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WILL BRAZIL EVER ESCAPE ITS TAX “MADHOUSE”?: KEY TAKEAWAYS FOR FOREIGN INVESTORS

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ABSTRACT

Brazil’s tax regime is described as perplexing and cumbersome, even a “madhouse”, baffling taxpayers and their advisors alike. In fact, Brazil remains at the top of the list in terms of the number of hours typically spent during the calendar year by companies to comply with tax filings and payments. This Article covers the more salient features of the country’s legislation focusing on the determination of taxable income (distinguishing taxes on net income versus presumed profits); indirect levies on consumption at the federal, state and municipal levels; cross-border transactions (including interest on net equity payments, and application of tax treaties); ending with the time-consuming resolution of controversies. Comparisons to the laws of its Latin American neighbors are made where pertinent. Previously, an overview of tax collections is offered, along with a brief historical perspective before and after independence.

The author offers specific recommendations to simplify the Brazilian tax system, with the goal of reducing compliance costs for local businesses while simultaneously increasing the nation’s attractiveness for foreign investors. Specific proposals include: (1) combining the two corporate income taxes into one single levy; (2) eliminating the multiple assessments triggered upon a cross-border payment; (3) consolidating the various levies on consumption into a single national value added tax; and (4) enabling taxpayers to conclude settlement

agreements with government officials, at least with regards to routine matters, reducing the heavy caseloads tribunals currently face. In essence, synchronizing Brazil's tax laws to those adopted by other OECD-member nations should be the prime objective.

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INTRODUCTION

Complicated, intricate, convoluted, elaborate, impenetrable, mysterious, tortuous, enigmatic, arcane, confusing, puzzling, entangled, ambiguous, incomprehensible, undecipherable . . . these represent just a sample of terms taxpayers and advisors often use to portray the tax regime adopted by the Federative Republic of Brazil (*República Federativa do Brasil*). For instance, earlier this year, the President of the Senate, Rodrigo Pacheco, characterized the nation's tax system as "chaotic in need of fixing" (*o sistema caótico tributário que precisa ser corrigido*).¹ Even the Ministry of Economy states on its web site that the country's tax system is "unjust, expensive and complex" (*injusto, caro e complexo*) and needs to be revamped in favor of one that offers more efficiency and equity.² As a matter of fact, one could forcefully argue the entangled web of laws currently in force in Brazil is the inevitable outcome of a poorly designed tax regime.³

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1. See, e.g., Gabrielle Varela, *Reforma Tributária Pode Ser Votada na Primeira Semana de Abril, diz Pacheco*, CNN BRASIL (Mar. 25, 2022, 3:52 PM), <https://www.cnnbrasil.com.br/https://www.cnnbrasil.com.br/business/reforma-tributaria-pode-ser-votada-na-primeira-semana-de-abril-diz-pacheco/>.

2. *Reforma Tributária: Mudar o Que é Preciso, Cuidando de Quem Precisa – Reforma do Imposto de Renda*, MINISTÉRIO DA ECONOMIA, <https://www.gov.br/economia/pt-br/aceso-a-informacao/acoes-e-programas/reforma-tributaria> [hereinafter MINISTÉRIO DA ECONOMIA].

3. See MICHAEL REID, *BRAZIL: THE TROUBLED RISE OF A GLOBAL POWER* 225 (2014). For instance, during the period 1988 to 2012, almost 30,000 tax rules were issued by the federal government, without taking into account those issued by state and municipal authorities. *Id.* at 225-26.

Yet perhaps the most famous and insightful term used to describe Brazil's tax legislation was made back in 1963, when the illustrious professor Alfredo Augusto Becker referred to it as a "legal tax madhouse" (*manicômio jurídico tributário*).⁴ Professor Becker made this famous characterization a few years prior to promulgation of the National Tax Code,⁵ which unfortunately has failed in its mission to improve the overall scenario. In similar fashion, the former Minister of Economy, Paulo Guedes, has repeatedly portrayed the nation's tax code as a "madhouse" to justify a much needed overhaul.⁶ According to Minister Guedes, whoever exerts political power benefits from exemptions and whoever enjoys economic power avoids paying tax by means of litigation, resulting in a "perverse, regressive and inefficient" (*perverso, regressivo e ineficiente*) system of tax collection.⁷

Arguably, Brazilian tax legislation is by its very nature, intrinsically complex, containing many distinctive adaptations. This becomes even more evident when one compares Brazil to its neighbors in Latin America—such as Mexico, Chile, or Colombia—which tend to be more

4. ALFREDO AUGUSTO BECKER, *TEORIA GERAL DO DIREITO TRIBUTÁRIO* 6 (Saraiva ed., 1963). The complete paragraph states as follows: "In Brazil, as is any other country, the same *pathological-tax phenomena* occurs. And more witnesses are unnecessary, because all jurists who live at this present time – upon reflection without pride and prejudice – realize that they circulate within the corridors of a *legal tax madhouse*." (emphasis added).

5. See *infra* note 145.

6. See, e.g., Joe Rowley, *Brazil Set To 'Surprise The World' in Post-COVID-19 Recovery, Minister Says*, LATINFINANCE (July 20, 2020); <https://www.latinfinance.com/daily-briefs/2020/7/20/brazil-set-to-surprise-the-world-in-post-covid-19-recovery-minister-says>; see also, e.g., Rodrigo Viga Gaier, *Guedes Diz Que Para Crescer Brasil Tem Que Sair de "Manicômio Tributário"*, REUTERS (Nov. 8, 2019, 1:30 PM), <https://economia.uol.com.br/noticias/reuters/2019/11/08/guedes-diz-que-para-crescer-brasil-tem-que-sair-de-manicomio-tributario.htm>.

7. Anderson Vieira, *Reforma Não Vai Elevar Carga, Mas Acabar com 'Manicômio Tributário', diz Guedes*, SENADONOTÍCIAS (Aug. 5, 2020, 12:00 PM), <https://www12.senado.leg.br/noticias/materias/2020/08/05/reforma-nao-vai-elevar-carga-mas-acabar-com-manicomio-tributario-diz-guedes>. See also Guedes: *'Reforma Tributária Ajudará a Reduzir R\$ 300 Bilhões por Ano em Desonerações e Isenções'*, GAZETA BRASIL (May 4, 2021), <https://gazetabrasil.com.br/politica/reforma-tributaria/2021/05/04/guedes-reforma-tributaria-ajudara-a-reduzir-bilhoes-em-desoneracoes-e-isencoes/?msclkid=6972ed16cecc11ec92f0881c682bbd7e> (taxpayers in Brazil enjoy annual exemptions of nearly R\$ 300 billion, and have filed appeals at the various tribunals challenging assessments, currently valued at almost R\$ 4 trillion).

receptive to incorporating the various international tax principles, initiated by the OECD, into their respective domestic laws and regulations. Brazil's competitive disadvantage (of which tax is a major component) in attracting foreign investments, when compared to other developing nations, is commonly referred to as "the Brazil cost" (*o custo Brasil*).⁸ The term *o custo Brasil* was first coined in 1995 at a conference organized by the National Confederation of Industry (*Confederação Nacional da Indústria, CNI*),⁹ where local business leaders implored the need to lessen the cascading impact of multiple levies.¹⁰ Other factors contributing to the country's lack of competitiveness are labor costs, high interest rates, excessive administrative regulations, and inefficient transportation.¹¹

Despite continuous improvements in its digital bookkeeping system (*Sistema Público de Escrituração Digital, SPED*),¹² Brazil remains the world's worst jurisdiction (when compared to any other nation) with regard to the number of hours expended during the calendar year by local companies to comply with tax filings and payments, with just over 1,500 hours in 2018 as reported by the World Bank.¹³ Moreover according to the CNI, large companies spend significantly more

8. REID, *supra* note 3.

9. Decreto-Lei No. 1.402, de 5 de Julho de 1939, seção 1, art. 25 §1, Diário Oficial da União [D.O.U.] de 07.07.1939 (Braz.) (CNI was established pursuant to this decree).

10. *O Custo Brasil: Entraves à Competitividade e ao Crescimento Industrial do País*, VEJA (Sep. 27, 2021, 10:21 AM), <https://veja.abril.com.br/insights-list/o-custo-brasil-entraves-a-competitividade-e-ao-crescimento-industrial-do-pais/> [hereinafter VEJA].

11. REID, *supra* note 3; see also VEJA, *supra* note 10 (other factors contributing to "the Brazil cost" include quality of workforce, lack of access to capital, poor infrastructure, and judicial uncertainty).

12. Decreto No. 6.022, de 22 de Janeiro de 2007, Diário Oficial da União [D.O.U.] de 22.01.2007, Edição Extra (Braz.) (SPED was instituted pursuant to this decree).

13. *Paying Taxes 2020*, PWC, 18 (2020), <https://www.pwc.com/gx/en/paying-taxes/pdf/pwc-paying-taxes-2020.pdf> (last visited Nov. 5, 2022) [hereinafter *Paying Taxes 2020*]. The average time in Brazil to comply with tax obligations decreased from 2,600 hours in 2004 to 1,958 hours in 2016, and thereafter to 1,501 hours in 2018. *Id.* By comparison, the world average reported for 2018 was 234 hours, while in Mexico, the average time to comply during the period 2014 to 2018 has remained steady at 241 hours. *Id.* at 8.

time—up to 34,000 hours annually—to fulfill all their tax requisites.¹⁴ Along the same lines, a survey conducted in 2019 revealed that 96% of Brazilian entrepreneurs believe the onerous tax burden and inherent complexity of the nation’s tax regime represent major obstacles for the development of their businesses.¹⁵ Indeed, Professor Becker’s notorious depiction of a “legal tax madhouse” has turned out to be prophetically accurate nearly sixty years later.¹⁶

This Article offers some helpful insights into Brazil’s uniquely cumbersome fiscal regime, as viewed from the perspective of a foreign practitioner who has worked in close collaboration with local advisors and dealt with a variety of corporate and tax matters arising from the implementation of multiple transactions in the country. The goal here is to highlight a few of the more salient features embodied by Brazil’s domestic fiscal legislation, which differs greatly to those present in other Latin American countries. In particular, this article discusses the determination of taxable income, including taxation of net income versus presumed profits, goodwill amortization, and non-taxation of dividends. Furthermore, this article addresses levies on gross receipts and consumption at the federal, state and municipal levels, cross-border transactions including interest on net equity payments and the application of tax treaties, and resolution of tax controversies. Prior to that, an overview of tax collections is offered, along with a brief historical perspective surrounding taxation in Brazil, beginning in the sixteenth century when the territory formed an integral part of the Portuguese royal domain.

Finally, this article offers straight-forward recommendations in four different areas to simplify the country’s tax regime, reducing the compliance burden for local businesses while simultaneously increasing the country’s attractiveness for foreign investors. In essence, synchronizing

14. VEJA, *supra* note 10.

15. *Para 96% dos Empresários, Carga Tributária e Burocracia Impedem Crescimento dos Negócios, Revela Pesquisa CNDL/SPC Brasil*, POLÍTICAS PÚBLICAS 4.0 (Sep. 19, 2019), <https://cndl.org.br/politicaspublicas/2020-2/>.

16. See Wagner Balera, *Habitantes Perenes do Manicômio Jurídico Tributário*, CONSULTOR JURÍDICO (Oct. 13, 2021, 9:49 AM), <https://www.conjur.com.br/2021-out-13/balera-habitantes-perenes-manicomio-juridico-tributario>. Professor Balera asserts that this “legal tax madhouse” is ever present today, after so many futile attempts to reform the tax law. *Id.*

the country's tax laws to those adopted by other OECD-member nations should be the prime motivator for congressional leaders.

I. TAX COLLECTIONS

Brazil is a country notorious for imposing a relatively high tax burden on its citizens. This makes sense given the numerous levies in force at the federal, state, and municipal levels, some of which overlap. The number of taxes (*impostos*), fees (*taxas*) and contributions (*contribuições*) currently in place within Brazilian territory is estimated to exceed sixty.¹⁷ Collections from federal levies accounted for just over 65% of the total during the years 2016 and 2017, with the remainder raised by the various states and municipalities.¹⁸ Surprisingly, state taxes imposed on commerce and selected services¹⁹ generate the most funds for the nation's coffers, exceeding those derived from federal taxes on income.²⁰

According to the OECD, in 2020, Brazil reported a tax-to-GDP ratio of 31.6%.²¹ This was significantly higher than the average 21.9% reported for Latin America that same year, but slightly below the OECD average of 33.5%.²² Not surprisingly, tax-to-GDP ratios have steadily risen over the past few decades from 26% in 1994 during the administration of Fernando Henrique Cardoso to 35.2% during the regime of Jair Bolsonaro.²³

17. Malu Delgado, *Que Impostos Pagamos*, VALOR (Sep. 19, 2019), <https://valor.globo.com/reforma-tributaria/tributos/>. The actual number of levies is 63. *Id.*

18. *Id.* The Federal Union collected 65.63% of the total, with the states and municipalities collecting 27.92% and 6.45%, respectively. *Id.*

19. *See infra* Section IV.B.

20. Delgado, *supra* note 17. Collections from state-level ICMS accounted for 27.7% of the total reported for year 2016 and 2017, while federal taxes on income accounted for less than 20% of the total. *Id.*

21. *Revenue Statistics in Latin America and the Caribbean 2022 - Brazil*, OECD (2022), <https://www.oecd.org/tax/tax-policy/revenue-statistics-latin-america-and-caribbean-brazil.pdf> [hereinafter OECD].

22. *Id.*; *see also* REID, *supra* note 3, (going back in time, Brazil reported a tax-to-GDP ratio of 25% in the mid-1980s, rising to 37% by the year 2012).

23. *Há Mais de 25 Anos, Termo Custo Brasil Sintetiza Obstáculos ao Desenvolvimento*, ESTÚDIOFOLHA (Aug. 14, 2020, 4:29 PM), <https://estudio.folha.uol.com.br/cni-custobrasil/2020/08/1988822-ha-mais-de-25-anos-termo-custo-brasil-sintetiza-obstaculos-ao-desenvolvimento.shtml>.

Historically, the burden experienced by taxpayers in Brazil has focused predominantly on goods and services, impacting disproportionately low-income sectors. According to the nation's federal tax administration (*Receita Federal do Brasil, RFB*),²⁴ over 48% of all fiscal revenues reported in 2016 were derived from taxes on consumption, encompassing the sale of goods and rendering of services.²⁵ This stands in contrast to the average reported by OECD countries, where revenues from consumption taxes represent just 33% of the total collected, and even more sharply with the United States where a mere 18% are derived from sales taxes.²⁶ By contrast, revenues collected in Brazil from taxes on income (*imposto de renda*) represent a meager 19% of the total.²⁷ This percentage is well below the OECD average of 33%, and further below the United States where nearly half of all revenues originated from income taxes.²⁸

Statistics compiled by the OECD in its report for the year 2019 essentially confirm those compiled by the RFB.²⁹ In particular, the OECD report indicates that 43% of all tax revenues collected that year in Brazil was derived from the sale of goods and services, while only 18% originated from taxes on personal and corporate income.³⁰ That same report goes on to indicate that the OECD average was 32% with

24. Decreto No. 63.659, de 20 de Novembro de 1968, seção 1, Diário Oficial da União [D.O.U.] de 21.11.1968 (Braz.) (RFB was first instituted pursuant to this decree). It administers all taxes imposed at the federal level (*união*), and is directly subordinated to the Ministry of Finance. *Id.* art. 2. With the establishment of the RFB, the Departments of Internal Revenue, Customs, and Income Tax were no longer necessary and became extinct. *Id.* art. 6.

25. Alexandro Martello, *Propostas de reforma tributária mantêm inalterado peso dos impostos sobre o consumo*, G1 (Aug. 25, 2019, 11:00 AM), <https://g1.globo.com/economia/noticia/2019/08/25/propostas-de-reforma-tributaria-mantem-inalterado-peso-dos-impostos-sobre-o-consumo.ghtml>. See also Delgado, *supra* note 17, (in years 2016 and 2017, consumption taxes accounted for 48.3% of all tax collections in Brazil).

26. Martello, *supra* note 25; see also Delgado, *supra* note 17 (for years 2016 to 2017, collections from levies imposed in the United States on the sale of goods and services accounted for just 16.95% of total tax revenues).

27. Martello, *supra* note 25.

28. *Id.* See also Delgado, *supra* note 17 (collections derived from income taxes in Brazil accounted for just 20.3% of the total for the period 2016-2017).

29. See OECD, *supra* note 21.

30. *Id.*

respect to taxes on goods and services, and 34% concerning income taxes.³¹

While Brazil's heavy reliance on the consumption of goods and services as a means to collect fiscal revenues adversely impacts those with less economic means, high-income sectors enjoy a relatively low tax burden.³² This is primarily due to the many exemptions and deductions they can claim for income tax purposes, and the low to nil assessment on passive-type income, especially as it pertains to dividends and other profit distributions.³³ Brazil's tax system, accordingly, can best be depicted as predominantly regressive in nature, to the extent indirect taxes on goods and services continue to play a major role when compared to direct taxes on income and profits.³⁴

II. HISTORICAL BACKGROUND

To fully comprehend the complexity of the tax framework currently in vogue in Brazil, one must consider (albeit briefly) what occurred in the past. That being the case, what follows is a survey of the main non-income levies imposed during the three-hundred year period of Portuguese colonial rule, as well as the plethora of taxes on consumption and income enacted during the time of the Brazilian Empire and thereafter, when the monarchy was supplanted by a republican form of government at the latter half of the nineteenth century. Overall, the history of tax legislation in Brazil emulates more or less the events occurring elsewhere in Latin America, formally belonging to the Spanish empire.

