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TAX REFORM AND INTERNATIONAL TAX NORM TRANSMISSION. CASE STUDY OF BRAZIL: VALUE-ADDED TAXES

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1. INTRODUCTION. THE ISSUE OF CASCADING TAXES AND THE OBJECT OF VALUE ADDED TAXATION.

The influence from International Organizations on the Brazilian tax system has been noticed in different fields, with varying intensities through the times, be it through individual income or corporate taxes, or be it through the so-called "indirect" taxes on consumption.

The growing globalization of the markets tends to multiply the interactions between governments, corporations and tax administration systems[3]. In this context, it's

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important to notice that value-added taxation showed extraordinary growth in the last 50 years. If in the 1960's there were only ten countries that had it, including Brazil, in the XXI century that number was already 136, making it one of the most important sources of income for governments. Currently every one of the 30 OECD countries have implemented the value-added tax, except the US[4].

These are the reasons that led us to set our focus on the valued-added taxation in Brazil. Thus, this article will address the importance of the VAT and the main external influences that led to its adoption in Brazil.

Having said that, in order to correctly define the purpose of the work, it is necessary to point out that the cascade or the overlap of taxes – which VAT's adoption prevents from occurring – may derive from three different situations, which are:

(a) Imposing two or more taxes on the same taxable event, which may be:

(a.1) double taxation; or

(a.2) *bis in idem*;

(b) Inclusion of taxes in the tax base of other taxable events, artificially inflating the taxable amount;

(c) Levying a tax on two or more stages of the supply chain.

It follows an analysis of them, one by one.

The first situation – imposing identical taxes on the same event – may constitute double taxation (in case two different entities make an identical charge over a single matter) or *bis in idem* (if both charges are imposed by the same governmental entity).

Double taxation, *verbi gratia*, occurs when two sovereign States intend to levy income tax on the same amount. The issues arising from the conflict between territorial source principle of taxation and the worldwide income principle of taxation (which serve as guidelines to the worldwide income taxation) bring up such questions, which

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[3]After the Second World War in 1948, the Organization for European Economic Cooperation (OEEC) is created based on the Marshall Plan and is supported by the United States and by Canada, having as its goal the reconstruction of the European economies. With its reformation in 1961 to Organization for Economic Cooperation and Development – OECD – its objectives expanded to encompass the governmental needs for lasting economic and social development. Its actions are not limited to activities involving the 30 countries that make up its members, but rather it is associated with a network of other developing countries. For example, in June 2007, when the G8 summit at Heiligendamm decided to talk to the emerging economies (South Africa, Brazil, China, India and Mexico), it requested OECD to propose a program for an adequate process of dialogue since the goal of the Organization is exactly to foster the expansion of the international commerce without discrimination.

[4] www.oecd.org.

are often solved by the treaties against international double taxation or unilateral solutions eventually adopted by the States (such as exemptions and the granting of presumed credits)[5]. At the national level of a federative State, double taxation occurs when two Member States or Municipalities wish to tax the same event (the best example, in Brazil, is the Tax on Services (ISSQN) – for which there is constant debate between the municipalities as to which one should levy it. Based on its own interests, each municipality uses the criterion of service provider location or that of the location where the services are provided).

The *bis in idem*, in turn, is less common. After all, the Member State may freely exercise its right to levy taxes on a specific event, given that it abides to the constitutional taxation principles. Once there is interest in increasing the revenue, the public authority may simply raise the rate of the existing tax. For this reason, the *bis in idem* occurs, commonly, whenever the taxation on some types of events is already very high and, even so, the State intends to raise it. In order not to be classified as a confiscation – more clearly noticed when one single tax is levied at an abusive rate – the public Authority uses the subterfuge of creating another tax on the same event. This situation is not accepted by the Brazilian Tax Law.

The second situation where tax overlap occurs is when taxes are included in the calculation of the tax base of other taxable events. This scheme, seldom present in other countries, has been constantly used by the Brazilian tax laws in taxes such as contributions to the Social Integration Program (PIS) and to Social Security (COFINS), in whose calculations both the Tax on Sale of Goods and on Services of Interstate and Intermunicipal Transportation and Communication (ICMS) and the Tax on Manufactured Products (IPI) are included. Therefore, the effective tax rate becomes higher than the one literally defined by the law, because the calculation is done based on an inflated tax

[5] SANTIAGO outlines that the issue of international double taxation is so complex that, "even where there is explicit conventional regulation, the income, the capital, the inheritance and donations may still be subject to double taxation, which was to be avoided (or subject to the opposite, double non-taxation, which is also not the purpose of the treaties), due to the diverging interpretations of factual matters or legal matters by the States that are parties to the treaties". (SANTIAGO, Igor Mauler. *Direito Tributário Internacional: Métodos de Solução dos Conflitos*. São Paulo: Quartier Latin, 2006, pp. 77/78).
Nonetheless, there is worldwide guidance as to avoid this double taxation, which creates barriers for the development of nations. As evidence of this, the United Nations (UN) and the previously mentioned OECD have sample treaties against international double taxation aimed at guiding the States that wish to eliminate this hindrance to free trade.

base. In spite of the errors of such scheme, the Brazilian case law has accepted the inclusion of taxes in the calculation basis of other taxes[6].

The third and last sort of tax overlap happens when the same tax is levied on more than one stage of the supply chain, which can only occur with taxes on consumption (imposed on the production and trade of goods and services). After all, only in these cases there is a logic-operational link from the first tax imposed, in the beginning of the chain, down to the acquisition of the good or service by the end consumer. Taxation on events that are isolated, not part of a process of value transfer, does not enable this type of tax overlap to be observed.

Based on that, it is possible to classify the three situations in which there is tax overlap:

(a) Double taxation on the same event: double taxation or *bis in idem*;

(b) Inclusion of taxes in the calculation basis of other taxes;

(c) Repeated imposition of the same tax along a production/transportation process of a good or service;

This last type of tax overlap is confronted by the value-added taxation. Hence, for the purpose of the present article, the statutes that determine the inclusion of taxes in the calculation basis of other taxes, as well as the situations of *bis in idem* or double taxation do not have any importance. Our interest is restricted to the cases in which there is cascading taxation due to the imposition of the same tax on different stages of the supply chain and of the transportation of goods.

2. ORIGINS OF THE VALUE-ADDED TAXATION.

Value-Added Taxes started to be implemented from the half of the XX century on.

Until then, the taxes levied on trade and on the services provided were similar to the *alcabala*, imposed by medieval Spain on all its colonies, and levied on all commercial transactions with rates up to 10% (ten percent), without any opportunity for deducing the taxes already paid in previous operations. Such system led to an increase in the price of goods, which became more expensive – because of the tax being repeatedly

[6] The inclusion of ICMS in the calculation of the PIS contribution (conclusion also valid for COFINS) is allowed based on the Judgment Docket N. 68 from the Superior Court of Justice.

levied on them – after each stage of the supply chain. This type of taxation, entitled turnover or cascading (*à cascade*, to the French people), was used by most of the countries before the VAT – with all the vicissitudes typical of that taxation scheme.

