VAT System and the Internal Market' (Amsterdam, IBFD 2009) p 140.

stops companies from fulfilling their potential in terms of competitiveness.[105]

The wide disparity of VAT rates across the European Union can potentially cause significant distortions of competition. Companies trading in a Member State applying a lower standard rate, a reduced or zero rate of VAT may be able to take higher profit margins, giving them an advantage over competitors in other Member States.[106]

Finally, the difficulty determining the VAT rates applicable in other Member States, due to the high compliance costs it entails, can constitute a deterrent for traders, namely for small and medium size businesses, to engage in intra-community trade.[107] A complex set of different VAT rates across the Union for the same products will create some barriers to the internal market as non-domestic sellers will have to spend more time finding the proper VAT rate applicable in other Member States and consequently be more hesitant about marketing products in other countries.[108] By creating a hindrance to intra-community trade, the lack of VAT rates harmonization constitutes an obstacle to the free movement of goods and services.[109]

However, the European Commission adopted an Action Plan in April 2016 proposing, among others, options for a modernized policy on European rules governing VAT rates. Through this Action Plan, the European Commission presents two options that could possibly hinder the main issues caused by the lack of convergence of the VAT rate structure, such as increased compliance costs, distorted competition and hindrance to intra-community trade.

Brazil on the other hand, does not seem to any plan on the agenda aiming to simplify the multiple rate system adopted by the levies imposed on consumption in the country. For instance, taxes like the state ICMS should have their rate system constrained by a Senate Resolution, in accordance with the 1988 Federal Constitution. However, in reality, states set their own tax rates on intra-state transactions autonomously due to the fact that no Senate Resolution has been enacted up to this date.

6. Conclusions

Brazil is a federalist country and, due to that, its subnational levels have a considerable degree of fiscal autonomy that is conferred constitutionally. All the levels of government have the competence to impose levies on consumption. Besides, these levies can take different forms, some are imposed on the value added and some are turnovers levied under a cumulative regime. On the other hand, all of them are similar with regard to

[105] Rita de la Feria, ‘The EU VAT System and the Internal Market’ (Amsterdam, IBFD 2009) p 142.
[106] Rita de la Feria, ‘The EU VAT System and the Internal Market’ (Amsterdam, IBFD 2009) p 140.
[107] Rita de la Feria, ‘The EU VAT System and the Internal Market’ (Amsterdam, IBFD 2009) p 141.
[108] Copenhagen Economics, Study on reduced VAT applied to goods and services in the Member States of the European Union, p 98.
[109] Rita de la Feria, ‘The EU VAT System and the Internal Market’ (Amsterdam, IBFD 2009) p 142.

their basis of assessment that is very limited and their rate system that is multiple. The Brazilian consumption tax system goes thus against the system adopted in the European Union, especially in relation to the basis of assessment that is very broad in the European Union.

The main purpose of this study was thus to determine whether the replacement of the levies currently imposed on consumption in Brazil with a single and broader-based value added tax, within the parameters of the European VAT model as it stands, is feasible based on an evaluation of the basis of assessment, the method of calculation, the rate system and the place of supply rule adopted by both consumption tax systems.

Returning to the question posed at the beginning of this thesis, it is now possible to state that the value added tax implemented in the European Union is fiscally more advantageous, due to the fact that the latter is an efficient revenue yielding. The European tax is even a source to the financing of the own resources of the European Union's budget.

IPI, the tax under the scope of the Brazilian federal government, on the other hand, is an inefficient revenue earmarked, mainly due to the apportionment of the tax with other subnational levels. This obliges the federal government to rely on social contributions, which are non-shared levies, to complement its budget. The same logic occurs with the states and the municipalities, which rely not only in the ICMS and ISS, respectively, but also on intergovernmental transfers to fulfil their budgets.

Besides, these intergovernmental transfers were created with the aim to promote a fiscal equalization by transferring revenue to the less developed subnational governments. Nevertheless, in reality, these transfers neither mitigate regional inequalities, nor reduce the Brazilian horizontal fiscal disparities in any significant way.

The European VAT is also a neutral tax vis-à-vis competition between Member States, and Member States and third countries. Due to the fact that most of the transactions are taxed in the country of destination, all products, domestic or foreign, bear the same tax burden when finally sold to the consumer.

Before, interstate transactions in Brazil were taxed at the origin. Besides that, the Brazilian states were often allowed to confer fiscal benefits and to lower their rates to attract businesses into their jurisdictions. This practice led mainly to a distortion of competition between states. For that reason, new rules were introduced with regard to interstate transactions. Aiming a more equitable tax collection, the ICMS is now apportioned between the state of origin and the state of destination. However, the new rules oblige companies to be registered in each state where they have costumers, increasing even more the costs on taxpayers for information and compliance, especially for small and medium size entrepreneurs.

The calculation of the European VAT is furthermore considered to be easy. By using the tax-credit method, VAT is paid after each sale and refunded

after each purchase. The tax liability is thus attached to the transaction, which makes it legally and technically easier to follow.[110]

Many of the levies imposed on consumption in Brazil also follow the tax-credit method, with the tax paid in previous transactions being credited against the tax due in the following transaction. Nevertheless, this is not synonymous of non-cumulativity. The levies imposed on consumption in Brazil are not creditable against each other, resulting in an aggregate cumulative effect between the various consumption taxes assigned to all levels of government.