A. Colonial Era

Throughout the colonial period, which extended from the start of the sixteenth century up until the first two decades of the nineteenth

31. *Id.*

32. See Renan Pimentel, *A Taxing Process: Brazilian Tax Reform*, HARVARD POLITICAL REVIEW (June 9, 2021), <https://harvardpolitics.com/a-taxing-process-brazilian-tax-reform/>.

33. See *infra* Section III.D.

34. REID, *supra* note 3.

century, fiscal policy was designed primarily to extract as much revenue as feasibly possible for the benefit of the Portuguese crown.³⁵

Hence, three of the more prominent non-income levies to be instituted within Brazilian territory during this era encompass the *quinto* (royal fifth), assessed at one-fifth of the value of gold extracted from the mines, under the premise that the underlying land belonged to the king;³⁶ the *dízimo* (tithe), levied on agricultural products, including tobacco and sugar, the latter product securing ample funding for the monarchy until replaced by gold in the middle of the seventeenth century;³⁷ and the *capitação* (tax per head), a general levy imposed on ownership of slaves, as well as on businesses such as stores, taverns, workshops, and slaughterhouses.³⁸ Import tariffs or customs duties on overseas trade, collected at major ports, also played a prominent role in raising revenues for the royal coffers all throughout this time period.³⁹

Collections of the *quinto*, originating from the mining region of Minas Gerais (general mines in English), ultimately proved to be the Portuguese crown's leading source of fiscal revenues.⁴⁰ Despite that, efforts to collect the *quinto* and *capitação* suffered greatly due to widespread evasion by the local populace and extortion by crown officials.⁴¹ The *quinto*, in particular, constituted a serious disincentive to gold production, incentivizing miners to reportedly engage in smug-

35. BORIS FAUSTO & SERGIO FAUSTO, A CONCISE HISTORY OF BRAZIL 50 (2d ed. 2014); see also N.P. MACDONALD, THE MAKING OF BRAZIL: PORTUGUESE ROOTS 1500-1822, 380 (1996).

36. FAUSTO & FAUSTO, *supra* note 35, at 51; see also MOACYR FLORES, DICIONÁRIO DE HISTÓRIA DO BRASIL 431 (1996) (in 1730 the *quinto* was reduced to 12%).

37. E. BRADFORD BURNS, A HISTORY OF BRAZIL 77 (3d ed. 1993); see also N.P. MACDONALD, *supra* note 35, at 383 (in addition to agricultural products, the *dízimo* was expanded to cover livestock, dairy products, and bread).

38. FAUSTO & FAUSTO, *supra* note 35, at 51; see also EDITH BETHELL, COLONIAL BRAZIL 218 (1987) (taxes on slaves, along with other fees, contributed to increasing the price of slaves in the interior mining region of Minas Gerais versus the coastal cities).

39. BURNS, *supra* note 37; see also N.P. MACDONALD, *supra* note 35, at 383.

40. BETHELL, *supra* note 38, at 304.

41. *Id.* at 227-28; see also TERESA A. MEADE, A BRIEF HISTORY OF BRAZIL 28 (2d ed. 2014).

gling activities to avoid paying the assessment.⁴² Moreover, a steady decline in gold production during the second half of the eighteenth century further undermined the effectiveness of the *quinto*, making it more difficult for the region to fulfill its tax obligations to the crown.⁴³ To counteract this trend, the governor of Minas Gerais even announced the promulgation of a *derrama* (another variant of the head tax) to be charged on all of its inhabitants, which became notorious for sparking a celebrated uprising in the late eighteenth century.⁴⁴

Comparable levies arose in other parts of Latin America under Spanish colonial rule that essentially mirrored those enforced by the Portuguese in Brazil. The *quinto real*, for instance, was a levy initially equal to one-fifth (subsequently reduced to one-tenth) of the value of products extracted from gold and silver mines concentrated in Mexico and Upper Peru (present-day Bolivia),⁴⁵ based on the notion these sites were owned by the royal crown.⁴⁶ An ecclesiastical tithe called *diezmo* was charged at one-tenth (that is, 10%) on agricultural production, and collected by the Spanish crown.⁴⁷ Another common source of revenue for the Spanish crown entailed a contribution per head (*capitación*), assessed primarily on the local native population, irrespective of income earned or property owned;⁴⁸ in New Spain (which

42. 5 ENCYCLOPEDIA OF LATIN AMERICAN HISTORY & CULTURE 447 (Jay Kinsbruner, 2d ed. 2008).

43. FAUSTO & FAUSTO, *supra* note 35, at 61.

44. *Id.* at 60-62 (the announced collection of a *derrama* by the governor of Minas Gerais sparked an insurrection in the former capital city of Ouro Preto (literally, Black Gold) called the Minas Conspiracy (*Inconfidência Mineira*), ultimately leading to the execution of the legendary rebel *Tiradentes* (tooth-puller, in English) in 1792). *See also* BETHELL, *supra* note 38, at 336-37.

45. E. BRADFORD BURNS & JULIE A. CHARLIP, *LATIN AMERICA: AN INTERPRETIVE HISTORY* 37 (2007); *see also* ALBERTO TAURO, *ENCICLOPEDIA ILUSTRADA DEL PERÚ 1737* (1987) (due to its pervasive impact on the profitability of the mining industry in Peru, the *quinto real* was reduced to one-tenth (*décimo*) in 1735).

46. PETER BAKEWELL, *A HISTORY OF LATIN AMERICA: EMPIRES AND SEQUELS 1450-1930* 179 (1997).

47. JAIME SUCHLICKI, *HISTORICAL DICTIONARY OF CUBA* 592 (2d ed. 2001); *see also* 2 ENCYCLOPEDIA OF LATIN AMERICAN HISTORY AND CULTURE 820 (Jay Kinsbruner & Erick Detlef Langer eds., 2d ed. 2008).

48. II *THE CAMBRIDGE HISTORY OF LATIN AMERICA: COLONIAL LATIN AMERICA* 237 (Leslie Bethell ed., 1984) [hereinafter *CAMBRIDGE*]. The *capitación* was modeled after similar contributions in Europe during the Middle Ages and was first introduced into the Americas in Santo Domingo in 1501. *Id.* The tribute displayed

included modern-day Mexico), the head tax replaced a previous indigenous levy while recognizing the Spanish king's overlordship.⁴⁹

Furthermore, Spain applied a customs duty (*almojarifazgo*), inherited from the Arabs, on the importation and exportation of goods at major port cities in the Americas,⁵⁰ with rates varying over the years between 2.5% and 15%, depending on the quality and origin of the merchandise;⁵¹ in the case of La Habana (Havana) it was first enacted in 1515, and constituted the main source of revenue for the island of Cuba.⁵² Also prevalent was a general sales tax (*alcabala*), originating in Muslim Spain and eventually brought over to the Americas, initially set at 2%,⁵³ reaching as high as 6% in most areas of the Spanish Empire by the end of the colonial era;⁵⁴ given its cascading nature, the levy impacted each stage of production, creating a heavy burden for businesses and ultimately consumers.⁵⁵ As was the case in Brazil under Portuguese rule, tax evasion was a common occurrence throughout Spain's American colonies, often taking the form of bribery of officials and smuggling of goods.⁵⁶

In conclusion, Brazil inherited from the Portuguese an uncoordinated and haphazard array of levies displaying mixed results in terms of raising funds, an unfortunate pattern that taxpayers must deal with

great resilience, remaining in force in certain remote areas of Bolivia and Peru well into the 1880s. *Id.* at 237.

49. LUIS WECKMANN, *THE MEDIEVAL HERITAGE OF MEXICO* 358-59 (Frances M. López-Morillas trans., 1992).

50. *Id.* at 342. The *almojarifazgo* was assessed in major coastal cities such as Veracruz (in Mexico), La Habana (in Cuba), Cartagena (in present-day Colombia), and Callao (in Peru). CAMBRIDGE, *supra* note 48, at 244-45.

51. WECKMANN, *supra* note 49, at 342. Rates of *almojarifazgo* varied over the years from 2.5% to 15%, depending on the quality and origin of the merchandise. *Id.*

52. LEVÍ MARRERO, *HISTORIA ECONÓMICA DE CUBA: GUÍA DE ESTUDIO Y DOCUMENTACIÓN* [ECONOMIC STORY OF CUBA: STUDY GUIDE AND DOCUMENTATION] 146 (1956). As initially enforced, all Spanish goods entering the island were assessed a 7.5% ad valorem tax, while goods exported were charged a 2.5% tax. *Id.*

53. CAMBRIDGE, *supra* note 48, at 245. Basic goods such as bread, arms, religious ornaments, and horses were not subject to the *alcabala*. *Id.*

54. 1 *ENCYCLOPEDIA OF LATIN AMERICAN HISTORY & CULTURE* 84 (Jay Kinsbruner & Erick D. Lander eds., 2d ed. 2008). In Mexico, the rate of *alcabala* was first raised to 6% in 1635. *Id.*

55. SUCHLICKI, *supra* note 47, at 21.

56. CAMBRIDGE, *supra* note 48, at 244.

even today at the federal, state and municipal levels, urgently requiring a makeover by legislators in the form of a comprehensive tax reform (discussed in more detail in the following sections).

B. Post-Independence

Upon the proclamation of independence in 1822 by Dom Pedro I, the Empire of Brazil (*Brasil Império* or *Brasil Monárquico*)⁵⁷ has sporadically enacted temporary taxes on income. The first serious attempt at implementing a formal income tax occurred in 1843 at the beginning of the reign of his son Dom Pedro II.⁵⁸ Salaries earned by government employees were subject to an extraordinary contribution (*contribuição extraordinária*) at rates ranging from 2% to 10% during a two-year period.⁵⁹ The economic system put into place in Brazil during this period can best be described as elitist and heavily dependent on slave labor.⁶⁰ Accordingly, the number of potential individual taxpayers was quite limited.⁶¹ By 1867, the war with Paraguay forced the monarchy to adopt another temporary tax on income, assessed on property and salaries at a rate of 3%.⁶²

57. MARY DEL PRIORE & RENATO VENANCIO, *UMA BREVE HISTÓRIA DO BRASIL* 163-64 (2d ed. 2016). Brazil's monarchy was inaugurated on September 7, 1822 upon the formal proclamation of independence by prince regent Dom Pedro, who was installed as the first Emperor under the name Dom Pedro I on October 12, 1822. *Id.* at 163-64.

58. CRISTÓVÃO BARCELOS DA NÓBREGA, *HISTÓRIA DO IMPOSTO DE RENDA NO BRASIL, UM ENFOQUE DA PESSOA FÍSICA [HISTORY OF INCOME TAX IN BRAZIL, A FOCUS OF THE INDIVIDUAL]* (1922-2013) 24 (Receita Federal 2014), <https://www.gov.br/receitafederal/pt-br/aceso-a-informacao/institucional/memoria/imposto-de-renda/arquivos-e-imagens/livro-historia-do-imposto-de-renda-no-brasil-v-24x17-livro-completo-de-22-04-2014-1.pdf>.

59. Lei No. 317, de 21 de Outubro de 1843, Coleção de Leis do Brasil de 1843, art. 23 §1 (Braz.); see NÓBREGA, *supra* note 58. Amounts assessed were collected to meet budgets for fiscal years 1843-1844 and 1844-1845. *Id.*

60. DEL PRIORE & VENANCIO, *supra* note 57, at 179, 181. Between 1820 and 1840, a sharp increase in the cultivation of coffee required cheap labor, resulting in large scale immigration of slaves from Africa. *Id.* at 179.

61. NÓBREGA, *supra* note 58, at 24.

62. Lei No. 1.507, de 26 de Setembro de 1867, Coleção de Leis do Brasil de 1867, arts. 10, 22 (Braz.). Revenues were collected to fulfill budgets for fiscal years 1867-1868 and 1868-1869. *Id.* See Alexandro Martello, *Imposto de Renda faz 100 anos em 2022 à espera da aprovação de reforma pelo Congresso [Income*

After the proclamation of the Republic in 1889,⁶³ fierce resistance against the adoption of a permanent income tax continued to persist for the remainder of the 19th Century.⁶⁴ By the early part of the 20th Century, this resistance diminished somewhat due to the government's need to escalate spending during the First World War.⁶⁵ Tax on consumption (*imposto de consumo*) expanded considerably, thus impacting various sectors of the economy during the early 1900s, in detriment of declining revenues from imports.⁶⁶ Shortly thereafter, a general income tax (*imposto geral sobre a renda*) was finally promulgated in 1922, to be levied annually on both individuals and corporations, irrespective of their residence.⁶⁷ Accordingly, the current iteration of the income tax scheme has been in force for a century in the South American nation.

Throughout its first years in the 1920s, collections from income tax represented a mere 3% of total fiscal revenues reported by the federal government.⁶⁸ The following decade, the populist government headed by Getúlio Vargas, encouraged continued reliance on customs duties to stimulate the country's industrial sector.⁶⁹ The 1934 Carta Magna formally granted powers to the states to impose sales taxes, which had previously been the sole domain of the federal govern-

tax turns 100 years in 2022 waiting for the approval of reform by Congress], <https://g1.globo.com/economia/imposto-de-renda/noticia/2022/02/20/imposto-de-renda-faz-100-anos-em-2022-a-espera-da-aprovacao-de-reforma-pelo-congresso.ghtml>; see also MÁRCIO DA SILVA EZEQUIEL, RECEITA FEDERAL: 50 ANOS 1968-2018 43-4 (Receita Federal 2018), https://www.gov.br/receitafederal/pt-br/aceso-a-informacao/institucional/memoria/50anos/arquivos-e-imagens/livro-50-anos-receita-federal__final-reduzido.pdf. The levy was short-lived, as it was cancelled once the war concluded in 1870. *Id.* at 44.

63. DEL PRIORE & VENANCIO, *supra* note 57, at 211. The Brazilian monarchy was eventually toppled by the military on November 15, 1889, with the installation of the Republic, barely a year after slavery was officially abolished. *Id.* at 210-12.

64. Martello, *supra* note 62.

65. NÓBREGA, *supra* note 58, at 28-29.

66. EZEQUIEL, *supra* note 62, at 65, 67. The first official consumption tax was assessed on tobacco in 1891. *Id.* at 61.

67. Lei No. 4.625, de 31 de Dezembro de 1922, art. 31, Diário Oficial da União [D.O.U.] de 31.12.22 (Braz.). Tax was initially assessed on income reported during the fiscal year of 1923, but was not collected until the following year. *Id.*

68. NÓBREGA, *supra* note 58, at 61.

69. Martello, *supra* note 62.

ment.⁷⁰ Consequently, up until the end of the 1930s, levies on imports maintained their historic lead, followed closely by consumption tax.⁷¹ However, the advent of the Second World War caused revenues from customs duties to fall sharply,⁷² while those originating from levies on income steadily increased.⁷³ From 1944 through 1978, revenues from income taxes competed with those arising from consumption tax.⁷⁴ This coincided with a growing percentage of the population moving into the middle class.⁷⁵

The maximum rate of income tax on individuals (*imposto de renda das pessoas físicas*, IRPF) was first set at 8%, but steadily escalated over the years to 20% in 1944, rising sharply to 50% by 1948, where it stayed level until 1961.⁷⁶ By the mid-1960s, during the Presidency of João Goulart and first two years of the military dictatorship headed by General Humberto Castello Branco, the IRPF rate reached an all-time high of 65%.⁷⁷ Predictably by 1979, income tax became the nation's principle federal levy in terms of collections.⁷⁸ Within six years, it reached as high as 57.3% of total federal fiscal revenues.⁷⁹ The maximum rate of IRPF remained at or above 50% until the end of the 1980s,⁸⁰ after which it started to decrease, not only in Brazil but

70. HENRY J. GUMPPEL & RUBENS GOMES DE SOUSA, *TAXATION IN BRAZIL* 285 (1957).

71. NÓBREGA, *supra* note 58, at 61.

72. EZEQUIEL, *supra* note 62, at 97. Upon the outbreak of the Second World War, tax on importation ceded its position in 1940 as the principal federal levy in favor of tax on consumption. *Id.*

73. NÓBREGA, *supra* note 58, at 62. In 1943, revenues collected from income taxes exceeded, for the first time, those derived from consumption and import duties. *Id.*

74. *Id.*

75. *Id.* at 62, 111.

76. *Id.* at 65.

77. Lei No. 4.154, de 28 de Novembro de 1962, seção 1, Diário Oficial da União [D.O.U.] de 30.11.1962 (Braz.). Starting fiscal year 1963, personal income was subject to rates of tax ranging from 3% to 65%. *Id.* art. 2. See NÓBREGA, *supra* note 58, at 73, 111. The 65% rate was in force for fiscal years 1963 to 1965. *Id.*

78. NÓBREGA, *supra* note 58, at 61.

79. *Id.* at 112.

80. *Id.* at 250-93. Fiscal year 1988 was the last period reporting a maximum tax rate at or above 50%. *Id.* at 293.

around the globe.⁸¹ Since 1999, the maximum personal income tax rate settled at 27.5%,⁸² which is lower than the worldwide average. By comparison, the combined rate of income tax for corporations can reach as high as 34%, exceeding most other countries.⁸³

Despite this trend in recent decades, most analysts would argue that Brazil's continued reliance on the consumption of goods and services, to the detriment of income and patrimony, makes its tax regime essentially inequitable at its core. The tax regime disproportionately impacts those individuals who are the least capable of paying. This sharply contrasts with most developed nations, where the focus is on imposing tax on income, which thereby places the burden more squarely on those sectors of the population who can most afford to pay.

Proposals by members of the Brazilian Congress to modify the current system of income tax inevitably entail reassessing a tax on dividends and other forms of profit distributions, while reducing rates of income tax for corporations, to promote fiscal justice (*justiça tributária*).⁸⁴ The purpose of these legislative initiatives is to enable Brazil to become more competitive in the eyes of foreign investors, stimulating the creation of jobs.⁸⁵ These measures directly impact the profitability of investments held by multinationals in Brazil, especially as it pertains to repatriation of funds. Up until now, these proposals have yet to come into fruition.