The problem of cascade taxation was so pronounced that A. SMITH[7], in the XVIII century, blamed the *Alcabala* for the economic decline of the Spanish empire. In fact, the multi-phase cascading turnover taxation works against the free organization of the market players (which, in order to avoid multiple taxation on the same product, tend to verticalize) and incites tax evasion, as a result of its excessive burden.

However, even with these disadvantages, the turnover taxation spread out in the modern world, but with rates significantly lower if compared to the ancient *Alcabala*. This is case of the Philippines in 1904, of the German *Umsatzsteuer* in 1918, of France (which adopted it 1920, cancelled it in 1936, readopted it in 1939 and definitely abandoned it in 1954), of Spain (which went back to cascading taxation in 1964[8]), besides Chile[9], Mexico and Canada (the latter, only between 1920 and 1923), *inter alii*[10].

The advantage of the cascading multi-phase tax – which helped it to spread out worldwide – is its simplicity, since the *quantum* due to the State is calculated through the simple application of the percentage determined by law to the value of the operation or service, without the need for any additions or deductions. On the other hand, given the fact that the tax is imposed on various stages of the supply chain, the rate does not need to be high in order to assure a satisfactory revenue[11], which amounts to the resignation of the taxpayers towards the payment of such tax. However, the disadvantages

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[7] SMITH, Adam. *Uma Investigação sobre a Natureza e Causas da Riqueza das* Nações, 2ª ed. Trad. por LIMA, Norberto de Paula. São Paulo: Hemus, 1981, p. 475.

[8] The rates were 1.5% and 3%, based on who the tax was levied on, the Spanish nation or the colonies.

[9] Chile adopted the multi-phase cascading taxation on goods and services in 1954, with a base rate of 3%. Nonetheless, after successive increases, in 1969 the rate had grown to almost three times the initial value.

[10] DUE, John F. *Indirect Taxation in Developing Economies.* Baltimore, London: Johns Hopkins, 1970, pp. 117-20.

[11] DUE, John F. *Indirect Taxation in Developing Economies.* Baltimore, London: Johns Hopkins, 1970, pp. 117-20.

have overcome, along the years, the benefits obtained through its adoption[12]. The disadvantages are, according to the list prepared by J. DUE[13]:

(a) the verticalization of the economic players: after all, the more stages of the supply and commercial chain one single company can encompass, the less the tax burden will be on its product;

(b) tax discrimination, given that the larger companies, besides the normal benefits from large scale production (present in any market), will also have fiscal advantages for encompassing various stages of production, escaping the numerous burdens of the *à cascade* taxation. Hence, such discrimination occurs, against small and medium-sized companies, which in modern economies account for most of the jobs created.

(c) the unfeasibility of effectively removing the tax burden on exports: since the tax is multi-phased and cascades, the good that is not exported directly by its manufacturer is subject to one or more taxes along the supply chain, without having the chance to recover or abate this amount at the time of the sale abroad. Thus, the world rationale of not exporting taxes is ruined, resulting in a loss of competitiveness of domestic products in the global market;

(d) the damage to the equality in taxation of imported goods, which, in most of the cases, will be subject to a lower tax burden than that applied on domestic product. The latter usually follows the chain manufacturer > distributor-wholesaler > retailer until the end consumer, whereas the imported goods, if directly purchased by the end consumer, will be subject to taxation one single time at the customs clearance. So the goods from abroad will have a smaller tax burden than the domestic goods[14];

(e) lack of transparency: it is not clear what the tax burden is on the final price of the sold product, because this burden will vary according to the number of stag-

[12] In Brazil, the multi-phase cascading taxation was adopted as a form of old taxes on sales and consignments – IVC – and on consumption, replaced, respectively, by ICM and IPI.

[13] DUE, John F. *Indirect Taxation in Developing Economies.* Baltimore, London: Johns Hopkins, 1970, pp. 120-3.

[14] And it cannot be argued that the Import Tax (II) would mitigate this difference. The II is a tax that must be used as an instrument of the State's development policy and not as a means to reduce the problems created by an inadequate tax system that is disadvantageous to domestic companies.

es in the supply chain. Thus, the consumer does not know the sum that is being collected by the government – fact that does not comply with the fiscal transparency[15];

(f) in comparison with taxes such as the retail sales tax (according to which taxation is imposed only once at the stage of final sale), with multi-phase cascading taxes the number of taxpayers is very high. They, furthermore, are not interested in self-inspecting each other, since the tax paid by one is not deductible from the tax amount due by another. This creates two problems:

(f.1) incentive to tax evasion: no member of the supply chain can gain from the taxes paid previously (as opposed to what happens with VATs, where, if the taxes are indicated in the invoice, the buyer may deduct that amount from the taxes due by him/her);

(f.2) difficulties in inspection: the vast numbers of taxpayers inclined to evasion makes the work of Fiscal Inspection excessively troublesome, this has led A. SMITH to state that its inspection "requires a crowd of fiscal employees"[16];

(g) although it is an apparently simple tax, in practice – due to the necessity to grant exemptions for some goods and the need to differentiate the rates according to the nature of the product (based on the essence of the product or on the market circumstances) – its application becomes complex. This feature leads to the loss of one of its few positive characteristics.

Faced with such issues and in search for alternatives to stir up economic growth without harming fiscal revenue, the European countries tried, in the first half of the XX century, to find a new form of imposing taxes on operations with goods and services that would not impact consumption severely and, consequently, would allow a more pronounced development of the economies, which were by then significantly damaged

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[15] In accordance with the principle that states that taxation on consumption must be done transparently, the Brazilian 1988 Constitution determines:

> "Article 150. (…)
> §5º. The law shall institute measures for the consumers to be clarified about the taxes imposed on goods and services."

[16] In France, the *Taxe sur la Valeur Ajoutée* (TVA) is categorized by MERCIER and PLAGNET as *La Taxe Unique à Paiements Fractionnés*, denoting by the very nomenclature ("single tax that is levied in a partitioned manner") the taxation method that distinguishes it from the cascading taxes. (MERCIER, Jean-Yves e PLAGNET, Bernard. *Les Impôts em France*, 29ª ed. Levallois: Francis Lefebvre, 1997, pp. 298-301).

by the two world wars. The solution appeared with the adoption of a proposal by the industrial VON SIEMENS, which was initially presented to the German government in 1918, but only implemented first in 1948 (in a limited way) and later in 1954 (in a more comprehensive manner) in France: the value-added tax.