Under the non-cumulative regime, PIS and COFINS' simplicity and certainty is also jeopardized, mainly due to its complex basis of assessment. Besides, the high rates in force under the non-cumulative regime may render the latter more costly than the cumulative regime.[111]

With regard to ISS, IPI and COFINS (imposed under the cumulative regime[112]), they do not allow any credit for the same levies paid at earlier stages, which leads to a detrimental cascading effect.

The Brazilian consumption tax system as it stands is very complex, causing high costs on taxpayers for information and compliance, and high administrative costs for the public sector. Nevertheless, it deserves mentioning the fact that the European VAT also has its drawbacks. The multiple rate tax system adopted by the European Union, for instance, leads to economic distortions such as increased compliance costs, distorted competition and hindrance to intra-community trade. For that reason, the European Commission adopted an Action Plan in 2016 proposing, among others, options for a modernized policy on European rules governing VAT rates, aiming the avoidance of the issues caused by the lack of convergence of the VAT rate structure.

Brazil on the other hand, does not seem to have any plan on the agenda aiming to simplify the multiple rate system adopted by the levies imposed on consumption in the country. For instance, taxes like the state ICMS should have their rate system constrained by a Senate Resolution, in accordance with the 1988 Federal Constitution. However, in reality, states set their own tax rates on intra-state transactions autonomously due to the fact that no Senate Resolution has been enacted up to this date.

It can be concluded that, overall, there is a strong case for the implementation of a single and broader-based value added tax in Brazil, within the parameters of the European tax. However, another aspect has to be considered in this case, such as the federalist pact adopted by the country. Brazil has a tradition of very strong federalism[113] and, as a result, any

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[110] Alan A Tait, 'Value Added Tax – International Practice and Problems' (Washington DC, International Monetary Fund 1988) p 5.

[111] Ernst and Young, 'Experiences with Cash-flow Taxation and Prospects – Final Report' (2015) Taxation Papers Working Paper N. 55, p 99.

[112] PIS and COFINS can be imposed under a cumulative or a non-cumulative regime.

[113] Unlike the American federation that was formed by the union of previously autonomous colonies, the Brazilian federation was created in 1889 by the conversion of the old provinces that existed under the unitary colonial system into autonomous states. See, Victoria P Perry, 'International Experience in Implementing VATs in Federal Jurisdictions:

alteration in the subnational tax system is extremely difficult. Significant transformations would require not only the states' agreement but also constitutional amendments.[114] The 1988 Federal Constitution may be amended through a constitutional amendment proposal, which is foreseen in Article 60.[115] However, the constitutional framers stipulated some limitations to such amendment process. One of the explicit limitations is established in the fourth paragraph of Article 60 of the 1988 Federal Constitution, which sets forth that no constitutional amendment proposal shall be considered aiming to abolish the federalist pact adopted by the country. The autonomy conferred to the federal entities is inherent in the Federalism and, as such, cannot be abolished. Such autonomy implies, among others, the tax competence constitutionally conferred to the different levels of government. A constitutional amendment that aims to abolish the federal entities' autonomy, even partially, signifies a tendency to abolish the federalist regime as a whole, which, as mentioned, is unconstitutional.

The implementation of a harmonized VAT in a federalist regime always faces difficulties and the simple shift of experience from one country to another is nearly impossible due to the particularities of each nation. The situation is thus not different with Brazil. The federalist pact implies a considerable degree of autonomy conferred to the federal entities and such autonomy cannot be abolished, not even minimally, under the 1988 Federal Constitution.

All said, the analysis in this thesis shows that, a consumption tax reform in Brazil faces constrains of legal order. Nevertheless, despite this complexity, nothing hinders Brazil, on the other hand, to apply the principles that bolster the European VAT, such as fiscal neutrality, non-cumulativity, taxation at destination and so on, on its existing taxes imposed on the value added (IPI and ICMS), living up to the characteristics that made VAT a phenomenon worldwide. The same principles could also be applied to the remaining levies without extinguish them, keeping, in that way, the autonomy conferred to the federal entities and thus the spirit of the federalist pact in which the Brazilian Constitution is strongly based.

A summary' (2009) American Tax Policy Institute Conference on Structuring a Federal VAT: Design & Coordination Issues, footnote 12.

[114] Victoria P Perry, 'International Experience in Implementing VATs in Federal Jurisdictions: A summary' (2009) American Tax Policy Institute Conference on Structuring a Federal VAT: Design & Coordination Issues, p 5.

[115] Article 60 of the 1988 Federal Constitution establishes that one-third of the members of the Chamber of Deputies or of the Federal Senate; the President of the Republic; or more than one half of the Legislative Assemblies of the units of the Federation, each of them expressing itself by the relative majority of its members, can present a proposal to amend the Constitution. A proposal, presented to one of the Houses of Congress, must first be submitted to its Constitution and Justice Committee in order to have its constitutionality certified. Next, a special committee, specifically appointed to perform this task, analyzes its merits. The committee may accept, reject or modify the proposal. If approved, the original or modified version advances to the plenary, where it may be further altered. Approval by the House requires favorable votes of at least three-fifths of its members in each of two ballots. The approved terms of the proposal, which may be utterly different from the original, are then presented to the other House where a similar procedure takes place. If modified, the proposal is sent back to the former House for a final round of political negotiation.

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