81. See Martello, *supra* note 62.

82. Lei No. 9.887, de 07 de Dezembro de 1999, Diário Oficial da União [D.O.U.] de 8.12.1999 (Braz.); see NÓBREGA, *supra* note 58, at 118. Since 1996, IRPF has been determined pursuant to norms set forth by Lei No. 9.250, de 26 de Dezembro de 1995, Diário Oficial da União [D.O.U.] de 27.12.1995 (Braz.), under the Presidency of Fernando Henrique Cardoso.

83. See Martello, *supra* note 62.

84. *Brazilian House of Deputies Approves Bill Modifying the Corporate Income Tax System as Part of Comprehensive Tax Reform*, EY Tax News Update (Sept. 2, 2021), https://www.ey.com/en_gl/tax-alerts/brazilian-house-of-deputies-approves-bill-modifying-the-corporate-income-tax-system-as-part-of-comprehensive-tax-reform; see MINISTÉRIO DA ECONOMIA, *supra* note 2.

85. See MINISTÉRIO DA ECONOMIA, *supra* note 2.

III. DETERMINATION OF TAXABLE INCOME

Having surveyed the more prominent aspects of the Brazilian tax legislation in the past centuries, we focus our attention on the unique features contained in the current version to ascertain the amount of corporate income that is subject to tax. No other jurisdiction in Latin America has adopted Brazil's somewhat unconventional measures. Accordingly, foreign investors must carefully consider their impact before engaging in transactions with local companies, or expanding business operations within Brazilian territory.

A. Corporate Income Taxes

Contrary to the domestic laws adopted by other Latin American jurisdictions, Brazilian companies are generally subject to two distinct levies on net income: (1) a corporate income tax (*imposto de renda de pessoas jurídicas*, IRPJ);⁸⁶ and (2) a social contribution on net profits (*contribuição sobre o lucro líquido*, CSLL) enacted in 1988 to fund the nation's federal social security system.⁸⁷

Complicating matters further, the taxable base to determine IRPJ versus CSLL is slightly different. This means an increase in the administrative burden for companies engaged in commercial activities in Brazil, compared to their neighbors in the region. For example, IRPJ is levied on the taxable profits of a corporation at a rate of 15%, in addition to a 10% surcharge imposed on annual taxable income exceeding 240,000 reais.⁸⁸ In contrast, CSLL is assessed on net income, as determined for book purposes, prior to accounting for income taxes, which allows for certain adjustments made for nondeductible expenses and other items.⁸⁹ Notably, CSLL payments made throughout the year to the federal tax authority are not deductible for purposes of determining IRPJ.⁹⁰

86. See Lei No. 9.249, de 26 de Dezembro de 1995, Diário Oficial da União [D.O.U.] de 27.12.1995 (Braz.).

87. See Lei No. 7.689, de 15 de Dezembro de 1988, Diário Oficial da União [D.O.U.] de 16.12.1988 (Braz.).

88. Lei No. 9.249, *supra* note 86, art. 3.

89. Lei No. 7.689, *supra* note 87, art. 2.

90. Lei No. 9.316, de 22 de Novembro de 1996, art. 1, Diário Oficial da União [D.O.U.] de 23.11.1996 (Braz.).

Since the CSLL levy is compulsory, and comparable in nature to that of a tax on net income, foreign-based multinationals should be able to claim CSLL—paid by their Brazilian subsidiary—as an indirect credit for income tax purposes.⁹¹ Most companies are subject to the general CSLL rate of 9%,⁹² resulting in a combined corporate income tax rate of up to 34%.⁹³ This percentage is significantly higher than the average rate prevalent amongst South American counterparts and distinctly inflated when compared to the world average.⁹⁴

B. Net Income versus Presumed Profits

Since 1996, small to medium sized-companies in Brazil qualify to elect to pay a combined 34% tax on presumed profits (*lucro presumido*), based on a fixed percentage of operating revenues that varies according to the company's predominant activity.⁹⁵ For example, the taxable base is 8% of revenue for sales of goods or products, or real estate activities.⁹⁶ Concerning service activities, the taxable base equals 32% of revenues, resulting in an overall 10.88% effective income tax rate.⁹⁷ However, non-operating income, such as interest derived from bank deposits and foreign exchange gains, continues to be

91. See *Brazil – Taxable Income*, DLA Piper, (last visited Nov. 22, 2022), <https://www.dlapiperintelligence.com/goingglobal/tax/index.html?c=HK&mc=BR&t=06-tax-holidays>.

92. *Id.* at 5. CSLL rate for financial institutions and private insurance companies is currently set at 15%. *Id.*

93. A typical Brazilian company reporting annual net income in excess of R\$ 240,000 is subject to tax at a rate of 34%, calculated as follows: 15% IRPJ + 10% IRPJ surcharge + 9% CSLL = 34%.

94. See SEAN BRAY, CORPORATE TAX RATES AROUND THE WORLD, 2021 8 (Nov. 2021). The average statutory corporate income tax rate in 2021 for South America is estimated at 26.63%, and for the world at 23.54%. *Id.*

95. See *Global Tax Guide to Doing Business in Brazil*, DENTONS 6 (2022), <https://www.dentons.com/en/services-and-solutions/global-tax-guide-to-doing-business-in/brazil?pdf=1&page=5hsGjZHYLe9rp4+VHxI0/Lwnc8+14UKEUdDbw9V3F4E0AvZ7wQzuN07mdjRvoPmQ&countryKey=>.

96. Lei No. 9.249, de 26 de Dezembro de 1995, art. 15, Diário Oficial da União [D.O.U.] de 27.12.1995 (Braz.).

97. See *id.* For example, if a Brazilian service company reports gross receipts of 100 reais, the resulting tax pursuant to the presumed profit method is 10,88 reais: that is, R\$ 100 x 32% x (25% IRPJ + 9% CSLL) = R\$ 10.88.

taxed on net income (*lucro real*), the general regime applicable to all other Brazilian companies.⁹⁸

The election to pay tax on presumed profits is filed annually, upon the first tax payment of the calendar year.⁹⁹ This option is restricted to entities reporting annual gross receipts of less than 78 million reais.¹⁰⁰ Prior to 2014, the gross receipts threshold was lower.¹⁰¹ For companies making this election, business expenses and fiscal losses are simply disregarded when calculating income tax liability, in sharp contrast to those companies that pay tax on net income.¹⁰² These features may prove to be problematic in the foreign investor's country of residence as tax paid by the local Brazilian subsidiary may not necessarily qualify as a tax on net income. This, in turn, could lead to a classic case of international double taxation, because the foreign corporate shareholder would be unable to claim a foreign tax credit with respect to the repatriated funds. No other country in Latin America has enacted comparable legislation to determine a company's annual income tax liability.¹⁰³

In contrast to companies paying tax on net income, corporate entities that opt to pay tax on presumed profits can forego the requirement to maintain proper commercial bookkeeping (*escrituração comercial*) for tax purposes, provided their accounting accurately reflects all cash movements.¹⁰⁴ This measure is presumably intended to alleviate the

98. Lei No. 9.718, de 27 de Novembro de 1998, art. 13, Diário Oficial da União [D.O.U.] de 28.11.1998 (Braz.).

99. Lei No. 9.430, de 27 de Dezembro de 1996, art. 26 §1, Diário Oficial da União [D.O.U.] de 30.12.1996 (Braz.).

100. Lei No. 12.814, de 16 de Maio de 2013, art. 7, Diário Oficial da União [D.O.U.] de 17.05.2013 (Braz.).

101. Up until 2002, corporations could elect to be taxed on presumed profits provided reported annual revenues did not exceed R\$ 24 million. See Lei No. 9.718, *supra* note 98, art. 14(I). Between 2003 and 2013, the threshold was raised to R\$ 48 million, see Lei No. 10.637, de 30 de Dezembro de 2002, art. 46, Diário Oficial da União [D.O.U.] de 31.12.2002 (Braz.), and in 2014, the threshold increased further to the current R\$ 78 million limit. See Lei. No. 12.814, *supra* note 100.

102. See *Global Tax Guide to Doing Business in Brazil*, *supra* note 95, at 6-7.

103. No other major jurisdiction in Latin America enables small to medium-sized companies to elect on an annual basis to pay tax on presumed profits, rather than on net income.

104. Lei No. 8.981, de 20 de Janeiro de 1995, art. 45, Diário Oficial da União [D.O.U.] de 23.01.1995 (Braz.).

administrative burden that small companies would normally incur to record their statutory book.

Increasing the eligibility threshold for taxation on presumed profits from the original R\$ 24 million (set in 1998) to the current R\$ 78 million (effective as of 2014) might have had the unintended effect of spreading this accounting benefit to medium-sized companies. By forgoing formal bookkeeping requirements, federal tax agents find it increasingly difficult to determine whether the underlying earnings reported by these companies are properly assessed and taxed. This calculation is especially relevant when considering the amounts presumably recorded as accumulated earnings or reserves in the equity section of the company's balance sheet, which are not subject to further taxation in Brazil. Given constant advances in the country's electronic tax filing system, referred to as Digital Accounting Bookkeeping (*escrituração contábil digital*, ECD),¹⁰⁵ and the need to crack down on tax avoidance while promoting transparency,¹⁰⁶ one could argue there is less of a need to maintain this bookkeeping dispensation for medium-sized companies.

C. Goodwill Amortization

Brazil is one of the last remaining jurisdictions in Latin America to allow companies to amortize, for income tax purposes, the value of goodwill (*ágio*) paid in relation to the acquisition of shares or quotas in local companies. In Colombia, for instance, goodwill arising from the purchase of shares in local companies is no longer amortizable for income tax purposes since 2017.¹⁰⁷ In Brazil, this fiscal incentive was first introduced in 1997.¹⁰⁸ Under the military dictatorship of the 1970s and 1980s, the country experienced periods of economic stag-

105. See Instrução Normativa RFB No. 1.774, de 22 de Dezembro de 2017, Diário Oficial da União [D.O.U.] de 27.12.2017 (Braz.).

106. See *id.* art. 2, sole paragraph. Transmission of accounting books and related data (ECD) requires digital signature to guarantee a document's authenticity. *Id.*

107. See *Colombia – Corporate Deductions, Goodwill*, PWC WORLDWIDE TAX SUMMARIES (Aug. 8, 2022), <https://taxsummaries.pwc.com/colombia/corporate/deductions>.

108. Lei No. 9.532, de 10 de Dezembro de 1997, art. 7, Diário Oficial da União [D.O.U.] de 11.12.1997 (Braz.).

nation and high inflation. The fiscal incentive was aimed at promoting the privatization of Brazil's public companies, with a focus on the energy and telecommunication sectors.¹⁰⁹

From a historical context, goodwill is defined under corporate tax law as the positive difference between the acquisition price and the net equity of the acquired company.¹¹⁰ Taxpayers can amortize the value of goodwill over a 60-month period, once the merger of the acquired company with the Brazilian purchasing company takes effect.¹¹¹ Often times the legal entity acquiring the shares (or quotas) in the target is a local holding company, set up right before closing. Given the volume of commercial transactions and significant monetary amounts involved, there has been an increase in the number of proceedings held at the administrative level.¹¹² In such cases, the RFB has questioned the economic substance or business purpose of the steps undertaken to achieve this income tax benefit. This is especially true with regards to those transactions conducted between related parties and those involving successive steps implemented in a relatively brief period of time.¹¹³

An intriguing case extensively covered by the local press involved the Spanish bank, Banco Santander. As part of the Brazilian government's overall strategy to favor privatizations, Banco Santander participated in a public auction to acquire a local bank called Banco do

109. *Id.*

110. *See, e.g.*, Decreto-Lei No. 1.598, de 26 de Dezembro de 1977, art. 20 (III), Diário Oficial da União [D.O.U.] de 27.12.1977 (Braz.).

111. Lei No. 9.532, *supra* note 108, arts. 7, 8. For these purposes, the merger can be implemented upstream (where the parent company is the surviving entity), or downstream (where the target acquired at closing survives).

112. *See* Phelippe Toledo Pires de Oliveira, *Goodwill Amortization—The End of a Longstanding Tax Dispute in Brazil?*, BLOOMBERG TAX (May 17, 2022), <https://news.bloombergtax.com/tax-insights-and-commentary/goodwill-amortization-the-end-of-a-longstanding-tax-dispute-in-brazil>.

113. CARF, Acórdão No. 1402-000.802—4ª Câmara/2ª Turma Ordinária, Processo No. 16561.000222/2008-72, Relator: Des. Antônio José Praga de Souza, 21.10.2011, 85 (Braz.); *see* Alessandro Cristo, *CARF Aprova Uso de Ágio pelo Santander*, CONSULTOR JURÍDICO (Oct. 21, 2011), <https://www.conjur.com.br/2011-out-21/carf-aprova-uso-agio-santander-gerado-compra-banespa>.

Estado de São Paulo S.A. (Banespa).¹¹⁴ Banco Santander previously set up a holding company in Brazil, to comply with Central Bank requirements.¹¹⁵ After closing took place in year 2000, the holding company was merged with Banespa, enabling Banco Santander to later claim amortization of goodwill for local tax purposes.¹¹⁶ The RFB disputed the deductions claimed by Banco Santander between years 2002 to 2004, arguing that the holding company was a mere vehicle (*empresa veículo*) with no business substance, and should be disregarded.¹¹⁷ Eventually, after years in litigation, Banco Santander was able to overcome RFB's challenge. Judges at the administrative tax tribunal (*Conselho Administrativo de Recursos Fiscais*, CARF)¹¹⁸ unanimously held in 2011 that incorporating a holding company to participate in the public bid, while also claiming a tax benefit by means of goodwill amortization, constituted a legitimate business purpose (*propósito negocial legítimo*).¹¹⁹

114. See, e.g., Cristo, *supra* note 113; see also, e.g., *Santander Escapa de Multa Bilionária*, BRASIL 247 (Oct. 22, 2011), <https://www.brasil247.com/economia/santander-escapa-de-multa-bilionaria>.

115. CARF, Acórdão No. 1402-000.802—4ª Câmara/2ª Turma Ordinária, Processo No. 16561.000222/2008-72, Relator: Des. Antônio José Praga de Souza, 21.10.2011, 25 (Braz.). Banco Santander competed against two domestic banks (Bradesco and Itáú) and needed to incorporate a local entity to participate in the bid to acquire Banespa. *Id.* at 117-18. Accordingly, a holding company called Santander Holding Ltda. was established on October 25, 2000, a month prior to closing. *Id.* at 3.

116. *Id.* at 4. The amount of goodwill under dispute was close to R\$ 7.5 million. *Id.*

117. CARF, Acórdão No. 1402-000.802—4ª Câmara/2ª Turma Ordinária, Processo No. 16561.000222/2008-72, Relator: Des. Antônio José Praga de Souza, 21.10.2011, 85 (Braz.); see Cristo, *supra* note 113.

118. See *Carta de Serviços CARF*, CONSELHO ADMINISTRATIVO DE RECURSOS FISCAIS MINISTÉRIO DA ECONOMIA, <https://carf.economia.gov.br/aceso-a-informacao/institucional/carta-de-servicos-carf/> (last visited Nov. 20, 2022). CARF is an administrative body within the Ministry of Finance and is responsible for rendering decisions on appeals primarily brought by taxpayers against federal tax assessments issued by the RFB. CARF was first established under Lei No. 11.941, de 27 de Maio de 2009, art. 48, Diário Oficial da União [D.O.U.] de 28.5.2009 (Braz.).

119. CARF, Acórdão No. 1402-000.802—4ª Câmara/2ª Turma Ordinária, Processo No. 16561.000222/2008-72, Relator: Des. Antônio José Praga de Souza, 21.10.2011, 86 (Braz.); see Cristo, *supra* note 113.

As a result of this and similar litigation, new rules were issued for acquisitions which took effect in year 2015.¹²⁰ As such, the tax amortization of goodwill is limited to those instances in which the transaction is carried out between unrelated parties, and where the value of the purchase is properly segregated by: (1) net equity of the acquired company; (2) fair value of net assets; and (3) future profitability of goodwill, often referred to as residual value.¹²¹ The fair value of net assets and goodwill is amortizable provided that an appraisal report, prepared by an independent firm, is filed with the RFB, or alternatively, a summary is duly recorded with the Registry of Deeds and Documents.¹²²

D. Dividends and Profit Distributions

Owners of Brazilian companies routinely repatriate earnings through dividends as in the case of a *sociedade anônima*,¹²³ or as profit distributions as in the case of a *sociedade por quotas de responsabilidade limitada* (or *limitada*).¹²⁴ For many decades, these items of income were historically subject to tax in Brazil. In fact, a tax on dividends (*imposto sobre dividendos*) was first established in 1891 by means of withholding at source by banks and companies.¹²⁵ Thereafter, from 1926 until 1995, dividends in Brazil were subject to withholding tax at source and/or formed part of the individual's taxable base.¹²⁶

Since the enactment of a 1995 law, dividends and other amounts distributed from accounting profits generated on or after January

120. Lei No. 12.973, de 13 de Maio de 2014, Diário Oficial da União [D.O.U.] de 14.05.2014 (Braz.).

121. *Id.*

122. *Id.* art. 2. *Cartório de Registro de Títulos e Documentos*, in Portuguese. *Id.*

123. *Sociedades Anônimas* are governed by Lei No. 6.404, de 15 de Dezembro de 1976, Diário Oficial da União [D.O.U.] de 17.12.1976 (Braz.).

124. *Limitadas* are governed by Decreto No. 3.708, de 10 de Janeiro de 1919, COL. LEIS REP. FED. BRASIL, Dezembro 1919 (Braz.).

125. Lei No. 25, de 30 de Dezembro de 1891, COL. LEIS REP. FED. BRASIL, Dezembro 1891 (Braz.). Tax withheld was to be remitted to the National Treasury by the 15th day after payment of the dividend. *Id.* art. 3; see NÓBREGA, *supra* note 58, at 121.