When it was instituted, the *Taxe sur la Valeur Ajoutée* (TVA)[17] demonstrated to be an extremely complex tax, if compared to the old cascading taxes imposed on the consumption of goods and services in France[18]. Its calculation method was absolutely different from everything that was used until then: the tax amount due was calculated based on the commercial transactions carried out by the taxpayer during a certain period of time. Nevertheless, the taxes paid for the acquisition of the goods that were used in the production were deducted from the tax amount due. In other words: in order to calculate the *quantum debeatur* a system of debits and credits was applied, and after taking into account all of them, the tax amount to be effectively collected by the governmental fiscal authorities was determined[19].

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[17] The indirect taxes in France can be divided into two large groups: the *taxes déterminées*, which are imposed on especial goods or operations (such as alcohol sale) and the *taxes sur le chiffre d'affaires*, which are levied on the sale of goods and services in general. The latter can be further classified in three categories, according to when they were adopted in France:

(a) *taxes cumulatives* or *à cascade*: multi-phase cascading taxes, adopted in 1920 with low rates (around 1%), but cancelled due to a reform implemented by an act published on December 31st 1936, because of the problems caused by cascading taxation;
(b) *taxes uniques*: adopted starting from 1937, along with the big reform of the French tax system that took place in the previous year. They were levied one single time, on production, at a rate of 6% (so, six times greater, on average, than the rate of the *taxe cumulative*). However, the high numbers of tax evasion related to this type of tax combined with the budget problems faced by the French State led to their cancellation shortly. Hence, the *à cascade* taxation was put in place again in 1939, through the *taxe sur le transactions* and local taxes. And they were in force until 1968, when the TVA more comprehensive was adopted;
(c) *taxe sur la valeur ajoutée*: adopted partially in 1948 and, fully, in 1954, to go into force as of 1955. Also known as *la taxe unique à paiements fractionnés*, it had the benefit of combining the collecting advantages of the cascading system with the taxation neutrality, which began to have efficient mechanisms for transferring it to the end consumer.

[18] TVA, initially, was imposed only on commercial transactions carried out by wholesalers and retailers. Only in 1968, with the cancellation of two other taxes that were imposed on services and on retail trade, a more comprehensive TVA was created, encompassing the transactions that involved goods (including commercial rentals and leasing) and services in general.

[19] The Treaty of Rome, first foundation of the present European Union, is anchored on four fundamental freedoms, which are:

(a) free movement of persons;
(b) free movement of goods;
(c) free movement of services;
(d) free movement of capital.

The new taxation mechanism became, from the start, a success. In 1962, the NEUMARK report (one of the most influential documents on European taxation) recommended the adoption of VAT by the countries of the European Common Market, which occurred from the end of the 1960's. The report stated that the taxation on value added enables the free movement of goods and services, which is one of the basic principles of the Treaty of Rome[20]. Thus, despite the fact that the tax calculation is considerably more complex (when compared with the multi-phase cascading taxation, which was then the standard), and the fact that the VAT rates are necessarily higher than the *à cascade* taxes, the advantages overcome the flaws, if seen from the perspective of the manufacturers or from the perspective of the collecting State. After all:

(a) the mechanism of abatement of the tax paid in the previous stage generates a cross inspection among the taxpayers themselves. As opposed to what happens in the multi-phase cascade scheme, through which the tax evasion of the seller is beneficial to the buyer of the goods or services (reducing the prices charged), through VAT the tax burden on the buyer/taxpayer is greater if the product is not sold with an invoice (given that the indication[21] on the invoice that the tax amount paid by the seller permits the buyer/taxpayer to deduct it from the his/her VAT amount due). This fact, *per se*, is a great ally of the inspection authorities;

(b) the deduction at each stage of the tax amount paid at the previous stage, as to allow for the tax burden to be equivalent to the application of the rate on the end price, makes the due *quantum* independent of the number of stages in the supply chain of the good or service. For this reason, VAT is considered neutral (its burden does not depend on the number of transactions subject to taxation);

(c) with taxation neutrality, there is benefit to the economic players of the supply chain, which do not have to verticalize to reduce tax costs, thus being able to focus on the activity, to which they are best suited (manufacturing, distribution or retail);

[20] VAT, by enabling taxation neutrality, allows the four objectives to be achieved.

[21] It is obviously not the buyer's responsibility to supervise the payment of taxes by the seller. In order for it to be entitled to the credit, it is enough to have a purchase invoice that is idoneous and that shows the tax paid. Nevertheless, the mere request, by the buyer, for the invoice, makes an important contribution in the prevention of tax evasion.

(d) for international trade, the advantages are substantial: the tax burden on exportation can be effectively removed (the calculation method under analysis allows for the reimbursement to the exporter of the taxes levied on the materials used in the production of the goods sold abroad – which is impossible to be done with multi-phase cascading taxes, through which it is very difficult to ascertain the exact amount of taxes imposed on the supply chain). Furthermore, the foreign goods, when subject to taxation at the customs clearance, will be appropriately equated – from a fiscal perspective – with the domestic goods. This is due to the fact that since the real tax rate will be equivalent to the nominal rate, regardless of the number of supply chain transactions, the domestic products will always be subject to a fixed tax rate: the VAT rate determined by law. Hence, it is only necessary to levy the same tax rate, at the customs clearance, on the foreign good in order to equate it with the domestic good;

(e) the way through which the tax is charged makes taxation transparent, so that in each stage of the supply chain it is possible to know how much is being paid in taxes, for it is indicated in the invoice.

At first, in spite of its vicissitudes (complex calculation and higher rate), the French experience spread out in Europe and in practically every country in the globe[22]. Nowadays VAT is used in 136 nations where more than 70% of the world's population lives[23]. And, as shall be shown next, the most common method of VAT taxation does not characterize it – despite the name – as a tax imposed on value added. In fact, its tax base is the total price of the sale transaction. Only after calculating the due VAT amount based on the entire sum of the transaction, can the reduction in the *quantum debeatur* be obtained through the mechanism of deducting the taxes paid in previous transactions (indirect subtractive method).

3. THE ADOPTION OF VALUE-ADDED TAXATION BY THE BRAZILIAN LEGAL SYSTEM: EXTERNAL INFLUENCES.

[22] Brazil adopted it in 1958, including it in the Constitution in 1965; Denmark, in 1967; Germany, in 1968; Sweden and Holland, in 1969; Luxemburg and Norway, in 1970; Belgium, in 1971; Italy and England, in 1973; Argentina in1975; Turkey in 1985; Portugal, New Zealand and Spain in 1986; Greece in 1987; Hungary in 1988, *et caterva*.

[23] EBRILL, Liam; KEEN, Michael; BODIN, Jean-Paul; SUMMERS, Victoria. *The Modern VAT*. Washington: International Monetary Fund, 2001, p. xiv.