126. See NÓBREGA, *supra* note 58, at 121.

1996, are no longer subject to withholding tax nor form part of the taxable base of the income recipient, irrespective of where that person resides.¹²⁷ According to the Ministry of Economy, in 2019, nearly R\$ 230 billion dividends were received by just 20,000 individuals, representing a mere 0.01% of Brazil's total population, without having paid any tax.¹²⁸ As expected, the publication of this type of information could potentially lead to the buildup of tensions amongst the middle to lower income sectors of the population.

It is highly unusual not to tax this type of income, not only within Latin America, but around the world. Latvia is the only other jurisdiction that has adopted a similar approach to taxation as Brazil, whereby dividends are generally not subject to personal income tax, provided the underlying earnings were previously subject to corporate tax.¹²⁹ By contrast, throughout Latin America, dividends distributed to foreign-based shareholders are routinely subject to withholding tax. In Argentina, tax is withheld at a rate of 7% on distributions of profits generated after fiscal year 2017 to resident individuals or foreign investors.¹³⁰ In Mexico, a 10% withholding tax applies on outbound dividends derived from profits generated after 2013.¹³¹ Finally, dividends in Ecuador are generally subject to a 25% withholding tax on 40% of the amount paid, resulting in an effective rate of 10%.¹³²

127. Lei No. 9.249, de 26 de Dezembro de 1995, art. 10, Diário Oficial da União [D.O.U.] de 27.12.1995 (Braz.).

128. See MINISTÉRIO DA ECONOMIA, *supra* note 2.

129. See *Latvia - Personal Income Tax Rates*, PWC WORLDWIDE TAX SUMMARIES (July 19, 2022), <https://taxsummaries.pwc.com/latvia/individual/taxes-on-personal-income>.

130. See EY WORLDWIDE CORPORATE TAX GUIDE 2022 – ARGENTINA 45 (2022). Dividends distributed to resident corporations are not subject to withholding tax. *Id.*

131. See EY WORLDWIDE CORPORATE TAX GUIDE 2022 – MEXICO 1147 (2022). Dividends are not subject to corporate income tax if the amount distributed is derived from previously taxed earnings and if the distributing company reports sufficient net after-tax profit (*cuenta de utilidad fiscal neta*, CUFIN) to cover the dividend. *Id.*

132. See EY WORLDWIDE CORPORATE TAX GUIDE 2022 – ECUADOR 488 (2022). The effective rate of withholding increases to 14% (tax base of 40% times 35% rate), if the dividend is paid to a shareholder residing in a low-tax jurisdiction. *Id.*

Even more bewildering is the fact that gains from the sale (alienation) of shares, quotas, or other participations in Brazilian entities, continue to be fully taxed in Brazil.¹³³ From a tax perspective, this inconsistency in treatment between items of income reported by Brazilian resident individuals with regard to dividends distributions and the gains derived from the sale of corporate ownership interests is absent in all other Latin American jurisdictions, reaffirming the peculiarities embedded within Brazil's tax system.

The non-taxation of dividends and profits distributed to resident individuals has presumably incentivized Brazilian-based companies (concentrated mainly in the service industry) to remunerate certain key employees in an alternative manner. This can be accomplished by refraining from registering these individuals on the company payroll, and instead assigning each of them a quota.¹³⁴ Generally under this scheme, individual quotaholders (*quotistas*) of a *limitada* receive their remuneration by means of non-taxable profit distributions,¹³⁵ on a monthly basis, in addition to receiving a minor taxable portion for services rendered as a non-employed director (*pró-labore*).¹³⁶ These individuals *are* presumed to receive not only their basic "salaries" tax-free, but also labor-type benefits that are readily available for

133. See Lei No. 13.259, de 16 de Março de 2016, Diário Oficial da União [D.O.U.] de 17.03.2016, Edição Extra (Braz.). Income tax is assessed on these types of gains at rates starting from 15% up to 22.5%. *Id.* art. 1.

134. For instance, to incentivize an individual with unique capabilities or knowledge, who presumably can help grow the business, the owners of a small to medium-size Brazilian service company will typically assign that person a single quota, and they will receive future monthly distributions on a (mainly) tax-free basis.

135. See Lei No. 10.406, de 10 de Janeiro de 2002, Diário Oficial da União [D.O.U.] de 11.01.2002 (Braz.). A *limitada* is able to distribute profits to its partners in a disproportionate manner to the extent established by the company's Articles of Association (*Contrato Social*). *Id.* art. 1.007.

136. See Lei No. 13.467, de 13 de Julho de 2017, Diário Oficial da União [D.O.U.] de 14.7.2017 (Braz.). Amounts paid to *quotistas* as *pró-labore* represent remuneration for services rendered by partners/directors who manage the company's operations (*relação de trabalho sem vínculo de emprego*) and thus, fall outside the scope of labor law. *Id.* art. 1.

company employees.¹³⁷ By contrast, this practice is not observed in other Latin American jurisdictions.¹³⁸

Labor courts may reclassify these “advance dividend payments” (*pagamentos antecipados de dividendos*), received by *quotistas*, as taxable salaries.¹³⁹ The reasoning for this is that the connection between the individual and the company is, in essence, more akin to an employment relationship, rather than that of a true shareholder who assumes risks inherent as an investor. Pursuant to labor law (*Consolidação das Leis do Trabalho*, CLT),¹⁴⁰ an employment relationship between the company and the individual is deemed to exist if personal services are rendered on a habitual basis under terms of subordination in exchange for remuneration.¹⁴¹

An employment relationship arises to the extent all of the following factors are present: subordination, economic dependence, personal services, and continuous services.¹⁴² Brazilian legislation does not offer clear guidelines as to what facts and circumstances create eligibility for a *quotista* to be reclassified as a de facto employee.¹⁴³ Nonetheless,

137. Depending on company policy, under this scheme individuals receive their basic salaries and any related labor benefits (vacation pay, overtime, bonuses).

138. Based on the author’s experience as tax counsel at a multinational, this remuneration scheme is non-existent in the service sector in other Latin American jurisdictions due to one or more of the following reasons: (1) dividends constitute taxable income; (2) the company’s ability to subsequently pay dividends abroad on a tax-free basis may be impacted negatively; (3) corporate law may prevent certain entities from making disproportionate distributions to their shareholders; (4) the amount of remuneration subject to social security and other contributions may be capped; and (5) in certain countries, the company’s labor costs may rise as the amount of profit sharing required to be paid annually to its registered employees is likely to increase.

139. *See infra* note 143.

140. *See* Decreto-Lei No. 5.452, de 1 de Maio de 1943, Diário Oficial da União [D.O.U.] de 09.08.1943 (Braz.) [hereinafter CLT], which consolidated Brazil’s labor laws, during the Presidency of Getúlio Vargas. *See also* Lei No. 8.212, de 24 de Julho de 1991, Diário Oficial da União [D.O.U.] de 25.7.1991 (Braz.), where a person who renders services under subordination, in exchange for remuneration, is regarded as an employee within the context of social security. *Id.* art. 12(I)(a).

141. CLT, *supra* note 140, art. 3.

142. *Id.*

143. No regulations or advice have been issued by RFB clarifying the meaning of the terms *subordination*, *economic dependence*, *personal services*, and *continuous services*, as set forth under article 3 of the CLT. *Id.*

one should keep in mind that transactions can be disregarded if their objective distorts or obstructs application of the CLT.¹⁴⁴

Similarly, the RFB and social security agents are granted the authority under the National Tax Code (*Código Tributário Nacional*, CTN)¹⁴⁵ to disregard the *quotista* (or any other) status of a particular individual, asserting that an employment relationship is actually present between that person and the company.¹⁴⁶ Recharacterization pertains solely to tax and social security matters and not to labor matters. The CTN further adopts a substance over form approach,¹⁴⁷ which essentially requires the agent to prove that either fraud (*fraude*) or sham (*simulação*) is present.¹⁴⁸ This approach considers the particular facts and circumstances surrounding each person and is thus applied on a case-by-case basis.¹⁴⁹

Should an employment relationship exist, the Brazilian company could be liable for paying social security charges (*Instituto Nacional do Seguro Social*, INSS)¹⁵⁰ and federal income tax withheld at source (*imposto sobre a renda retido na fonte*, IRRF),¹⁵¹ among interest and other penalties. Separately, the individual may file a labor lawsuit

144. *Id.* art. 9.

145. CTN was promulgated pursuant to Lei No. 5.172, de 25 de Outubro de 1966, Diário Oficial da União [D.O.U.] de 27.10.1966 (Braz.). The CTN regulates the national tax system and establishes the general norms of tax law applicable to the federal government (*união*), Federal District, states and municipalities. *Id.* art. 1.

146. *Id.* arts. 116, 149.

147. *Id.* art. 116.

148. *Id.* art. 149 (VII).

149. *Id.* art. 116 (I).

150. INSS was established in the year 1991 pursuant to Decreto No. 99.350, de 27 de Junho de 1990, Diário Oficial da União [D.O.U.] de 28.06.1990 (Braz.). Employers are obliged to make social security contributions, generally at a flat rate of 20%, along with additional social charges, reaching as high as 28.8% of total payroll. See Luis Fernando Rezende Gomez & Daniel Yamamoto, *International Tax - Brazil Highlights 2022*, DELOITTE, <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-brazilhighlights-2022.pdf> (last visited Nov. 5, 2022).

151. See Instrução Normativa RFB No. 1.455, de 6 de Março de 2014, Diário Oficial da União [D.O.U.] de 07.03.2014 (Braz.). IRRF is generally equal to 15% of the outbound payment, unless paid to a resident of a low tax jurisdiction, in which case the rate of withholding increases to 25%. *Id.* art. 1.

seeking employee-type benefits,¹⁵² such as a 13-month salary,¹⁵³ vacation pay,¹⁵⁴ and a severance indemnity fund (*Fundo de Garantia do Tempo de Serviço*, FGTS).¹⁵⁵

IV. LEVIES ON CONSUMPTION

Companies engaging in commercial activities in Brazil are subject to tax on their income. This is in addition to a wide selection of indirect levies imposed on revenues and industrialized goods by the federal government on the transfer of goods and selected services by the various states, and on gross receipts derived from the rendering of services by the vast majority of municipalities. The creditability of these multiple levies is quite complex compared to its neighboring jurisdictions, and inevitably increases the cost of doing business in the South American country.

A. Federal Level

Companies conducting business activities in Brazil are required to make contributions to fund specific social programs. Two notable programs include Contributions for Social Integration (*contribuição*

152. See Lei No. 13.467, *supra* note 136. An individual can file a lawsuit within two years of dismissal or resignation from the company, seeking labor benefits with regards to the previous five years. *Id.* art. 11.

153. The 13th month salary (in Portuguese, *13º salário*), also known as Christmas Bonus (in Portuguese, *Gratificação de Natal*) was first established by the government headed by President João Goulart, pursuant to Lei No. 4.090, de 13 de Julho de 1962, Diário Oficial da União [D.O.U.] de 26.07.1962 (Braz.). Each company employee is entitled to receive, on an annual basis, an amount equal to one extra month salary, to the extent they worked all twelve months of the year; those who have not receive a proportional amount. *Id.* art. 1.

154. See Decreto-Lei No. 1.535, de 15 de Abril de 1977, Diário Oficial da União [D.O.U.] de 13.4.1977 (Braz.). For every 12 months worked, an employee is entitled to 30 days of vacation. *Id.* art. 130 (I).

155. FGTS was first promulgated in the year 1966 pursuant to Lei No. 5.107, de 13 de Setembro de 1966, D.O.U. de 14.09.1966 (Braz.), during the military dictatorship headed by General Humberto Castello Branco. Currently, it is regulated pursuant to Lei No. 8.036, de 11 de Maio de 1990, Diário Oficial da União [D.O.U.] de 14.05.1990 (Braz.). FGTS is a special fund designed to protect workers against dismissals without a just cause (*despedidas sem justa causa*). The company is obligated to make monthly deposits equivalent to 8% of the employee's salary to this fund. *Id.* art. 15.

para o programa de integração social, PIS),¹⁵⁶ and for Social Security (*contribuição para o financiamento da seguridade social, COFINS*).¹⁵⁷ The contribution amount varies depending on whether the local company pays tax on net income or presumed profits. For entities paying tax on regular net income, PIS and COFINS are assessed on monthly gross revenues at 1.65% and 7.6%, respectively, resulting in a combined rate of 9.25%.¹⁵⁸ In contrast, businesses that elect to pay tax on presumed profits are assessed PIS and COFINS at 0.65% and 3%, respectively, resulting in a combined rate of 3.65%.¹⁵⁹

Corporations paying income tax on their net income can claim credits for any PIS and COFINS levied against qualified purchases of goods and services.¹⁶⁰ The credits are determined pursuant to a mechanism referred to as the non-cumulative regime (*regime não-cumulativo*),¹⁶¹ which is somewhat akin to the value added tax (VAT) adopted worldwide. Alternatively, no credits are available for companies electing to pay tax on presumed profits under the alternate mechanism frequently designated as the cumulative method (*regime cumulativo*).¹⁶²

For taxpayers under the non-cumulative method, Brazilian tax law is rather vague as to what constitutes input credits. The law restricts its

156. PIS was promulgated in the early 1970s by the military dictatorship governing Brazil at that time, pursuant to Lei Complementar No. 7, de 7 de Setembro de 1970, Diário Oficial da União [D.O.U.] de 10.9.1970 (Braz.).

157. COFINS was promulgated in the early 1990s by the government of Fernando Collor de Mello, pursuant to Lei Complementar No. 70, de 30 de Dezembro de 1991, Diário Oficial da União [D.O.U.] de 30.12.1991 (Braz.).

158. Lei No. 10.637, *supra* note 101, art. 2, *with regards to PIS*; Lei No. 10.833, de 29 de Dezembro de 2003, art. 2, Diário Oficial da União [D.O.U.] de 30.12.2003 (Braz.), *with regards to COFINS*.

159. Lei No. 9.715, de 25 de Novembro de 1998, art. 8, Diário Oficial da União [D.O.U.] de 26.11.1998 (Braz.), *with regards to PIS*; Lei No. 9.718, *supra* note 98, art. 8, *with regards to COFINS*.

160. See Gabriel Caldiron Rezende & Ricardo Marletti Debatin da Silveira, *Brazil Evaluates Input Criteria For PIS and COFINS Credits*, INTERNATIONAL TAX REVIEW (Feb. 25, 2019), <https://www.internationaltaxreview.com/article/2a68tfd1dbv4158hyn2dj4/brazil-evaluates-input-criteria-for-pis-and-cofins-credits> (last visited Nov. 5, 2022).

161. See *Brazil – Corporate-Other Taxes, Value Added Tax*, PWC Worldwide Tax Summaries, <https://taxsummaries.pwc.com/brazil/corporate/other-taxes> (last visited Nov. 5, 2022) [hereinafter PWC Worldwide Tax Summaries].

162. *Id.*

application to the costs a company directly incurs in manufacturing products or rendering services. Specifically, PIS and COFINS paid to suppliers can potentially be claimed by the company as an input credit. However, in contrast to VAT,¹⁶³ only costs directly incurred for the manufacturing of goods or rendering of services can be claimed. For example, an advertising agency can claim credits for taxes paid for the production of a campaign for a client, but the agency cannot claim professional fees charged by accounting or law firms because these fees are viewed as indirectly related to the agency's business.

Unsurprisingly, taxpayers have challenged the government's stance via administrative and judicial proceedings in a mostly futile attempt to broaden the definition of input credits to include costs necessary and customary to conduct commercial activities. For instance, in 2020, a local toy manufacturer argued that royalties paid pursuant to a license contract for the trademark's use qualified as input credit.¹⁶⁴ However, the RFB rejected the argument asserting that royalty payments did not constitute an acquisition of services, as defined in the applicable PIS and COFINS legislation.¹⁶⁵

Finally, the importation of goods and services from abroad became subject to PIS and COFINS starting in 2004.¹⁶⁶ Conversely, no federal gross receipt taxes should be collected on the exportation of goods and services, provided payment is made by a non-resident results in the flow of foreign currency, duly registered through the Central Bank, into Brazil.¹⁶⁷ This is a mechanical test that sharply contrasts with VAT adopted elsewhere in Latin America, which routinely requires effective use and enjoyment of the goods sold or services rendered to take place or materialize outside of the respective national territory in order to benefit from a 0% tax rate.

163. To the extent VAT paid exceeds VAT collected, taxpayers may carry forward such excess balance to offset future VAT liability (more common option), or exceptionally seek cash reimbursement by filing a request with the local tax authority.

164. Solução de Consulta COSIT No. 117, 213, de 28 de Setembro de 2020, Diário Oficial da União [D.O.U.] de 30.09.2020 (Braz.).

165. *Id.*

166. Lei No. 10.865, de 30 de Abril de 2004, Diário Oficial da União [D.O.U.] de 30.04.2004 (Braz.).

167. Medida Provisória No. 2.158-35, de 24 de Agosto de 2001, art. 14 (III), Diário Oficial da União [D.O.U.] de 27.8.2001 (Braz.).

Another federal indirect levy to note is the tax on industrial products (*imposto sobre produtos industrializados*, IPI), formally known as the tax on consumption up until the mid-1960s.¹⁶⁸ IPI is an excise tax, levied monthly on goods imported or manufactured within Brazilian territory.¹⁶⁹ Exports are exempt from IPI.¹⁷⁰ From a mechanical perspective, IPI is a non-cumulative levy comparable to VAT (and state-level taxes on goods and selected services, discussed in the next section) in that IPI, paid by a manufacturing company to its suppliers, can be claimed as a credit to offset its IPI liability arising from sales.¹⁷¹ Tax rates vary considerably from 0% (essential foods) to 330% (cigarettes), depending on the type of goods.¹⁷²

B. State Level

Officially adopted with the elaborate name, *Imposto sobre Operações Relativas à Circulação de Mercadorias e Prestação de Serviços de Transporte Interestadual e Intermunicipal e de Comunicação* (ICMS) in Portuguese, the state consumption levy is primarily sanctioned by the 1988 Federal Constitution.¹⁷³ The state consumption levy is primarily regulated by a complementary law (*lei complementar*)¹⁷⁴ promulgated in 1996, and commonly referred to as *Lei Kandir*, which delineates the types of transactions covered, the

168. Decreto-Lei No. 34, de 18 de Novembro de 1966, art. 1, Diário Oficial da União [D.O.U.] de 18.11.1966 (Braz.).

169. See *Brazil - Indirect Tax Guide*, KPMG, <https://home.kpmg/xx/en/home/insights/2018/10/brazil-indirect-tax-guide.html> (last visited Nov. 5, 2022) [hereinafter KPMG].

170. DENTONS, *supra* note 95.

171. KPMG, *supra* note 169.

172. DENTONS, *supra* note 95. Most IPI rates fall between 0% and 30%. *Id.*

173. CONSTITUIÇÃO FEDERAL [C.F.] art. 155(II) (Braz.), enabling States and the Federal District to enact ICMS.

174. See Gustavo Carvalho Chehab, *A Lei Complementar No Direito Brasileiro*, 49 *Revista de Informação Legislativa* 191 (2012), <https://www2.senado.leg.br/bdsf/bitstream/handle/id/496567/000940658.pdf?sequence=1&isAllowed=y>. A complementary law is a juridical instrument created to regulate the application of a norm set forth under the Federal Constitution. *Id.* at 194. It enjoys the same authority when compared to an ordinary law. *Id.* at 199. Pursuant to Article 69 of the Federal Constitution, complementary laws must be approved by an absolute majority of the votes in both chambers of the legislative branch. *Id.* at 200.

taxable base, and the claiming of credits.¹⁷⁵ ICMS embodies a revised version of two earlier indirect state taxes on the sale of goods.¹⁷⁶ In comparison to its predecessors, ICMS expanded the levy's scope by encompassing other sectors of the economy such as fuel and energy, as well as communication services, to stay in line with its official name.¹⁷⁷

Each of the twenty-six states that make up the Federative Republic of Brazil, along with the Federal District in Brasilia, charges ICMS on the physical movement (circulation) of goods, as well as transportation and communication services, including imports.¹⁷⁸ Most entrepreneurs perceive ICMS as the most problematic levy because it negatively impacts the competitiveness of their businesses.¹⁷⁹ Despite being a state-authorized levy, the Federal Constitution obligates state governments to transfer 25% of ICMS collections to their respective municipalities.¹⁸⁰ Accordingly, the uniqueness of the Brazilian tax regime is confirmed, once again, as there is no levy comparable to ICMS in neighbouring jurisdictions at the national or even subnational spheres.

Nonetheless, as with VAT enforced elsewhere, ICMS acts as a non-cumulative tax assessed monthly on the value-added arising at

175. Lei Complementar No. 87, de 13 de Setembro de 1996 (Lei Kandir), Diário Oficial da União [D.O.U.] de 16.09.1996 (Braz.).

176. See Fernando Rezende, *Brazil's ICMS Tax: Origin, Changes, Current Situation, and Paths to Recovery*, Inter-American Development Bank (2013), <https://publications.iadb.org/publications/english/document/Brazil-ICMS-Tax-Origin-Changes-Current-Situation-and-Paths-to-Recovery.pdf>. Pursuant to the 1934 Federal Constitution, states were granted the authority to establish a tax on sales and consignments (*Imposto sobre Vendas e Consignações*, IVC). *Id.* at 2. IVC was replaced in 1965 by a tax on the circulation of goods (*Imposto sobre Circulação de Mercadorias*, ICM), pursuant to a constitutional amendment; ICM would itself be replaced by ICMS, pursuant to the 1988 Federal Constitution. *Id.* at 3.

177. *Id.* at 5. See also EURICO UEDA & IVO TORRES, *ESTRUTURA TRIBUTÁRIA ESTADUAL: POTENCIALIDADES, ADEQUAÇÃO E REFORMAS* (1984). By contrast, ICMS's immediate predecessor (ICM) imposed tax solely on tangible goods; intangible goods and services were simply excluded. Rezende, *supra* note 176, at 22. Likewise, fuel and electric energy were not subject to ICM. *Id.* at 23.

178. PWC Worldwide Tax Summaries, *supra* note 161.

179. VEJA, *supra* note 10.

180. See CONSTITUIÇÃO FEDERAL [C.F.] art. 158(IV).

each stage of circulation.¹⁸¹ Taxpayers recognize tax credits from ICMS paid on the purchase of raw materials, intermediate products, packaging materials, and goods to be resold.¹⁸² Where a taxpayer reports more ICMS debits than credits in a particular month, it must pay the difference to the state government.¹⁸³ Unlike VAT where tax is collected at destination, ICMS is generally collected at origin in the state where the supplier of goods is physically located.¹⁸⁴

Rates of ICMS vary widely depending on the state, as well as the degree of essentiality (*essencialidade*) assigned to goods produced or services rendered, but normally oscillate between 17% to 20%.¹⁸⁵ The three most industrialized states in Brazil reported comparable standard rates. In the State of São Paulo, pursuant to a 1989 law,¹⁸⁶ ICMS was first instituted and assessed at 18% on most products and services.¹⁸⁷ Seven years later, the State of Rio de Janeiro enacted similar legislation,¹⁸⁸ equally calling for a general 18% rate.¹⁸⁹ By contrast, the regular rate in the southern State of Rio Grande do Sul declined to 17% earlier this year.¹⁹⁰ Lower rates apply for interstate sales,¹⁹¹

181. PWC Worldwide Tax Summaries, *supra* note 161.

182. DENTONS, *supra* note 95.

183. PWC Worldwide Tax Summaries, *supra* note 161.

184. *Id.* at 22. *See also* UEDA & TORRES, *supra* note 177 (explaining ICM (the predecessor to ICMS) assessed tax based on origin, rather than on destination).

185. PWC Worldwide Tax Summaries, *supra* note 161; *see* CONSTITUIÇÃO FEDERAL [C.F.] art. 155 §2(III).

186. Lei No. 6.374, de 01 de Março de 1989, Diário Oficial do Estado de São Paulo [D.O.E.S.P.] de 02.03.1989(Braz.).

187. *Id.* art. 34(I).

188. Lei No. 2657, de 26 de Dezembro de 1996, Diário Oficial do Rio de Janeiro [D.O.E.R.J.] de 27.12.1996 (Braz.).

189. *Id.* art. 14(I).

190. Decreto No. 55.692, de 30 de Dezembro de 2020, Diário Oficial do Estado do Rio Grande do Sul [D.O.E.R.S.] de 30.12.2020 (Braz.). The rate was set at 18% for years 2016 to 2020, and 17.5% in 2021. *Id.*

191. DENTONS, *supra* note 95 (concluding interstate transactions are generally subject to ICMS rates ranging between 7% and 12%, depending on the state, and 4% when the goods are imported from abroad).

while as part of the federal government's goal to promote exports, the *Lei Kandir* excluded outbound sales of goods and services.¹⁹²

By contrast, luxury goods, along with tobacco and beverages, are often taxed at appreciably higher rates fluctuating between 30% and 35%.¹⁹³ Moreover until recently, telecommunication services and gasoline were subject to elevated rates of ICMS varying between 25% in the States of São Paulo and Rio Grande do Sul, to 32% and 34%, respectively, in the State of Rio de Janeiro.¹⁹⁴ Facing the pressures of upcoming presidential elections and the prospect of persistent high inflation, President Jair Bolsonaro acted to swiftly sanction legislation on June 23, 2022 (LC 194/2022)—by means of a complementary law amending the CTN and *Lei Kandir*—and reclassifying certain products such as fuel and natural gas, services such as electricity, telecommunications and public transportation, as essential and indispensable (*essenciais e indispensáveis*).¹⁹⁵ These categories were subjected to a maximum ICMS general rate of 17% or 18%, depending on the state.¹⁹⁶ A few days later, the governor of the State of São Paulo, Rodrigo Garcia, promptly announced a reduction in the rate of ICMS charged on gasoline, from 25% to 18%.¹⁹⁷

192. Lei Complementar No. 87, *supra* note 175, art. 3 (II). *But see* UEDA & TORRES, *supra* note 177, at 24 (stating exports were subject to ICM, the predecessor to ICMS).

193. Luiz de Mello, *The Brazilian 'Tax War': The Case of Value-Added Tax Consumption Among the States* (OECD Econ. Dep't Working Papers No. 544, 7, 2007), <https://doi.org/10.1787/286220576442>.

194. See Danielle Nader, *ICMS: Confirma o Valor das Alíquotas sobre Combustíveis, Energia e Telecomunicações* [Check the Value of Taxes on Fuel, Energy and Telecommunications], CONTÁBEIS (June 9, 2022), <https://www.contabeis.com.br/noticias/51866/aliquotas-de-combustiveis-energia-e-telecomunicacoes-por-estado/>.

195. Lei Complementar No. 194, de 23 de Junho de 2022, art. 1-2, Diário Oficial da União [D.O.U.] de 23.06.2022, Edição Extra (Braz.).

196. *Brazil – Corporate-Other Taxes, Value Added Tax*, *supra* note 161. The complementary law also entitles states to reduce the amount of debt owed to the federal government should collections from ICMS decrease by more than 5% in 2022 (when compared to 2021), as a result of the imposition of these new caps. Lei Complementar No. 194, *supra* note 195, art. 3.

197. Informativo SPF, Secretaria da Fazenda e Planejamento [Secretary of Finance and Planning], Diário Oficial do Estado de São Paulo [D.O.E.S.P.] de 27.06.2022, Edição Suplementar (Braz.) (explaining electric energy and communications services would also benefit from this rate reduction in ICMS). *See also*

The basic premise behind LC 194/2022 is that essential and indispensable items for the public interest cannot be treated as superfluous items (such as beverages, cigarettes, and perfumes), but are oftentimes subject to elevated rates of ICMS.¹⁹⁸ Due to the ongoing tensions between federal and local authorities, governors of several states have collectively criticized this new federal measure, promptly asserting that it could cause significant losses in collections and compromise budgets allocated to critical areas of public service, such as health and education.¹⁹⁹ Annual losses in the State of São Paulo, resulting from a decline in ICMS rates on these essential goods and services, are estimated at R\$ 15.3 billion.²⁰⁰ Moreover, according to a preliminary report prepared by the Legislative Assembly, the State of Rio de Janeiro could lose up to R\$ 10 billion in annual revenues should the rate applied to these essential items decrease to 17%.²⁰¹

Accordingly, governors representing eleven states and the Federal District filed an appeal (*ação direta de inconstitucionalidade*, ADI)²⁰²

Governo de São Paulo Reduz ICMS na Gasolina de 25% para 18% [Government of São Paulo Reduces ICMS on Gasoline from 25% to 18%], GOVERNO DO ESTADO DE SÃO PAULO (June 27, 2022), <https://portal.fazenda.sp.gov.br/Noticias/Paginas/Governo-de-São-Paulo-reduz-ICMS-na-gasolina-de-25-para-18.aspx>.

198. See Câmara dos Deputados, Projeto de Lei Complementar No. 18, de 2022, Texto Original – Justificação [Original Text – Justification], <https://www.camara.leg.br/propostas-legislativas/2317648>. Projeto de Lei Complementar No. 18/2022 was transformed into Lei Complementar No. 194/2022, upon validation by President Bolsonaro.

199. See Comunicação, *Governadores Questionam Nova Mudança no Reglamenteo do ICMS [Governors Question New Change in ICMS Regulation]*, SUPREMO TRIBUNAL FEDERAL (June 29, 2022), <https://portal.stf.jus.br/noticias/verNoticiaDetalhe.asp?idConteudo=489769&ori=1> [hereinafter Comunicação].

200. See Processo ADI/7195, Documento Comprobatório (49011/2022) No. 2, Perdas de Arrecadação Decorrentes do PLP 18/2022, Supremo Tribunal Federal, <https://redir.stf.jus.br/estfvisualizadorpub/jsp/consultarprocessoeletronico/ConsultarProcessoEletronico.jsf?seqobjetoincidente=6434957> (last visited Nov. 5, 2022) [hereinafter Comunicação].

201. See Hélder Duarte & Guilherme Schiavinato, *RJ Pode Perder até R\$ 10 bilhões por Ano com Aprovação de Projeto que Limita ICMS sobre Combustíveis [RJ May Lose Up to R\$10 Billion a Year with Approval of a Project that Limits ICMS on Fuels]*, G1 (June 20, 2022), <https://g1.globo.com/rj/rio-de-janeiro/noticia/2022/06/20/rj-pode-perder-ate-r-10-bilhoes-por-ano-com-aprovacao-de-projeto-que-limita-icms-sobre-combustiveis.ghtml>

202. See CONSTITUIÇÃO FEDERAL [C.F.] art. 102(I)(a) (Braz.). Translated into English as Direct Action for the Declaration of Unconstitutionality, an ADI consists

with the Federal Supreme Tribunal (*Supremo Tribunal Federal*, STF),²⁰³ calling into question the constitutionality of LC 194/2022.²⁰⁴ The governors specifically argued that the federal complementary law compromises their financial autonomy as ICMS is the lead tool utilized by states to raise funds for essential services for the public, while also undermining the constitutional authority reserved for states to fix ICMS rates.²⁰⁵ The appeal further asserts that fuel should constitute a pollutant disqualifying it as an essential good and hence, should not be subject to the rate limitations set forth by LC 194/2022.²⁰⁶

ICMS plays a prominent role in contributing funds for state coffers; consequently, it is not surprising that several incentives designed to entice companies to invest in their respective jurisdiction have been promulgated by state legislatures.²⁰⁷ Article 155 of the 1988 Carta Magna²⁰⁸ stipulates that representatives of the States and Federal Dis-

of a proceeding filed with the highest tribunal in Brazil seeking to declare a law or normative act contrary to the text of the Constitution. *Id.*

203. See *The Brazilian Federal Supreme Court - Competence*, SUPREMO TRIBUNAL FEDERAL, https://portal.stf.jus.br/internacional/content.asp?id=120647&ori=2&idioma=en_us (last visited Nov. 5, 2022). The main role of the STF is to safeguard the interpretation of the Federal Constitution. *Id.* Accordingly, the STF is responsible for deciding matters related to the Constitution or about which there is doubt or controversy through special legal actions, such as an ADI. *Id.*

204. Comunicação, *supra* note 199.

205. Processo ADI/7195, Petição Inicial (49011/2022), SUPREMO TRIBUNAL FEDERAL, <https://redir.stf.jus.br/estfvisualizadorpub/jsp/consultarprocessoeletronico/ConsultarProcessoEletronico.jsf?seqobjetoincidente=6434957> (last visited Nov. 5, 2022). See also *11 Estados e DF Entram no STF Contra Teto de ICMS Sobre Combustíveis e Energia [11 States and Federal District Enter the STF Against ICMS Ceiling on Fuels and Energy]*, UOL (June 28, 2022), <https://economia.uol.com.br/noticias/estadao-conteudo/2022/06/28/11-estados-e-df-entram-no-stf-contrato-teto-de-icms-sobre-combustiveis-e-energia.htm>.

206. Flávia Maia, *Estados Pedem ao STF a Suspensão de Lei que Limita ICMS sobre Combustíveis [States Ask the STF to Suspend the Law that Limits ICMS on Fuels]*, JOTA (June 28, 2022), <https://www.jota.info/stf/do-supremo/estados-entram-com-acao-lei-icms-combustiveis-stf-28062022>.

207. See Bianca Lima & Luiz Guilherme Gerbelli, *Em Meio a Sistema Tributário Caótico, Estado e Contribuintes Disputam R\$ 5,4 Trilhões na Justiça [Amid a Chaotic Tax System, State and Taxpayers Dispute BRL 5.4 Trillion in Justice]*, G1 (Jan. 22, 2021), <https://g1.globo.com/google/amp/economia/noticia/2021/01/22/em-meio-a-sistema-tributario-caotico-estado-e-contribuintes-disputam-r-54-trilhoes-na-justica.ghtml>.

208. See CONSTITUIÇÃO FEDERAL [C.F.] art. 155 §2(XII)(g) (Braz.).

strict can grant or revoke ICMS benefits and exemptions through formal deliberations under the supervision of the federal government²⁰⁹ and pursuant to complementary law.²¹⁰

The disproportionate impact of ICMS can be seen throughout the country. Rather than being collected based on destination (where goods are delivered), ICMS is collected for inter-state trade based on origin (where goods/services are produced or supplied) to the disadvantage of poorer states, that tend to be net importers of goods and services, in the northeast region of the country.²¹¹ Predictably, a decades-long interstate fiscal war (*guerra fiscal*) has ensued, whereby states are competing to attract businesses by unilaterally lowering rates and granting exemptions for certain supplies of goods and services, in contravention of the Federal Constitution.²¹² Shifting collection of ICMS from an origin to a destination basis should, in principle, simplify taxation of inter-state trade, but would almost certainly face stiff opposition from net exporters mainly located in the richer states in the south and southeast regions.²¹³

C. Municipal Level

Pursuant to the authority granted by the Federal Constitution, municipal authorities across Brazilian territory have enacted laws that tax gross income derived from the rendering of specified services, including, most notably for foreign investors, the importation of services

209. Cynthia Maria Bastos de Freitas, *Guerra Fiscal de ICMS Entre os Estados e as Consequências Para o País [ICMS Tax War Between States and Consequences for the Country]*, DIREITONET (May 8, 2017), <https://www.direitonet.com.br/artigos/exibir/10161/Guerra-fiscal-de-ICMS-entre-os-estados-e-as-consequencias-para-o-pais> (discussing granting ICMS incentives necessarily translates into reduced state tax collections and thus, less resources allocated for education, health and infrastructure, often leading to macroeconomic instability).