3.1. The implementation of VAT in Brazil.

Considering the post-Second World War period, the only major reform in the Brazilian Tax System occurred in 1965, date on which, among many other changes, the value-added taxation was included in the country's legal system at the constitutional level.

The reform was carried out in two phases: firstly the Constitution, enacted in 1946, was amended, through the Constitutional Amendment N. 18, from December 1st 1965; subsequently the National Tax Code was enacted, through the Act N. 5172, from October 25th 1966. Further progress was made by the enactment of statutory laws by each federative entity (federal government, states and municipalities), fully reshaping the legal system according to the new reality.

The Constitutional Amendment N. 18/65 created two value-added taxes: a federal one (Tax on Manufactured Products – IPI) and a state one (Tax on the Sale of Goods – ICM). Only industries and importers are subject to the former, whereas the taxpayers of the latter include, besides industries, merchandising businesses in general and farmers.

These two taxes replace, respectively, the federal Tax on Consumption (IC) and the state Tax on Sales and Consignments (IVC). The latter was a multi-phase cascading tax; the former, although originally created as a multi-phase cascading tax, was changed into a value-added tax even before the constitutional reform of 1965. In fact, the Act N. 2974/56 already allowed importers to deduct the amount of IC paid on importation from the IC sum due to the sale of goods in the domestic market. Then, the Act N. 3520/58 had broadened the span of the non-cascading IC, enabling industries to deduct from the tax amount due the value of the tax levied on the raw materials used in the production.

The aforementioned IVC was, in a way, equivalent to IC at the state level, but with two fundamental differences:

(a) was more comprehensive, for it was not restricted to the operations of industries and importers, but encompassed trade in general; and

(b) it was completely cascading, which was the reason for it to be considered "inflation favoring, verticalizer of economic activity, hindering the development of the Federation and technically wrong"[24].

As mentioned before, the Constitutional Amendment N. 18/65 eliminated IC, replacing it by IPI. At the same time, it also created the ICM – at the state level – and constitutionalized the non-cascading feature of the ICM[25] and of IPI[26]. Pursuant to the Constitutional Amendment N. 18/65, the *quantum debeatur* of these taxes would be calculated "by deducting, at each transaction, the tax amount charged in the previous ones"[27].

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[24] COÊLHO, Sacha Calmon Navarro. *Curso de Direito Tributário Brasileiro*, 7th ed. Rio de Janeiro: Forense, 2004, p. 384.

[25] At the time when the Constitutional Amendment N. 18/65 was enacted, ICM could also be imposed by the municipalities, at a rate not higher than 30% of that imposed by the states.

[26] The Amendment was an outcome of the first major tax reform in Brazil, which rationalized and systematized national taxation. It is worth noting the section on "Taxes on Production and Sale':

> "Article 11. The tax on manufactured products falls within the federal government's competent jurisdiction.
> Single paragraph. *The tax* is specific according to the essenciality of the products, and *non-cascading, with the tax amount charged in the previous transactions being deducted at each transaction stage.*
> Article 12. The tax on transactions related to the sale of goods, undertaken by merchandising businesses, industries and farmers, falls within the states' competent jurisdiction.
> (...)
> § 2º. *The tax is non-cascading, with the tax amount charged in the previous transactions, by the same state or by another, being deducted at each transaction stage, according to the provisions set forth in supplementary law,* and it shall not be levied on retail sales, made directly to the end consumer, of first need items, defined as such by an act of the State Executive Branch." (highlights made by us)

[27] In fact, one of the objectives of the 1965 tax reform was the very elimination of IVC, replacing it by the value-added taxation, as RIBEIRO DE MORAES reports:

> "In the 'Government's Economic Action Program, 1964-1966', prepared by the Ministry of Planning the Economic Coordination, a reform on the tax system was already foreseen, planned as follows:
>
> > 'The Tax Reform must (…), supported by a constitutional reform, put into practice a coordination system for the tax policies of the states and municipalities with the Federal Administration, particularly the Tax on Sales and Consignments, which must be revised according to the criterion of added value.'
>
> In August 1964, through an invitation from our Government, Prof. Carl Shoup, from the University of Columbia, was in Brazil. After studying our tax system, he came to the conclusion that it was necessary to adopt the method of value-added taxation. The idea of replacing IVC, a cascading type tax, by a value-added tax, was being consolidated." (MORAES, Bernardo Ribeiro de. *Doutrina e Prática do ISS*. São Paulo: Revista dos Tribunais, 1984, p. 45).

The subsequent 1967 Constitution kept the non-cascading feature of IPI[28] and of ICM[29] based on the exact terms of the Constitutional Amendment N. 18/65. This method continued with the Constitutional Amendment N. 1/69[30].

3.2. External influences on the adoption of the VAT model by Brazil.

With the adoption of the value-added taxation by Brazil already in 1956, by means of statutory law applicable to the federal Tax on Consumption, and taking into consideration that at that time:

(a) the European Economic Community had not yet voted on the adoption of one single VAT system, which only took place on April 11th 1967, through the enactment of the First and Second Council Directives[31];

(b) the IMF and OECD were not preferentially devoted to the topic;

(c) only France, in the entire world, had VAT effectively in place;

the French influence must be primarily recognized as to shape the Brazilian preference, which would be consolidated in the following decades towards the value-added taxation. In that European country, VAT was first instituted in 1948, in a limited way, and later in 1954[32], in a more comprehensive manner.

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[28] Article 22, §4º of the 1967 Constitution.

[29] Article 24, §5º of the 1967 Constitution.

[30] The Constitutional Amendment N. 1/69 read:

> "Article 21. It falls within the competent jurisdiction of the Federal Government to levy tax on:
> (...)
> V – manufactured products (...);
> (...)
> § 3º. The tax on manufactures products will be specific according to the essenciality of the products, and *non-cascading, with the tax amount charged in the previous transactions being deducted at each transaction stage.* (highlights made by us)
> "Article 23. It falls within the competent jurisdiction of the states and of the federal district to levy taxes on:
> (...)
> II – transactions related to the sale of goods, carried out by farmers, industries and merchandising businesses, *taxes that shall not be cascading and from which, according to the provisions set forth in supplementary law, the tax amount charged in previous transaction stages by the same state or by another shall be deducted."* (highlights made by us)

[31] FÉNA-LAGUENY, MERCIER, PLAGNET. *Les Impôts en France – Traité de Fiscalité 2008/2009*. Paris: Francis Lefebvre, 2008, p. 315.