210. See Lei Complementar No. 24, de 07 de Janeiro de 1975, arts. 1-2, Diário Oficial da União [D.O.U.] de 09.01.1975 (Braz.).

211. De Mello, *supra* note 193.

212. See Melina Rocha Lukic & Ana Carolina Monguilod, *Will Brazil Finally Adopt a Modern VAT?*, KLUWER INT'L TAX BLOG (Aug. 28, 2020), <http://kluwer-taxblog.com/2020/08/28/will-brazil-finally-adopt-a-modern-vat/>; see also REID, *supra* note 3.

213. De Mello, *supra* note 193, at 8.

(*Imposto sobre Serviços de Qualquer Natureza*, ISSQN).²¹⁴ As its name in Portuguese implies, ISSQN applies, in principle, to a wide range of services regardless of its nature, and pursuant to a federal complementary law enacted in 2003 under the administration of then President Luiz Inácio Lula da Silva.²¹⁵ Nonetheless, this municipal levy is assessed to the extent that the service rendered is specifically listed in the annex to the complementary law.²¹⁶

Tax is ordinarily assessed on a monthly basis in the municipality where the service provider's place of establishment is located and is imposed at rates of up to 5%.²¹⁷ In 2016, to prevent municipalities from further engaging in "fiscal wars" to attract investors, the federal government set a 2% minimum tax rate.²¹⁸ However, ISSQN rates vary depending on the municipality and nature of the specific service rendered. For instance, the city of São Paulo has a general rate of 5%²¹⁹ and a reduced rate of 2.9% granted to information technology services.²²⁰ In the municipality of Rio de Janeiro, a 3% rate applies to advertising services, and a general 5% rate applies to services not otherwise assigned a specific rate.²²¹ Lastly, the main commercial city of

214. CONSTITUIÇÃO FEDERAL [C.F.] art. 156(III) (Braz.) (enabling municipalities to levy tax on services).

215. Lei Complementar No. 116, de 31 de Julho de 2003, Diário Oficial da União [D.O.U.] de 01.08.2003 (Braz.).

216. *Id.* §1.05 (examples of services enumerated in the annex include software licenses); *id.* at §7.01 (engineering and architecture); *id.* at §12.01 (theatrical spectacles); and *id.* at §17.06 (advertising).

217. *Id.* arts. 3, 8(II). See also *Imposto sobre Serviços (ISS) – Lançamento e Recolhimento [Tax on Services (ISS) - Entry and Collection]*, CIDADE DE SÃO PAULO: FAZENDA (Sept. 12, 2020), <https://www.prefeitura.sp.gov.br/cidade/secretarias/fazenda/servicos/iss/index.php?p=2486> (discussing the municipality of São Paulo, for instance, requires taxpayers to collect and pay ISSQN during the first ten days of each month, with respect to services rendered the previous month).

218. Lei Complementar No. 157, de 29 de Dezembro de 2016, Diário Oficial da União [D.O.U.] de 30.12.2016 (Braz.).

219. Lei No. 13.701, de 24 de Dezembro de 2003, art. 16, Diário Oficial do Município de São Paulo [D.O.M.S.P.] No. 245, de 25.12.2003 (Braz.).

220. Lei No. 16.757, de 14 de Novembro de 2017, Diário Oficial da Cidade de São Paulo [D.O.C.S.P.] No. 214, de 15.11.2017 (Braz.).

221. Decreto No. 10.514, de 8 de Outubro de 1991, art. 19, Regulamenta as disposições legais relativas ao Imposto sobre Serviços de Qualquer Natureza, Diário Oficial do Município do Rio de Janeiro [D.O.M.R.J.] de 09.10.1991 (Braz.).

Curitiba, located in the southern State of Paraná, grants a reduced 2% rate for call centers.²²²

Unlike Brazil's two federal gross revenue taxes, companies cannot claim a credit for payment of municipal ISSQN, but can instead deduct the amount paid for income tax purposes.²²³ Therefore, for financial reporting purposes, ISSQN essentially acts as a cumulative levy with a cascading effect, because it potentially impacts a company's gross margin and budget forecasts.

Municipal authorities have further repudiated the mechanical test adopted by the RFB for federal PIS and COFINS to determine whether a particular transaction qualifies as an exportation of services not subject to ISSQN.²²⁴ Fiscal agents instead embrace a more subjective test for application at the municipal level. In particular, ISSQN is ordinarily assessed on amounts invoiced by local companies to foreign recipients unless their effective use and enjoyment takes place solely outside national territory.²²⁵ Should a subsequent audit inspection arise, there must be adequate, contemporaneous documentation to support that company's assertion.²²⁶

V. CROSS-BORDER TRANSACTIONS

Unlike their Latin American counterparts, Brazilian companies face numerous issues regarding cross-border transactions, especially those involving foreign-related parties. Concerning outbound payments from Brazil, not only should one consider the multiple levies that are triggered, but also whether the relevant treaty can successfully be invoked to reduce the overall tax burden. On the flip side, amounts invoiced from Brazil to related parties abroad must comply with ex-

222. Lei Complementar No. 40, de 18 de Dezembro de 2001, art. 4, Diário Oficial do Município de Curitiba [D.O.M.C.] No. 96 de 18.12.2001 (Braz.).

223. Solução de Consulta COSIT No. 27, de 16 de Janeiro de 2017, seção 1, at 23, Diário Oficial da União [D.O.U.] de 25.01.2017 (Braz.).

224. See Lei Complementar No. 116, *supra* note 215, art. 2 (concluding no exportation is deemed to occur with regard to services rendered in Brazil to the extent its use and enjoyment takes place within national territory, even if payment is made by a foreign resident).

225. Lei Complementar No. 116, *supra* note 215, art. 2.

226. *Id.*

cruciatingly detailed transfer pricing regulations, which may not necessarily follow OECD principles.

A. *Non-Income Levies*

As opposed to other nations in the region, most outbound cross-border payments from Brazilian territory provoke tax results that are, perhaps, unintentionally confusing and cumbersome. This is particularly true for importation of technical services,²²⁷ which can attract up to five different types of levies under domestic law, excluding financial transaction tax (*imposto sobre operações de crédito, câmbio e seguro, ou relativas a títulos ou valores mobiliários*, IOF).²²⁸ Along with a 15% federal income tax withheld at source (IRRF),²²⁹ outbound payments are also potentially subject to withholding of municipal tax on services (ISSQN),²³⁰ generally at a rate of 5%. One should note that IRRF applies regardless of whether services are rendered abroad or within Brazilian territory.²³¹ Consequently, tax withheld in Brazil may not qualify as a valid credit in the jurisdiction where the income recipient resides. For good measure, the outbound payment also triggers three separate federal levies: two assessed on gross revenues (PIS and COFINS),²³² along with a 10% contribution, all of which are paid separately—and remitted to the RFB—by the local company importing the services.

The 10% federal contribution (*contribuição de intervenção no domínio econômico*, CIDE) mentioned in the previous paragraph was established in 2001 by the government headed by Fernando Henrique

227. See *infra* Section V.D for definition of the term “technical service” from a Brazilian domestic law perspective.

228. See Decreto No. 6.306, de 14 de Dezembro de 2007, Diário Oficial da União [D.O.U.] de 17.12.2007 (Braz.). IOF is to be collected pursuant to the terms set forth by this decree. *Id.* art. 1.

229. Instrução Normativa RFB No. 1.455, *supra* note 151, art. 17.

230. See Section IV.C.

231. Instrução Normativa RFB No. 1.455, *supra* note 151, art. 1. In other words, tax is withheld in Brazil irrespective of whether the income item originates from domestic or foreign sources (*exclusivamente na fonte*). *Id.*

232. See Section IV.A.

Cardoso to develop the nation's technological sector.²³³ Currently, nearly all royalties and technical service fees paid to non-residents give rise to CIDE on the gross amount paid.²³⁴ CIDE is not imposed on the foreign recipient, as is commonly the case within the context of cross-border payments. Rather, CIDE is imposed on the Brazilian payor, that is, the local Brazilian party that is responsible for paying and remitting the levy to the government. Unsurprisingly, CIDE cannot be claimed as a credit by the non-resident service provider in its country of residence.

No other jurisdiction in the region, and perhaps the world, imposes such an excessive tax burden on cross-border transactions. The complexity of the Brazilian tax regime becomes even more evident when compared to its Latin American neighbors, whereby a single national income tax is typically withheld on the outbound payment, irrespective of whether the technical service is rendered locally or abroad. In Colombia, for instance, a 20% withholding tax applies on payments made for the importation of technical services.²³⁵ However, amounts paid from Chile are generally subject to withholding tax at a rate of 15%, and may increase to a rate of 20% to the extent the amounts are paid to a resident of a low-tax jurisdiction.²³⁶

As noted below, invoking the various treaties to avoid double taxation tends to be a rather futile exercise because their limited scope fails to appropriately address the impact of non-income levies, such as the three federal contributions (PIS, COFINS, and CIDE) and the mu-

233. CIDE is regulated pursuant to CONSTITUIÇÃO FEDERAL [C.F.] art. 149 (Braz.), and adopted into legislation pursuant to Lei No. 10.168, de 29 de Dezembro de 2000, art. 2, Diário Oficial da União [D.O.U.] de 30.12.2000, Edição Extra (Braz.).

234. Initially, CIDE was imposed on contracts involving the acquisition or licensing of technological knowledge, or transfers of technology, but was expanded considerably to include not only royalties but payments for technical services and even mere administrative assistance, including management fees. CIDE does not apply to the use of software licenses in Brazil if there is no transfer of technology. See Lei No. 11.452, de 27 de Fevereiro de 2007, Diário Oficial da União [D.O.U.] de 28.2.2007 (Braz.).

235. See *Latin America Tax Guide 2019-20*, PFK, 39 (2019), https://www.pkf.com/media/8d89119f3564a79/pkf-latam-2019-2020_online.pdf.

236. *Id.* at 31. In Peru, tax is withheld at 15% on the outbound payment provided the Peruvian company obtains a report from a local audit firm certifying that the services were effectively rendered; otherwise the rate of withholding increases to 30%. *Id.* at 101.

nicipal tax on services (ISSQN).²³⁷ In particular, an ISSQN that is triggered upon a cross-border payment, is likely not creditable for foreign tax purposes, as ISSQN is not characterized as a tax on net income. In essence, this translates into an incremental cost for foreign-based companies conducting business with their Brazilian counterparts.

B. Interest on Net Equity

The vast majority of Latin American countries have enacted legislation assessing tax on profits and dividends received by resident individuals, and withholding tax on amounts distributed to foreign recipients, regardless of whether they are individuals or corporate entities. The notable exception is Brazil, of course, where profit distributions and dividends (*lucros e dividendos*) have not been subject to tax since 1996.²³⁸

Beginning that same year, Brazilian legislation allowed local companies to pay a national interest on net equity (*juros sobre o capital próprio*, JCP).²³⁹ The national interest is treated as a dividend or profit distribution for corporate and accounting purposes, and as a deductible interest payment for income tax purposes, subject to withholding tax.²⁴⁰ In fact, amongst its Latin American counterparts, Brazil is alone in making this alternative repatriation scheme available to local companies.²⁴¹

JCP was first established in 1995 to incentivize companies that pay tax on net income (*lucro real*) to finance their operations through equity, as opposed to debt.²⁴² Stated differently, the promulgation of

237. See *infra* Section V.D.

238. See *supra* Section III.D.

239. Lei No. 9.249, *supra* note 86, art. 9.

240. *Id.*

241. See *Belgium – Taxes on Corporate Income and Gains*, EY Worldwide Corporate Tax Guide 2022, https://www.ey.com/en_gl/tax-guides/worldwide-corporate-tax-guide (last visited Nov. 5, 2022). Nonetheless in Belgium, local companies and branches of non-resident companies may deduct a deemed interest expense in relation to qualifying equity, called notional interest deduction (NID); the NID amount is calculated on the incremental adjusted equity exceeding the average reported for the preceding five years. *Id.* at 163.

242. *Id.*

JCP motivated multinationals to fund their Brazilian operations presumably via capital contributions, rather than through third-party bank loans.²⁴³ The deductibility of JCP payments compensated, to a certain extent, Brazilian companies which were no longer able to recognize the effects of monetary corrections for financial statement purposes (*correção monetária das demonstrações financeiras*), at a time when inflation rates remained relatively high.²⁴⁴

The maximum amount of JCP that can be paid, at any given moment, is calculated by multiplying the company's reported adjusted net equity by the long-term interest rate (*taxa de juros de longo prazo*, TJLP).²⁴⁵ JCP payments are deductible for income tax purposes to the extent amounts paid do not surpass the greater of 50% of annual profits or 50% of accumulated retained earnings.²⁴⁶ This limitation is intended to prevent companies from distributing most of their after-tax earnings by means of JCP payments.

From a Brazilian tax perspective, JCP paid to foreign-based investors, not residing in a low tax jurisdiction, is subject to a 15% tax withheld at source (IRRF).²⁴⁷ Repatriating earnings by way of a JCP payment, versus a dividend distribution, leads to income tax deductions by the Brazilian company of up to 34% of the amount paid, mi-

243. Paulo Victor Vieira da Rocha et al., *Brazilian Income Tax Reform: Interest on Equity Extinction*, INTERNATIONAL TAX REVIEW (Sept. 28, 2012), <https://www.internationaltaxreview.com/article/b1ts0jcr5gqxvh/brazil-income-tax-reform-interest-on-equity-extinction>.

244. Lei No. 9.249, *supra* note 86, art. 4.

245. TJLP was promulgated pursuant to Medida Provisória No. 684, de 31 de Outubro de 1994, Diário Oficial da União [D.O.U.] de 03.11.94 (Braz.). TJLP represents the basic cost of financing granted by the National Development Bank (*Banco Nacional do Desenvolvimento*, BNDES). *Taxa de Juros de Longo Prazo—TJLP*, THE NATIONAL DEVELOPMENT BANK, <https://www.bndes.gov.br/wps/portal/site/home/financiamento/guia/custos-financeiros/taxa-juros-longo-prazo-tjlp> (last visited Oct. 10, 2022). The National Monetary Council (*Conselho Monetário Nacional*) sets forth TJLP rates. *Id.* The annual TJLP rate was initially set at 26.01% at the end of 1994, and is 7.20% as of the fourth quarter of 2022. *Id.*

246. Instrução Normativa RFB No. 1.700, de 14 de Março de 2017, art. 75 § 2, Diário Oficial da União [D.O.U.] de 16.03.2017 (Braz.).

247. Instrução Normativa RFB No. 1.455, *supra* note 151, art. 14; *see generally* Lei No. 9.779, de 19 de Janeiro de 1999, Diário Oficial da União [D.O.U.] de 20.1.1999 (Braz.). JCP paid to residents of tax haven jurisdictions (defined as a jurisdiction with a maximum rate less than 20%) is subject to IRRF at a rate of 25%. *Id.* art. 8.

nus the 15% IRRF on the reclassified interest paid to the shareholder, generating an overall tax benefit in Brazil of up to 19%. From a non-Brazilian tax perspective, JCP income is often reclassified as a dividend, as the underlying earnings originate from the Brazilian company's book profits available for distribution, thus creating a potential mismatch: that is, a sort of hybrid financing instrument.

In contrast to dividends, JCP payments have routinely been employed by multinationals to successfully reduce the overall effective income tax rate of their Brazilian subsidiary. However, the introduction of anti-hybrid legislation in many countries pursuant to the OECD's base erosion and profit sharing (BEPS) initiatives could negate the application of a participation exemption in the recipient country. As a result, this would lead to reclassifying the item of income received as interest and consequently result in taxation of the JCP amount. The Brazilian Congress formulated proposals to abolish the JCP altogether, but those proposals have not been met with success.²⁴⁸ If a reform is ultimately approved, companies would be incentivized to seek bank loans rather than increase its capital structure, particularly if dividends are subject to taxation in Brazil once again.

C. *Transfer Pricing*

Even though OECD principles firmly establish the arm's length principle for transactions undertaken between related parties, Brazil has adopted distinct transfer pricing rules.²⁴⁹ These rules set forth rigid arithmetical methods with pre-fixed profit margins, granting little to no consideration for functions performed, assets utilized, or risks as-

248. *See, e.g.*, Projeto de Lei No. 2.337/2021, Câmara dos Deputados, de 25 de Junio de 2021 (Braz.). Pursuant to the House of Representative bill, JCP payments would still have been available for taxpayers, but no longer deductible for corporate income tax (IRPJ and CSLL) purposes starting year 2022; payments would continue, nonetheless, to be subject to income withholding tax (IRRF). *Id.* art. 2.