[32] The French VAT at that time was restricted to the industries and wholesalers of goods. It would also be combined with another Tax on Services and with a Local Tax on Wholesale Trade. In Brazil, similarly,

Once the value-added taxation model was adopted by Brazil through statutory law, other external factors influenced its constitutionalization. One of them was the NEUMARK Report, published in 1962 by the Fiscal and Financial Committee of the European Economic Community. The aforementioned committee was composed of distinguished experts, all university-level professors, chaired by Prof. FRITZ NEUMARK, from Frankfurt, who was also rapporteur. Prof. CARL S. SHOUP from New York also took part in the committee. We have excerpted some relevant conclusions from that report, such as:

(a) the need of all Member States of the Community to suppress the cascading tax on gross revenue, levied on all stages. Instead of a cascading tax, a tax on net revenue would be imposed, that is, non-cascading;

(b) the non-cascading principle should be implemented through granting tax deductions not only to the taxes imposed on the materials needed for production, but also to the taxes imposed on the acquisition of capital goods for permanent assets. This view of the Committee resulted in the assessment that VAT should not a burden to the company, but to the consumers, for only so would VAT reach neutrality in the market;

(c) the VAT mentioned above could eventually be combined with a single tax on retail sales, with rates that could vary according to the country, however without causing distortions in competition;

(d) in intra-community relations, until harmonization was reached, the application of the country of destination principle could be applied for goods (meaning that the country of destination would be responsible for taxing the sale). Nevertheless, at the end of the harmonization period, the country of origin would be adopted for the purposes of taxing trade between the Member States, due to the fact that this system is more appropriate to integrated markets.

The influence of the NEUMARK Report occurred not only because of the close connection between France and Brazil, but also due to the collaboration from Professor CARL SHOUP (who was a member of the committee of the above cited report)

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the Tax on Consumption (IC), non-cascading as VAT, was restricted to the industrial production, though another tax on sales of goods was imposed by the Federation member-states on all transactions and with a cascading characteristic (IVC). Later, as mentioned above, IVC was changed into ICM through the 1965 Reform, becoming non-cascading.

to the Tax Reform Committee of the Brazilian Ministry of Finance[33], instituted in 1962, which led the way to the 1965 reform. The outcome of the collaboration from the American professor to the Brazilian Reform Committee was the SHOUP Report[34], published in 1965, with the following recommendations regarding value-added taxation:

(a) as for the federal Tax on Consumption:

(a.1) tax deductions should be granted for the IC imposed on the acquisition of machinery (permanent assets' goods) and other items not allowed at that time. In fact, despite the fact that IC was non-cascading at that time, its deductions were restricted to the materials used for the manufacturing of the end product. With this suggestion, SHOUP followed the same guidance given in the NEUMARK Report, which stated that the tax deductions should be large (the financial type), in order for the tax to reach the desired neutrality and not to hinder the economic development;

(a.2) IC should be extended to certain services, after amending the Constitution. This suggestion was never adopted, hence the Tax on Services continue to fall within the competent jurisdiction of the municipalities.

With respect to the states' cascading Tax on Sales and Consignments, which is imposed on all stages of production, manufacturing and trade, the SHOUP Report suggested:

(a) the replacement of the states' cascading tax by a single tax on sales or, alternatively, the creation of a tax on added value;

(b) in interstate transactions, the payment of taxes to the product's state of origin and not to the state of destination. By doing so, interstate customs barriers, "intolerable in a federal State"[35], would be avoided.

These were the same solutions proposed in the NEUMARK Report, which recommended that the destination principle for goods be only temporarily kept in the Eu-

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[33] The Reform Committee of the Ministry of Finance was made up of distinguished Brazilian experts on taxation, including the prominent Professor RUBENS GOMES DE SOUSA, speaker during the large meetings that took place, and that were open to other national authorities and experts, who were invited.

[34] SHOUP, Carl Summer. *The Tax System of Brazil.* Rio de Janeiro: Fundação Getúlio Vargas, 1965.

[35] SHOUP, Carl Summer. *The Tax System of Brazil.* Rio de Janeiro: Fundação Getúlio Vargas, 1965, p. 79.

ropean Community, until the harmonization was complete, and then the origin principle would enter into force[36].

After NEUMARK and SHOUP, there was the 1965 Reform, which shaped the Brazilian tax system that, since then, has been generally adopted by the subsequent Constitutions, including the current one from 1988 (as shall be observed in the following chapter).

At this moment, the chart below is useful to demonstrate, based on the fact chronology, the external influences on the formation of the Brazilian VAT:

1918: original proposal by the German industrial VON SIEMENS, made initially to the government of his country in 1918. After repeated and frustrated attempts, Germany would only adopt VAT, through a decision made in the European Economic Community – EEC, in the 1960's/1970's;
1948: the French tax on industrial production is changed into "*tax on partitioned payments*", in other words, this is the start of the VAT in France. In 1948, the tax is imposed on each industry or taxpayer, after deducting the tax levied on the acquisition of raw materials and of goods used in the manufacturing of the end product[37];
1954: the comprehensive VAT is instituted in France, allowing for the deductions associated with taxes levied on investments and general expenditures of the companies[38];
1956: in Brazil, Act N. 2974/56 altered the regulation of the federal Tax on Consumption in order to allow importers to deduct the IC amount paid on importation from the very IC sum due to the sale of the goods in the domestic market;
1958: in Brazil, based on the Act N. 3520/58, the reach of the non-cascading characteristic of IC was extended as to allow industries to deduct from the tax liability the tax amount imposed on the raw materials used for production;
1962: the NEUMARK Report is published, as a result of the work by the Fiscal and Financial Committee of the European Economic Community, EEC, created in 1960;

[36] It is known that, up to now, the change recommended in the NEUMARK Report was not implemented.

[37] C. LAMORLETTE; T. LAMORLETTE. *Fiscalité Française, 1994-1995*, 15th ed. Paris: Economica, 1994, p. 372.

[38] C. LAMORLETTE; T. LAMORLETTE. *Fiscalité Française, 1994-1995*, 15th ed. Paris: Economica, 1994, p. 372.

1964: national consolidation of VAT on the federal Tax on Consumption, for the provisions set forth in the Acts N. 2974/56 and 3520/58 were kept in the subsequent consolidation, enacted by the Act N. 4502/64;
1965: the SHOUP Report is published, written in 1964; the Constitutional Amendment N. 18, from December 1st 1965 is enacted.

We can arrive at the conclusion that the influence of the successful French experience was pivotal to convincing national lawmakers. Because of it Brazil adopted a federal, non-cascading Consumption Tax since 1956, which is in effect until today. It is obvious that the NEUMARK Report and the SHOUP Report, which were not necessary to the changes at the federal level, were important to put pressure on the states, because the shift from the old, cascading Tax on Sales and Consignments would only be implemented through the Constitutional Amendment N. 18/65, which was capable of altering the Constitution.

4. THE 1988 CONSTITUTION AND THE VALUE-ADDED TAXATION MODEL.

As mentioned before, Brazil's current Constitution followed the tax system model of the Constitutional Amendment N. 18, although it made a great effort to enhance state and municipal tax revenues[39].