249. *See Transfer Pricing in Brazil: Towards Convergence with the OECD Standard*, OECD (2019), <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-in-brazil-towards-convergence-with-the-oecd-standard.htm> [hereinafter OECD/Receita Federal do Brasil]. Brazil's transfer pricing regime was promulgated in 1996, inspired by the OECD's report issued in 1979, but has failed to incorporate more recent OECD transfer pricing guidelines addressing allocation of the taxable base among jurisdictions. *Id.* at 16.

sumed, and are contrary to the OECD's stance favoring a proper functional analysis.²⁵⁰ In sharp contrast to other Latin American jurisdictions that have incorporated OECD transfer pricing guidelines into their domestic legislation, Brazil's formulary apportionment system sets forth different methods for imports versus exports undertaken with a foreign related party or a resident of a low tax jurisdiction.²⁵¹

In general, profit margins related to the importation of goods that are resold vary anywhere between 20% to 40%, depending on the economic sector.²⁵² With regard to importation of services, a 20% profit margin over costs of production should satisfy the safe harbor rule under the CPL method,²⁵³ whereas exportation of services require at least a 15% profit margin over the costs of acquisition or production, plus taxes and duties imposed by Brazil pursuant to the CAP method.²⁵⁴ Additionally, in contrast to other Latin American countries, Brazil has not incorporated the best method rule into its domestic legislation, which would allow taxpayers more flexibility to adopt the methodology best suited to attain an arm's length result with respect to a particular intercompany transaction, taking into account assets utilized, functions performed, and risks assumed.²⁵⁵

D. Application of Tax Treaties

During the military rule of General Humberto Castello Branco, Brazil incorporated a national tax system into its internal legislation, officially called *Código Tributário Nacional* (CTN), pursuant to Law 5,172/1966.²⁵⁶ CTN sets forth the general norms of tax law suitable to the federal union, Federal District, states, and municipalities.²⁵⁷ Arti-

250. *Id.* at 317. The absence of a proper functional analysis may lead to instances of double international taxation or non-taxation. *Id.*

251. *Id.* at 73-76.

252. Lei No. 9.430, *supra* note 99, art. 18(III), § 12.

253. *Id.* *Método do Custo de Produção Mais Lucro* (CPL), in Portuguese. *Id.* art. 18(III).

254. *Id.* *Método do Custo de Aquisição ou de Produção Mais Tributos e Lucro* (CAP), in Portuguese. *Id.* art. 19 § 3(IV).

255. OECD/Receita Federal do Brasil, *supra* note 249, at 66.

256. *See generally* CTN, *supra* note 145.

257. *Id.* art. 1.

cle 98 of the 1966 law generally establishes that international treaties override domestic tax legislation and should be duly observed.²⁵⁸

Despite this rule, bilateral tax treaties entered into by Brazil with other countries are largely ineffective in order to avoid double taxation for four main reasons: (1) most levies assessed in Brazil on cross-border payments (federal PIS, COFINS and CIDE, along with municipal ISSQN) fall outside the scope of treaties; (2) as noted, dividend payments are subject to a 0% withholding tax (IRRF) per Brazilian internal law, making the 10% to 15% rates typically set forth under Article 10 of its treaties with third countries obsolete; (3) other than the treaty with Japan,²⁵⁹ Article 11 calls for a 15% IRRF on most interest payments, which is the same rate as established under Brazilian domestic law; and (4) the RFB has historically taken the controversial view that outbound payments related to the rendering of non-technical services should not qualify as business profits per Article 7.²⁶⁰ According to the RFB, the term “profits” (*lucros*, in Portuguese) should refer exclusively to items of net income, not gross income,²⁶¹ deviating significantly from the OECD’s interpretation and, in effect, defeating the treaty’s principal purpose to avoid double taxation.

Expanding on the first point, Article 2 (Taxes Covered) of the treaties, entered into by the various Latin American nations to avoid double taxation, generally include within its scope, levies assessed on net income however denominated²⁶² and alternative income taxes.²⁶³

258. *Id.* art. 98.

259. *See* Article 2 of the Protocol to the Brazil-Japan treaty, promulgated pursuant to Decreto No. 81.194, de 9 de Janeiro de 1978, art. 2, Diário Oficial da União [D.O.U.] de 11.1.1978 (Braz.) [hereinafter Brazil-Japan treaty]. The current version of Article 10(2) calls for a 12.5% withholding tax on the gross interest payment. *Id.* art. 10(2).

260. *See* Ato Declaratório Interpretativo RFB No. 1, de 5 de Janeiro de 2000, Diário Oficial da União [D.O.U.] de 19.01.2000 (Braz.), subsequently revoked by Ato Declaratório Interpretativo RFB No. 5, de 16 de Junho de 2014, Diário Oficial da União [D.O.U.] de 20.06.2014 (Braz.); *see also* *Brazil: Treaty Interpretation*, BINDER DIJKER OTTER (July 2014), <https://www.bdo.com/getattachment/0c9f75d4-c328-4acc-9d55-74b31600fcc7/attachment.aspx?International-Tax-Alert-July-2014.pdf> [hereinafter *Brazil: Treaty Interpretation*].

261. *Brazil: Treaty Interpretation*, *supra* note 260.

262. Commonly known as *Impuesto sobre la Renta* (ISR) or *Impuesto a la Renta* (IR) in nearly all Spanish-speaking jurisdictions, with notable exceptions be-

Unfortunately, there is a kaleidoscope of levies enacted throughout the region that fall outside the scope of Article 2, with Brazil leading the way.

Outbound payments from Brazil again often trigger a slew of levies and contributions, including federal IRRF, PIS, COFINS, and CIDE, along with municipal ISSQN.²⁶⁴ Taxes on income, including not only IRRF but also corporate income taxes (IRPJ and CSLL), are properly addressed by treaties entered into with third countries and signed by the Brazilian government. For these purposes, Brazil issued a law explicitly stating that CSLL is a covered tax for purposes of interpreting treaties.²⁶⁵ Nonetheless, the other four assessments (PIS, COFINS, CIDE and ISSQN) fall outside the scope of Article 2. Treaties bestow at most limited tax relief for non-residents doing business with their Brazilian counterparts.

Another controversial matter common throughout Latin America, including Brazil, surrounds the meaning of certain key terms when ascertaining the application of treaties. Most notably, disputes often arise as to whether IRRF should be withheld on amounts remitted abroad as compensation for the rendering of technical service and technical assistance.²⁶⁶ For these purposes, the RFB defines the term "technical services" as those in which execution relies on specialized technical knowledge or involves administrative assistance or consulting services performed by independent professionals or companies, or relies on automated means with clear technological content.²⁶⁷ Likewise, the term "technical assistance" is defined as advice, rendered by the transferor of a process or a secret formula to the transferee, by

ing Argentina where it is called *Impuesto a las Ganancias* (IAG), and Costa Rica where it is referred to as *Impuesto sobre las Utilidades* (ISU).

263. An example being the *Impuesto a la Ganancia Mínima Presunta* (IGMP) in Argentina.

264. See Section V.A.

265. Lei No. 13.202, de 8 de Dezembro de 2015, Diário Oficial da União [D.O.U.] de 9.12.2015 (Braz.). For purposes of interpretation, the international treaties to avoid double taxation signed by the Brazilian government encompass CSLL. *Id.* art. 11.

266. See Ricardo Maitto, *Brazil – Application of Double Tax Treaties To Cross-Border Service Fees*, BLOOMBERG TAX (Jan. 28, 2022, 12:00 AM), <https://news.bloomberglaw.com/daily-tax-report-international/brazil-application-of-double-tax-treaties-to-cross-border-service-fees>.

267. Instrução Normativa RFB No. 1.455, *supra* note 151, art. 17 §1(II)(a).

means of techniques, designs, studies, instructions, or other similar services, that enables the effective utilization of said process or formula transferred.²⁶⁸

In practice though, RFB agents tend to deem nearly all services rendered by foreign entities as technical in nature, including administrative support and consulting services, payments for data centers, and even management fees.²⁶⁹ When applying a particular treaty, RFB officials have often taken a rather expansive view arguing that these types of payments should be addressed by the royalty section of the treaty—typically contained in Article 12(3)—irrespective of whether there is a transfer of technology.²⁷⁰

Unsurprisingly, the majority of treaties entered into by Brazil with third countries, such as the ones currently in force with Mexico,²⁷¹ Spain²⁷² and China,²⁷³ classify these technical service payments, made pursuant to Article 12(3) of the respective treaty and accompanying

268. *Id.* art. 17 §1(II)(b).

269. Upon a tax audit inspection, agents often attempt to reclassify nearly all outbound payments from Brazil as technical services, rather than as business profits, in order to raise revenues for government coffers. It is up to the taxpayer to subsequently litigate the issue at the administrative and/or judicial courts (a time consuming process) once an assessment is officially recorded.

270. Ato Declaratório Interpretativo RFB No. 5, de 16 de Junho de 2014, Diário Oficial da União [D.O.U.] de 20.06.2014 (Braz.); *see* Solução de Consulta COSIT No. 5, de 12 de Janeiro de 2017, seção 1, at 13, Diário Oficial da União [D.O.U.] de 18.01.2017 (Braz.). The RFB ruled that the 15% IRRF should be withheld on technical services payments made to related parties residing in Canada (where a treaty applied) and the United States (where no treaty applied). *Id.* at 30; *see also* Solução de Consulta COSIT No. 155, de 22 de Novembro de 2016, seção 1, at 21, Diário Oficial da União [D.O.U.] de 30.11.2016 (Braz.). Payments for technical services or technical assistance made to a resident of Argentina are subject to a 15% IRRF, pursuant to Article XII of the treaty and related protocol. *Id.* at 14, 16.

271. *See* Section 6(a) of the Protocol to the Brazil-Mexico treaty, promulgated pursuant to Decreto No. 6.000, de 26 de Dezembro de 2006, Diário Oficial da União [D.O.U.] de 27.12.2006 (Braz.); *see also* Ato Declaratório Interpretativo SRF No. 1, de 1 de Março de 2007, Diário Oficial da União [D.O.U.] de 2.3.2007 (Braz.).

272. *See* Section 5 of the Protocol to the Brazil-Spain treaty, promulgated pursuant to Decreto No. 76.975, de 2 de Janeiro de 1976, Diário Oficial da União [D.O.U.] de 5.1.1976 (Braz.); *see also* Ato Declaratório Interpretativo SRF No. 4, de 17 de março de 2006, Diário Oficial da União [D.O.U.] de 20.03.2006 (Braz.).

273. *See* Protocol to the Brazil-China treaty, promulgated pursuant to Decreto No. 762, de 19 de Fevereiro de 1993, Diário Oficial da União [D.O.U.] de 20.02.1993 (Braz.).

protocols, as royalties subject to IRRF in Brazil. Concerning the application of the Brazil-Spain treaty, in particular, the RFB further issued a ruling in 2006 confirming that the term "royalties" includes nearly all types of technical services and assistance, whether or not a transfer of technology takes place.²⁷⁴ The RFB goes on to conclude that the scope (*âmbito*) of Article 7 (encompassing business profits) is somewhat diminished, by carving out income derived from the rendering of technical services.²⁷⁵

Notable exceptions, however, are present involving treaties negotiated by the Brazilian government with France²⁷⁶ and Japan.²⁷⁷ In fact, the RFB recently issued a ruling clarifying the application of the treaty with Japan by affirming that payments for technical services are not subject to withholding tax, to the extent no transfer of technology takes place.²⁷⁸ Both treaties classify these types of technical service payments as business profits under Article 7, not subject to income withholding tax in Brazil, provided that the foreign enterprise does not have a permanent establishment located within the national territory.²⁷⁹

In terms of tax treaty networks in Latin America, Brazil does quite well as it is ranked second only behind Mexico, with a total of 36 bilateral treaties currently in force.²⁸⁰ Notwithstanding, it is surprising

274. Ato Declaratório Interpretativo SRF No. 4, *supra* note 272, art. 3(I).

275. *Id.* art. 3(IV).

276. *See* Article VII of the Brazil-France treaty, promulgated pursuant to Decreto No. 70.506, de 12 de Maio de 1972, Diário Oficial da União [D.O.U.] de 16.05.1972 (Braz.) [hereinafter Brazil-France treaty]; *see also* Recurso Especial No. 1618897/RJ, *Alcatel-Lucent Submarine Networks S/A vs. Fazenda* (Superior Tribunal de Justiça, 19 de Maio de 2020). The Brazilian Superior Tribunal of Justice (STJ) held in 2020 that income received by a French company (without a permanent establishment in Brazil) rendering technical services to a Brazilian-based client, is not subject to income withholding tax (IRRF). *Id.*

277. *See* Article 5 of the Brazil-Japan treaty, promulgated pursuant to Decreto No. 61.899, de 14 de Dezembro de 1967, Diário Oficial da União [D.O.U.] de 18.12.1967 (Braz.).

278. Solução de Consulta COSIT No. 20, de 30 de Maio de 2022, seção 1, at 379, Diário Oficial da União [D.O.U.] de 01.06.2022 (Braz.).

279. Brazil-France treaty, *supra* note 276, art. VII (I); *see* Brazil-Japan treaty, *supra* note 259, art. 5(1).

280. As of July 25, 2022, Brazil reports a total of 36 bilateral tax treaties, well behind Mexico's 60 treaties. For a complete list of Brazil's treaties to avoid double taxation *see* *Acordos para evitar a dupla tributação e prevenir a evasão fiscal*, RE-

that Brazil lacks treaties with the United States, United Kingdom, and Germany.²⁸¹ These three jurisdictions represent some of the more preeminent countries where multiple multinationals are headquartered, diminishing its appeal to investors from those jurisdictions. In 1975, Brazil signed a treaty with Germany,²⁸² but the latter terminated the agreement in 2005, presumably due to the reluctance of Brazilian government officials to renegotiate its terms.²⁸³ The disagreement revolved around Brazil's insistence on disregarding the application of Article 7 for non-technical services rendered by and paid to German residents, as well as excluding other non-income levies from the treaty's purview.²⁸⁴

VI. TAX CONTROVERSIES

Brazil is infamous for being one of the most litigious nations worldwide, particularly in regard to tax matters. One reason for this is the soaring monetary value arising from disputes, litigated at the judicial and administrative courts between the State and taxpayers, with estimated totals reported in 2019 at R\$ 5.4 trillion, or 75% of the country's gross domestic product (GDP).²⁸⁵ These legal proceedings typically involve federal, state, and municipal authorities.²⁸⁶ This in-

CEITA FEDERAL DO BRASIL (July 25, 2022, 12:17 PM) <https://www.gov.br/receitafederal/pt-br/aceso-a-informacao/legislacao/acordos-internacionais/acordos-para-evitar-a-dupla-tributacao/acordos-para-evitar-a-dupla-tributacao>.

281. *Id.*

282. Decreto No. 76.988, de 6 de Janeiro de 1976, Diário Oficial da União [D.O.U.] de 7.1.1976 (Braz.).

283. See Napoleão Dagnese, *Is Brazil 'Developed'? Termination of the Brazil-Germany Tax Treaty*, 34 *INTERTAX* 195 (2006).

284. Termination of the Brazil-Germany treaty became effective on January 1, 2006. See Receita Federal do Brasil (RFB), Ato Declaratório Executivo SRF No. 72, de 22 de Dezembro de 2005, Diário Oficial da União [D.O.U.] de 26.12.2005 (Braz.).

285. Contencioso Tributário no Brasil Relatório 2020 – Ano de Referência 2019, INSPER (Dec. 2020), https://www.insper.edu.br/wp-content/uploads/2021/01/Contencioso_tributario_relatorio2020_vf10.pdf [hereinafter INSPER]. Of the R\$ 5.4 trillion total value assigned to tax litigation, roughly R\$ 3.8 trillion (or 52.7% of GDP) involve disputes with the federal government. *Id.* at 7-9.

286. *Id.* Nearly 75% of the monetary value from all proceedings conducted in 2019 - dealing with either federal, state or municipal levies - were adjudicated at the judicial level, with the remainder overseen by administrative courts. *Id.* at 10, tbl. 3.

evitably increases not only the amount of professional (legal and accounting) fees company directors must consider when planning their annual budgets, but also their overall sense of legal uncertainty (*insegurança jurídica*) when undertaking business transactions.²⁸⁷ Cases adjudicated in Brazil at the federal administrative level represent almost 16% of the GDP, in sharp contrast to the average percentage representing a mere 0.19% of GDP, reported for other Latin American jurisdictions.²⁸⁸

A. Underlying Reasons

In comparison with its Latin American brethren, there are multiple reasons to explain why Brazil currently has such a chaotic tax system in place. First, the federal government, along with the Federal District in Brasilia, 26 states, and over 5,000 municipalities, have been granted the constitutional authority to enact all sorts of levies with little coordination.²⁸⁹ This inevitably leads to a highly enigmatic legislation, manifested by its numerous laws²⁹⁰ and divergent interpretations as to the meaning of certain terms, and the constant amendments via decrees and provisional measures.²⁹¹ A further explanation for the inordinate volume of tax litigation in Brazil may revolve around the RFB's insistence on assessing penalties upon audit examinations, rather than offering much needed guidance to taxpayers,²⁹² particularly

287. Lima & Gerbelli, *supra* note 207.

288. INSPER, *supra* note 285, at 11-12.

289. Lima & Gerbelli, *supra* note 207. See CONSTITUIÇÃO FEDERAL [C.F.] arts. 145-49 (Braz.).

290. *Id.* Since the Federal Constitution's adoption in 1988, over 337 thousand tax regulations have been issued. *Id.*

291. See *Entenda o Processo Legislativo*, CÂMARA DOS DEPUTADOS, <https://www.camara.leg.br/entenda-o-processo-legislativo/>. A provisional measure (*medida provisória*, in Portuguese) is an act issued by the President, with the authority of law until approved by Congress; should Congress not approve the provisional measure within 120 days, it ceases to have effect. *Id.* at *Medida Provisória*. See also *Medidas Provisórias em Tramitação*, CONGRESSO NACIONAL, <https://www.congressonacional.leg.br/materias/medidas-provisorias>. Provisional measures pertain to relevant and urgent matters. *Id.* Initially valid for a 60-day period, they are automatically renewed for another 60 days. *Id.*

292. REID, *supra* note 3, at 226.

in those instances where the law encourages diverging interpretations or is simply silent as to its application.

Yet another reason for this lamentable situation is that tax law revisions potentially entail formal amendments to the Federal Constitution, which are often challenged by taxpayers as being unconstitutional. For example, unification of federal, state, and municipal taxes can only be accomplished by means of a proposal to amend the constitution (*proposta de emenda à constituição*, or “PEC”), which is a demanding process that often takes years and requires a qualified majority in both houses of Congress.²⁹³ Due in part to these continual constitutional challenges, courts are often congested, inevitably denying taxpayers a swift final outcome to disputes.