The 1988 Constitution kept the federal Tax on Manufactured Products (IPI) with the same name and characteristics it had hitherto.

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[39] A comparison of the constitutional evolution of Brazil's tax system shows the decentralization of tax revenues brought about by the Bill of 1988:

Previous Constitution (1967, Amended in 1969)

Federal taxes (9): imports and exports; rural-land property; income; manufactured products (value-added tax); interstate and intermunicipal transportation and communication services; credit operations.

State taxes (2): transfer of real estate; sale of goods (value-added tax);

Municipal taxes (2): urban real estate property; services (except communication and transportation).

1988 Constitution

Federal taxes (7 + contributions): imports and exports; income; manufactured products (value-added tax); credit operations; rural-land property; great fortunes. Besides these taxes, the federal government can also impose contributions for the social area and for the development of segments of the economy.

State taxes (3): sale of goods; communication and interstate and intermunicipal transportation services provided (value-added tax); inheritance; property of automotive vehicles.

Municipal taxes (3): services of any nature (except telecommunications and interstate and intermunicipal transportation, subject to state tax on the sale of goods and services); urban real estate property; transfer of real estate.

The great turnaround occurred in the state Tax on the Sale of Goods, which gained importance. The range of events subject to that tax was widened, as the taxation of some commodities and services hitherto subject to federal excise taxes, was transferred to the states. In fact, in the previous Constitution, the taxation of oil and its by-products, electrical energy and minerals was allotted to the Union, as well as the taxation of telecommunication and interstate and intermunicipal transportation services. As all of these were reallocated to the states taxing power in 1988, the tax on the Sale of Goods (ICM) was renamed to Tax on the Sale of Goods and Services (ICMS).

The VAT model continued being applied both to the Tax on Manufactured Products and to the Tax on the Sale of Goods and Services, as the experience since its adoption by the Constitution Amendment N. 18, of 1965, had been successful.

In the years 2002 and 2003, the last chapter in Brazil's value-added taxation history (until now) was written: a legislative reform transformed two federal turnover taxes into two new federal value-added taxes levied on gross revenue: the non-cascading contributions to the Social Integration Program[40] and to Social Security[41]. After the legislative change[42], a Constitutional Amendment (N. 42/2003) was passed, consolidating the new form of taxation. In the new non-cascading system of social contributions, taxpayers are allowed to deduct from the social contributions due (calculated based on gross revenue), the taxes paid on transaction expenses.

The adoption of this taxation system for the social contributions on gross income was influenced by the International Monetary Fund, despite the fact that the Brazilian government had already been seeking an alternative for it, due to strong internal pressures from all business sectors. In fact, the burden of social contributions in the cascade system is highly prejudicial to business, as any turnover tax is. Recognizing that, Brazil made a commitment to adopt, by the end of 2002, the non-cascading system for the PIS social contribution. Once it was successfully implemented, the reform of the other social contribution on gross revenue (COFINS) faced no difficulties in the following year.

5. CONCLUSIONS.

[40] Contribution to the Social Integration Program – PIS.

[41] Contribution to Social Security – COFINS.

[42] The change was enacted by Acts N. 10.637/02 and 10.833/03.

5.1. External influences and the particularities of Brazil's tax system.

The external influences, whether indirect, derived from successful experiences of other countries regarding value-added taxation – as it was the case with France and later with EEC – or from international economic or political institutions, IMF, OECD, can seldom be applied elsewhere in their raw form, without important changes and adaptations. Besides the different economic, political and social structure, the current Constitution, the academic culture and its traditional conceptual structures, the repeated practices of the tax administration system, all of it has an impact on the desired theoretical model, in such a way that it will hardly ever be replicated somewhere else with the same consequences. Let us, then, point out the most important reasons that interfere with the Brazilian VAT model or models, which guarantee us with many national characteristic features, some of which are worth a second thought, adaptations and, if very detrimental, changes to the VAT model adopted.

The national tax system currently in force had its structural outline modeled by the Constitutional Amendment N. 18/65, which modernized it, incorporating in the Constitution the non-cascading concept for the main multi-phase taxes that caused a burden on consumption, namely, the Tax on Manufactured Products (IPI) and the Tax on Sale of Goods (ICM). The new system adopted taxes similar to the European Value-added Tax (VAT), leading the way as far as the models in Latin America are concerned. Later, new alterations were made, by means of successive changes, such as the one brought about by the Constitutional Amendment N. 42/2003.

The intangible principles of the Constitution, such as the federative principle and the democratic State ruled by the law, constitute presuppositions of the tax system and, thus, of any proposed reform, in order to achieve legal security, freedom, social justice and development, which are objectives expressly assured in art. 3rd of the Constitution. Furthermore, new methods of tax collection, inspection, evasion control and simplification have been implemented, which sometimes lead to errors in the Brazilian VAT's.

At last, let us highlight in this brief article only two factors – among many others – which make the Brazilian system very peculiar:

- the federalism, which fuels the proliferation of the Brazilian VAT's;

- the new inspection and control techniques, many of them derived from distrust, whether regarding taxpayers or associated with federative relations between states and municipalities among themselves.

5.2. Some issues arising from federalism.

The Federation, throughout the last thirty years, has lived with the vicious aspects of the system, especially with respect to ICMS, tax of the member states, such as: fiscal war, fueled by the unfair distribution of taxes in the transactions between the net producing and net consuming states; disparities among state statutes; diversity of tax rates that cause the accumulation of structural credit, in particular in interstate transactions; loss of tax's neutrality and of the range of taxable events, due to the ever growing number of legal or illegal tax exemptions and fiscal benefits during the predatory competition among the states.

Since 1990, the Federal Government has presented numerous bills for a tax reform, without success. At the nonconstitutional level, through many statutory laws, it implemented the non-cascading PIS and COFINS, which led to the consolidation, among us, of the existence of various concurrent VAT's, working non-harmonically and in cascade: at the federal level, IPI+PIS+COFINS, all are taxes levied on added value; at the state level, ICMS, multi-phased and non-cascading; and at the local level, separately a Tax on Services is still imposed, the ISSQN.

It became common to state that the inclusion of a real VAT in our country, which would combine simplification, harmonization and non-cascading characteristics (in ideal sense), would only be possible if the following taxes fell within the competent jurisdiction Federal Government: IPI+ICMS+ISSQN+PIS+COFINS. Many bills for this type of reform have been proposed in the last fifteen years, since the 1988 Constitution, but they are always set aside, defeated by the reaction of the states and municipalities, which are worried about their revenue and their fiscal independence, which are already weak compared to the Federal Government.

As a matter of fact, federalization and the unification of the Brazilian VAT's would be the easiest and most efficient solution, definitively eliminating the cascading effect on one another.

In fact, there is no federative country in which the adoption of a national VAT occurs without arguments and difficulties. Each one finds the equation that suits it best, and that is compatible with its administrative, political and social culture, so that it is impossible to simply shift the experience of a country to another.

This is demonstrated by SÉRGIO PRADO, who analyzed, comparatively, the VAT in federative countries like Germany, Australia, Brazil, Canada and India, from three different prisms – competent jurisdiction (jurisdiction to legislate and control VAT), administration and collection (jurisdiction to administer, inspect and collect the tax) and revenue appropriation[43]. It seems certain that federalism is a matter of degree and that each country, in a tension field caused by centrifugal, disintegrating and diversifying forces, which are opposed to centripetal, integrating and unifying forces, finds its own balance. It involves a concept of constant historical change (and aren't all of them?), where diversifications between two extremes are known: the strong political inter-dependence, characteristic of the German model and the predominantly dualistic model of the North American regime.

Transferring to Brazil the German model (or the model of any other country), in which the VAT is totally governed by uniform federal regulations, would have to include the importation of other institutes characteristic of that country, such as the Federal Council, that provides the states with the opportunity to strongly interfere in the lawmaking process of the Federal laws, which may have an effect on their finances. It is interesting to note that in the German federalism, the competent jurisdiction of the state Legislative branch is reduced, but the state Executive branch actively participates in the role of lawmaking with the Federal Government (federalism of "joint policy", rather than cooperative federalism). Furthermore, the bulk of the taxes that exist in that country, not only VAT, in spite of being for the most part instituted by the Federal Administration, is administered and collected by the states, including the income tax. Finally, its system for revenue distribution, maybe the most complex of all in the planet, works efficiently and is able to balance the quality of the services provided to the residents of each state. It is not only based on vertical distribution (Federal Government → states), but it is also supported by horizontal distribution, carried out among the states themselves, aiming at equating and reducing inequalities.

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[43] PRADO, Sérgio. *Equalização e federalismo fiscal: uma análise comparada – Alemanha, Índia, Canadá, Austrália*. Rio de Janeiro: Konrad-Adenauer-Stiftung, 2006, p. 28.

The German model, in the meantime is unthinkable for us. Certainly, in the near future, we will be capable of perfectly integrating the tax administration, with loyalty and trustworthiness, as it is done in an enviable manner in Germany.

Canada, in turn, functions with a pronounced independence of the provinces and territories, led by Quebec. In 1991, a modern federal VAT was created and, with that, the Provinces were encouraged, through financial incentives granted by the Federal Government, to harmonize their internal Sales Tax to the federal VAT. Only three Provinces, exactly the three poorest ones, accepted the offer. The adoption by Quebec of the federal model was achieved by other means and requirements, namely, the institution in 1992 of its own state VAT (the Quebec sales tax), in harmony with the federal VAT by transferring the entire administration and collection of both taxes to that Province, which redistributes part of its revenue to the Federal Government. In Alberta, the richest of the Canadian Provinces, no sales tax is collected, only the federal VAT is imposed. SÉRGIO PRADO acknowledges the existence, in total, of nine different taxes in Canada[44]. Conversely, the XIX Report of the Tax Council of France[45] reduces those nine mentioned taxes to only four different regimes[46].

BEV DAHLBY, economics Professor at the University of Alberta, argues that the Quebec model – combination of two harmonic VAT's, collected and administered

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[44] PRADO, Sérgio. *Equalização e federalismo fiscal: uma análise comparada – Alemanha, Índia, Canadá, Austrália*. Rio de Janeiro: Konrad-Adenauer-Stiftung, 2006, p. 160.

[45] The European Union became interested in the Canadian experience after other federative countries were included in that Community.

[46] *La Taxe sur la Valeur Ajoutée.* XIX Rapport au Président de la République. Conseil des Impôts. Paris. Ed. des Journaux Officiels, 2001, p. 326. Here is the Report's position:

"In summary, Canada is presently characterized by the coexistence of four different regimes of taxes on consumption:

1) Two VAT's, one at the federal level and the other at the provincial level, which are different, but with the tax administration being done by the Province. This is the situation in Quebec. The provincial VAT is imposed on a tax base that also encompasses the federal VAT. The collection of both taxes is carried out by the Quebec's revenue office, which ensures the administration of the federal VAT pertaining to Ottawa.

2) Two VAT's, federal and provincial, shared among the following states and administered by the Federal Government: this is the situation of the three Atlantic provinces.

3) One federal VAT, besides the provincial sales tax, administered separately.

4) One single federal VAT: this is the case of Alberta, which does not impose any general tax on sales."

by the state, without economic overlapping on one another[47], and without the problems of having a state tax, whose incidence is only on retail sales – should be adopted by the other Provinces.

In summary, based on the small illustration of VAT in federative countries given, we have an example of the extraordinary possibility of combinations (besides many other imaginable). Because of that, we must not attempt to apply the model of a certain country to another one without careful consideration of the peculiarities of both, for such attempts have been a cause of frustration with respect to the expectations to improve the tax system.

In the last years, no proposal that considered removing that competent jurisdiction of states over VAT has evolved in Brazil. Similarly, the idea of transferring to the hands of the Federal Government the taxation of the most important services, included in the SHOUP Report, was not successful either. We stress the fact that the following should not be obstacles to the improvement of the Brazilian tax system: the current political impossibility to unify VAT in the hands of the Federal Government or the insistence by the municipalities on having competent jurisdiction to collect the ISSQN, the main source of revenue of the big capitals. It is not impossible, in spite of the legislative complications and of the number of governmental tax agents, to reach harmony and, above all, to reduce substantially the cascading effect. This is shown by the Canadian model. In order to do that, it is only necessary for the ICMS and the ISSQN to be deductible from the tax bases of PIS and COFINS.

5.3. Special tax collection techniques that distort the Brazilian VATs.

The national tax system makes use of several especial collection techniques, which tend to simplify the enforcement of the law, reduce its costs and fight fiscal fraud and evasion. All of this may be summarized in one word: practicality. The techniques are: fiscal accountability of third parties for taxes due by the taxpayer (such as the sources of income); charging the tax payment or defining the taxable event at an earlier stage (such as the progressive or “forward” substitution); assumption of the tax base, through which the treasury authorities disregard the real value of the event and stipulates an assumed value, fictitious value, etc.

[47] In fact, Quebec’s VAT is levied on the tax base that already includes the federal VAT, 7%. Due to that, its rate was reduced from 8% to 7.5%, thus, at the end, the total effective rate of both equals 15%.

In principle, such techniques are allowed by statutory law. But if excessively used, as is the case in Brazil, they cause many distortions. With regards to VAT, they distort the nature of the tax, its neutrality, they make it cascade-like and they remove the greatest attribute that is characteristic of it: being a tax that is adequate to the market. The progressive tax substitution takes place with the ICMS – state VAT – when the tax is no longer collected at each stage of the supply chain, but rather previously by the manufacturer only, though it is imposed on all stages down to the end consumer. The forward tax substitution, so called exactly because the entity accountable replaces the future taxpayer (which is still to come, afterwards) in later transactions. The tax base is, thus, assumed, everything is assumed, for the sale in the next stages has not yet taken place. The administration establishes then, estimated prices, determining the tax bases, based on which the taxpayers will pay taxes to the public treasury, ahead of time.

If the future taxable event does not take place, is there the obligation to reimburse the tax paid unfairly? Yes, there is, but only if the event does not happen at all, that is, if the sale is cancelled, for instance because the good has degraded or was lost. But if the taxable event happens, with a smaller tax base or at lower prices than the assumed ones, there is no right to a rebate of the amount that was paid in excess; this is the Constitutional Court precedents. Why isn't there the right to reimbursement? The Court's arguments are practicality reasons (easiness, efficiency).

The Constitutional Amendment N. 03/93 included §7º to article 150 of the Federal Constitution of 1988, with the very objective of eliminating the claims regarding the unconstitutionality of the progressive tax substitution. In fact, it can only be included in a statutory law. However, new debate arose, because the tax authorities began to interpret the new constitution provision literally, that is, would only accept to reimburse the tax paid in excess if somehow the taxable event had not taken place. The Brazilian Constitutional Court, in the trial of the ADIn (direct action for the declaration of unconstitutionality) N. 1851-4/A1, by a majority of votes, ruled in favor of the constitutionality of the progressive substitution, defining it as a fiscal instrument of practicality, and moreover, authorized the tax base assumptions to be definitive, that is, did not require the treasury authorities to reimburse the tax paid in excess.

This ruling made by the Supreme Court cause many damages to the system, namely:

(a) if on one hand it is true that in the weighted average of the cases there may be fairly accurate estimates, with small differences that can be disregarded, on the other hand it is also true that many taxpayers, in a free market, may sell their goods at a price substantially lower than the estimated value, or may – through a legal trade strategy –intentionally sell the product for its cost. Due to the economic capacity, they should not be subject to excess taxation and later being forbidden to equating the differences. Nor can the price of the transaction be imposed as in the Procrustes' bed. It is clear that the major industries and wholesalers are not at the end stages of trade, they are not subject to withholding and only do their tax returns and pay according to the real value of the transactions; this proves the relative unfairness of the technique: it puts a greater burden on the small sellers and industries than on the large ones. The marginal cases, on the other hand, which go against equality, economic capacity and the concept of non-cascading taxation, in their personal-subjective consequences, should always deserve the administrative control and, when needed, the interference by the Judicial Branch, which assures equity and individual justice;

(b) the mistaken ruling by the Court served as stimulus for the state treasury authorities to multiply the cases where forward tax substitution is applicable, so that ICMS, the state VAT of Brazil, will shortly have no resemblance with the multi-phased, classic, non-cascading tax, from which it originated, or with the European VAT. For example, the states of São Paulo and Minas Gerais expanded this odd regime to products such as: cigarettes, fuels, automobiles, soft drinks and beers, paints and varnishes, cement, tires and ice creams, hygiene and cleaning products, manufactured food, wines, CDs, etc. As a matter of fact, a few goods are subject to traditional tax collection, based on the system of debit and credit at each transaction until the end consumer, for instance, clothes, shoes, textile, and some electronic house appliances. (In principle, all other goods may be included).

(c) and moreover, the non-cascading concept is no longer used. The taxpayer that is replaced (who is at the end of the supply chain, for instance, the retailer) no longer pays any tax directly, but he/she carries the burden of taxation, for his/her supplier, the manufacturer, already offsets the sum associated with the

future transaction. Since he/she is not included in the taxation system, he/she is not entitled to any tax deductions related to the acquisition of goods as assets or machinery. Obviously, when estimating the tax base of the future transaction, the calculation is based on the net value, not the gross one, as to avoid the overlapping with the tax levied on the previous stage. Nonetheless, if the replaced taxpayer acquires goods as permanent asset (machinery, furniture and other goods that were subject to ICMS at the acquisition), the associated tax credits will be lost, contradicting the statutory laws and the Constitution. In order to obtain such credits, if the taxpayer works exclusively under the especial regime of progressive substitution, which happens in various cases, he/she will be faced with barriers that are difficult to overcome and ICMS, in that regime, will contradict the non-cascading principle.

Anyone who has seen the movie MINORITY REPORT, produced in Hollywood, and starred by TOM CRUISE, which portraits the punishment and elimination of people before the crime is committed (so the crime would not take place in the future), knows that, in Brazil, in the field of Tax Law, that is not science fiction. It is the pure truth. The obligations to pay may exist even before the taxable event takes place. Definitively.

We hope this technique is not copied by other treasury authorities, especially, the Federal Government, with respect to the Income Tax. It is evident that the federal tax, withheld by the source of income, is a simple tax anticipation, whose origin should occur in the future, when the taxable event happens. Therefore, the settlement with the treasury authority will always exist, once the fiscal year or the balance sheet is closed.

The progressive substitution or the withholding at the source of income, or even the accountability for a future taxable event – different names for similar phenomena – is the most desperate way of speeding up time that we know. With VAT, it is carried out so intensely only in Brazil, despite the fact that a similar tax is adopted in over 130 countries. This type of anticipation (without a settlement afterwards) is a technique to surmount the insurmountable: the time of the Law, which is not (and should not be) the time of the economic and social environments where the events take place. Through excessive simplification and distrust (we assume that all taxpayers are dishonest) and in the urge of reducing the time differences, we are distorting the ICMS, IPI

and the social contributions. We will not experience the concepts of multi-phase and non-cascading taxes in the near future, because the forward tax substitution is becoming the standards, not the exception.

A survey carried out by the National Industry Association (CNI), encompassing the entire Brazilian territory, showed that 58.2% of the companies reject the tax substitution regime. According to them, the anticipated collection of the state VAT at the beginning of the supply chain cuts the profit of the companies, reduces the cash flow and causes the loss of clients, especially by small and medium-sized companies. The survey diagnosed that the rejection is greater among small companies, around 62.7%[48].

In summary, we highlight only two principles or rules of the Brazilian system, the federalism and the practicality (with distrust), which illustrate the peculiarities of the value-added taxation in Brazil: multiplicity of VATs; assumption of tax bases and anticipation of the revenue at the manufacturer or at the wholesaler, so that there is harm to the equality among small and large companies, to neutrality and to the non-cascading concept. Certainly this reality deserves changes, as it doesn't reflect the VAT's characteristics that had made it a worldwide phenomenon.

[48] www.cni.org.br.