B. Increased Costs

The inordinate number of levies currently assessed in Brazil at the federal, state, and municipal levels, some of which can be claimed as credits to offset future tax liabilities, significantly increases the time and effort spent by local companies to fully comply with their monthly tax obligations, as compared to their Latin American counterparts.²⁹⁴ For instance, federal income taxes (IRPJ and CSLL) paid in March of a particular fiscal year can be utilized in principle to offset federal gross receipt taxes (PIS and COFINS) to be paid in June of the following year. However, without proper documentation to prove payment, the amount of credit claimed by the Brazilian company can be challenged by the RFB and, if not resolved within a certain time period, generates a new tax debt (*dívida tributária*).²⁹⁵ This could conceivably interfere with the ability of local companies to participate in future government bids, obtain financing from local banks, and engage in other commercial endeavors.

These routine “tax offset” cases can significantly increase the caseload reported at the administrative level and eventually at the judicial level, slowing down proceedings and delaying the final outcome

293. CONSTITUIÇÃO FEDERAL [C.F.] art. 60 §2 (Braz.). Proposed amendments to the Federal Constitution require a qualified majority of three-fifths of the votes in both houses of the National Congress. *Id.*

294. *Paying Taxes 2020*, *supra* note 13, at 18.

295. See Igor Utsumi, *Federal Revenue Tax Audit*, THE BRAZIL BUSINESS (Mar. 27, 2014), <https://thebrazilbusiness.com/article/federal-revenue-tax-audit>.

for taxpayers.²⁹⁶ Frustratingly, there is no specific provision under Brazilian law that enables taxpayers to negotiate a settlement agreement with the tax authority concerning a disputed tax obligation. Taxpayers are often left with no choice but to litigate the matter at the tribunals with the assistance of legal counsel, possibly impacting the company's cash flow. Moreover, upon a possible foreclosure, companies are generally required to place a cash deposit with the judicial courts to continue to litigate the matter. However, should the case ultimately be found in favor of the taxpayer, it may take several years to obtain a refund of the amount deposited.

All this, in turn, prolongs the time it takes for tribunals to address the more intricate cases. These cases involve the interpretation of tax laws and regulations, such as amortization of goodwill on acquisitions, the exportation of services on amounts invoiced abroad, the allocation of costs between related parties, whether a particular levy should be taken into account when determining the base to calculate another levy, or whether a certain good or service should be categorized as essential under federal law for purposes of applying the maximum ICMS rate under state law.

It is no surprise that some tax debt cases litigated through the court system in Brazil do not reach a final resolution until well over a decade has lapsed from the initial assessment by the tax inspector. For instance, the debate over whether the state-level VAT (ICMS) forms part of the taxable base to calculate the two federal contributions (PIS and COFINS) has been litigated for over two decades, and appears to have finally reached a definitive resolution.²⁹⁷ According to a recent study compiled by EY, as of 2017, the average time it takes to fully litigate a tax matter in Brazil, in consideration of both administrative (RFB and CARF) and judicial proceedings, is almost 19 years.²⁹⁸ In-

296. See Edimara Iansen Wiczorek & Marco Favini, *Brazil: Debit Balance Offsetting: From A Benefit To Companies To A Thorn In Their Side*, MONDAQ (Dec. 13, 2013), <https://www.mondaq.com/Article/280928>.

297. See Leandro Lucon, et al., *Brazilian Supreme Court Ruling on the Exclusion of ICMS from PIS/COFINS*, INTERNATIONAL TAX REVIEW (May 18, 2021), <https://www.internationaltaxreview.com/article/b1rwkmgsmqsk2/brazilian-supreme-court-ruling-on-the-exclusion-of-icms-from-piscofins>.

298. EY, DESAFIOS DO CONTENCIOSO TRIBUTÁRIO BRASILEIRO 12 (Instituto Brasileiro de Ética Concorrencial, 2019), <https://www.etc.org.br/wp-content/uploads/Estudo-Desafios-do-Contencioso-Tributario-ETCO-EY.pdf> [hereinafter DESAFIOS DO CONTENCIOSO TRIBUTÁRIO BRASILEIRO]. The actual time frame was 18 years

deed it would be an arduous task to identify another country where the time frame is longer, with perhaps India being the closest competitor.²⁹⁹ That same report also indicates that there were approximately 120,000 tax administrative proceedings being adjudicated at CARF during the years 2016 to 2018.³⁰⁰ Unsurprisingly, one suspects there is a disproportionate number of tax lawyers registered in Brazil to oversee this continuously heavy caseload, when compared to other Latin American jurisdictions.

C. Amnesty Programs

The excessive number of proceedings in Brazil contributes to an increased sense of frustration and judicial skepticism among taxpayers. This is exasperated by the federal government's tendency, when confronted by exorbitant budget deficits, to promulgate often-times convoluted amnesty programs to quickly raise badly needed funds.³⁰¹ Over the years, for instance, the Brazilian federal government enacted—originally as provisional measures which were subsequently converted into law—a tax amnesty program in 2009 called *Programa de Recuperação Fiscal* (REFIS) in Portuguese that enables taxpayers to pay off recorded debts as of November 30th of the prior year;³⁰² another tax amnesty program in 2015 called *Programa de Redução de Litígios Tributários* (PRORELIT) that enables taxpayers to settle debts recorded as of June 30th of that same year;³⁰³ and yet another

and eleven months. *Id.* In 2016, the average time to completely litigate a tax matter in Brazil was estimated to be even longer: 21 years. *Id.*

299. *Reducing Income Tax Disputes in India - A Way Forward* 7 (Deloitte, Tax Policy Paper No. 6, 2020), <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-reducing-income-tax-disputes-in-india-noexp.pdf#:~:text=The%20current%20tax%20litigation%20process%20in%20India%20could,fast-track%20dispute%20resolution%20mechanism%2C%20etc.%20%28refer%20Figure%203%29>. According to Deloitte's report, it could take anywhere from 12 to 14 years to resolve a tax dispute through the litigation process in India, including appeals all the way up to the Federal Supreme Court. *Id.*

300. *Id.* at 20.

301. See DESAFIOS DO CONTENCIOSO TRIBUTÁRIO BRASILEIRO, *supra* note 298, at 15 (listing a series of federal amnesty programs made available to taxpayers since 2000).

302. Lei No. 11.941, *supra* note 118.

303. Lei No. 13.202, *supra* note 265.

tax amnesty program in 2017 called *Programa Especial de Regularização Tributária* (PERT) that allowed the discharge of debts recorded as of April 30th of that year.³⁰⁴

Municipalities such as São Paulo, where many multinationals base their headquarters in Brazil, have also entered the fray by occasionally offering incentives to encourage taxpayers to cancel their debts by reducing penalties and interest charged on the principal amount of tax owed. By way of illustration, the City of São Paulo promulgated in 2011 an amnesty program called *Programa de Parcelamento Incentivado – PPI*,³⁰⁵ whereby taxpayers could pay off amounts due with respect to fiscal periods ending before December 31, 2009.³⁰⁶ Pursuant to the 2011 amnesty program, taxpayers were able to reduce interest by 100% and penalties by 75% if the tax debt were paid off in a single payment (*pagamento em parcela única*).³⁰⁷ Moreover, penalties were reduced by 50% if the taxpayer chose instead to settle the debt in installments (*pagamento parcelado*).³⁰⁸

Accordingly, amnesty programs typically allow taxpayers to pay off their debts in installments, reducing the amount of interest and penalties originally owed.³⁰⁹ However, some of these programs oddly enabled taxpayers to utilize accumulated tax losses to (partially) cancel tax debts.³¹⁰ Amnesties are widely considered by most experts as an improper tool to raise funds from a tax policy perspective, as they

304. Lei No. 13.496, de 24 de Outubro de 2017, Diário Oficial da União [D.O.U.] de 25.10.2017 (Braz.).

305. See, e.g., Decreto No. 52.485, de 11 de Julho de 2011, Diário Oficial da Cidade de São Paulo [D.O.C.S.P.] No. 128 de 12.07.2011 (Braz.).

306. *Id.* art. 2.

307. *Id.* art. 10.

308. *Id.* art. 11.

309. See, e.g., Lei No. 16.680, de 4 de Julho de 2017, Diário Oficial da Cidade de São Paulo [D.O.C.S.P.] No. 125 de 05.07.2017 (Braz.). In 2017, taxpayers could pay-off their debts to the City of São Paulo with respect to periods ending prior to 31 December 2016 through an amnesty program called *Programa de Parcelamento Incentivado de 2017*. *Id.* art. 1. Tax debts cancelled by means of a single payment, reduced interest by 85% and penalties by 75%; alternatively, debts paid-off in installments, reduced interest by 60% and penalties by 50%. *Id.* art. 5.

310. See, e.g., Lei No. 13.496, *supra* note 304, art. 2(I).

promote continued non-compliance by a significant portion of the population, while simultaneously discouraging transparency.³¹¹

Given the multiple overlapping levies, time-consuming proceedings and amnesty programs, multinationals are often left with no other choice but to expand their in-house financial and legal departments at their Brazilian subsidiary to properly oversee tax debts, while collaborating more closely with local counsel.³¹² Compared to other nations in Latin America, this adds to the already considerable costs typically incurred by multinationals when conducting business in Brazil.

VII. RECOMMENDATIONS

Taking into account the complexities surrounding Brazil's tax laws and regulations, the following section provides some common sense recommendations to bring more clarity to the rules that multinationals must confront when initiating or expanding operations in the South American nation. Moreover, simplification of the country's tax legislation should discourage states and municipalities from engaging in unhealthy fiscal wars, that oftentimes involve desperate attempts to entice companies to transfer commercial operations into their respective jurisdictions at the expense of severely curtailing tax collections. These propositions, however, are not meant to resolve all of the inadequacies arising from the Brazilian tax system; instead, they aim to form part of an initial blueprint to promote a more investor friendly environment within the context of an ever increasing competitive global marketplace.

311. See Fernando Herrero, *Tax Amnesties*, INTER-AMERICAN CENTER OF TAX ADMINISTRATION (June 21, 2013), <https://www.ciat.org/tax-amnesties/?lang=en>; see also ERIC LE BORGNE & KATHERINE BAER, *TAX AMNESTIES: THEORY, TRENDS, AND SOME ALTERNATIVES* 56 (2008), <https://www.imf.org/en/Publications/IMF-Special-Issues/Issues/2016/12/31/Tax-Amnesties-Theory-Trends-and-Some-Alternatives-21865>.

312. See Lima & Gerbelli, *supra* note 207. For instance, the president of a local manufacturer of machinery and equipment had to assign up to 5% of the company's workforce to exclusively oversee tax matters. *Id.* See also VEJA, *supra* note 10.

A. Corporate Income Tax

Given the considerable similarities between IRPJ and CSLL, it makes sense to eliminate the two in favor of a single federal corporate tax on net income, assessed at graduated rates, depending on the taxable base. Considering the current downward trend in corporate tax rates prevalent worldwide, the maximum rate should not exceed 25% in order to allow Brazil to remain competitive. By combining the two income levies into one, Brazilian companies should benefit, as well, from lower compliance costs. To further streamline the federal government's collection efforts, the election to pay tax on presumed profits should be abolished, thus requiring all companies doing business in the country to pay tax solely on net income. This, in turn, should reduce instances of international double taxation upon dividends distributed from Brazil, as the foreign shareholder should be able to fully claim a credit for taxes paid by the local company on the underlying income.

Besides, eliminating the option for small entities to elect the presumed profits tax method removes an incentive for certain workers to inappropriately lessen their tax burden on earned income, by performing services indirectly through a legal entity (*pessoa jurídica*). Commonly referred to as *pejotização*³¹³ in the local marketplace, rather than registering as a typical employee and receiving salaries subject to various payroll taxes, the individual worker instead sets up a *limitada* through which to render personal services to the operating corporation in exchange for receiving "fees" subject to lower rates of income tax.³¹⁴ The *pejotização* arrangement, in this instance, is intended essentially to disguise the underlying employment relationship in the form of a service contract entered into between the operating company

313. See TRT-3, No. TRT-00057-2015-011-03-00-0 RO, Relator: Des. Ana Maria Amormim Rebouças, 23.11.2016, Diário de Justiça do Estado de Minas Gerais [D.J.E.M.G.] de 01.12.2016 (Braz.). "The term *pejotização* refers to a common and current practice in the labor sphere. It entails a mechanism utilized by companies to boost profits and financial results, avoiding labor costs, and consists in hiring workers (individuals) by incorporating a legal entity (*pessoa jurídica*). This scheme results in the recharacterization of the employment relationship where a legal entity is used to replace the labor contract." *Id.*

314. *Pejotização: O Que É? Confira as Regras a Partir da Nova Reforma Trabalhista*, CONTABILIZEI.BLOG (Jan. 3, 2022), <https://www.contabilizei.com.br/contabilidade-online/pejotizacao/>.

and the individual's *limitada* and consequently, may be subject to reclassification pursuant to Article 9 of the CLT.³¹⁵

Along with a reduction in the corporate income tax rate, dividends and profits distributed to foreign resident shareholders should be subject to withholding tax (IRRF). The combined income tax burden, resulting from the imposition of corporate and withholding taxes, should not exceed 30%, to enable Brazil to remain competitive, while ensuring a steady stream of fiscal revenues. Tax withheld on dividends distributed to owners residing in low-tax jurisdictions could be set at a higher rate to encourage full transparency, which is also consistent with laws implemented in other countries. Moreover, moving forward, taxation of dividends and other profit distributions at the hands of resident individuals should induce local entities to formally register all their workers as employees in full compliance with labor law, rather than maintaining certain key members as *quotistas*.³¹⁶

B. Cross-Border Transactions

In exchange for reducing the corporate income tax rate of 34%, tax should be withheld on dividends distributed to foreign shareholders, at a rate ranging from 5% to 15%. This measure should be linked with abolishing the three federal levies (PIS, COFINS and CIDE), which assesses most outbound payments arising from the importation of services. Accordingly, this measure should reduce the tax burden experienced by foreign investors. In addition, removing the ability of local companies to make interest on net equity (JCP) payments would send a clear message that Brazil is serious about curtailing the usage of cross-border hybrid instruments, designed mainly to artificially lower the taxable base.

Furthermore, Brazil should replace its current fixed-margin system based on pre-established arithmetic formulas, in favor of transfer pricing rules that take into account assets used, functions performed, and risks assumed, as recommended by the OECD. Indeed, representatives of the RFB and OECD have recently met in the capital city of Brasília to set a timeframe for Brazil to explicitly integrate the

315. *Id.* See Section III.D.

316. *See* Section III.D.

arm's length principle into its domestic legislation.³¹⁷ Whether this initiative is enacted by means of a legislative bill (*projeto de lei*) requiring lengthy congressional debates or a provisional measure issued by the executive branch remains unclear, although the latter option seems more feasible given the urgency to have these rules in place starting 2023; this, in turn, should expedite Brazil's entry as a full-fledged OECD member, further inciting investments from overseas.³¹⁸

The new methodology would analyze all types of transactions undertaken with foreign related parties, not just imports, exports and loans, as evaluated under the current system.³¹⁹ It would also be helpful for Brazil to adopt the best method rule.³²⁰ A safe harbor rule ordaining a set profit margin (of up to 5%) is highly advisable, one specifically tailored for ancillary activities, such as the rendering of back-office and other low value-added functions, as it would presumably reduce compliance costs.³²¹ The eventual convergence of Brazil's transfer pricing norms with those of the OECD should reduce instanc-

317. See *OECD and Brazil Work Together to Align Brazil's Transfer Pricing Rules to International Standard*, OECD (Apr. 13, 2022), <https://www.oecd.org/tax/tax-global/oecd-and-brazil-work-together-to-align-brazil-s-transfer-pricing-rules-to-international-standard.htm>; see also *Brazil: Update on Revisions to Transfer Pricing Rules, Steps Toward OECD Transfer Pricing Guidelines*, KPMG INSIGHTS (Apr. 12, 2022), <https://home.kpmg/us/en/home/insights/2022/04/tmf-brazil-update-revisions-transfer-pricing-rules-oecd-transfer-pricing-guidelines.html>.

318. Bárbara Mengado, *Precos de Transferência: Prós e Contras da Mudança por Medida Provisória*, JOTA (Aug. 24, 2022), <https://www.jota.info/opiniao-e-analise/colunas/coluna-barbara-mengardo/precos-de-transferencia-pros-e-contras-da-mudanca-por-medida-provisoria-24082022>. See also Medida Provisória No. 1.152, de 28 de Dezembro de 2022, Diário Oficial da União [D.O.U.] de 29.12.2022 (Braz.). In fact, right before leaving office in late December 2022, President Jair Bolsonaro signed a provisional measure fully adopting OECD-inspired transfer pricing rules, effective January 1, 2024. *Id.* art. 48. Nonetheless, taxpayers can opt to apply these rules starting calendar year 2023. *Id.* art. 46.

319. *Receita Federal e OCDE Apresentam Projeto para Preços de Transferência no Brasil*, GOV.BR (Apr. 12, 2022), <https://www.gov.br/receita-federal/pt-br/assuntos/noticias/2022/abril/receita-federal-e-ocde-projeto-para-precos-de-transferencia-no-brasil>. In contrast to Brazil's current rules, all controlled transactions (*todas as transações controladas*), engaged with foreign related parties, would be covered under the proposal. *Id.*

320. *Id.* Taxpayers would be required, under the proposed rules, to select the "most appropriate method" (*método mais apropriado*) for each transaction under analysis. *Id.*

321. *Id.*

es of double taxation (*dupla tributação*) arising from cross-border intercompany transactions,³²² and offer much needed tax certainty (*segurança jurídica*) for foreign investors.³²³

In terms of tax treaties, Brazil should follow more closely the guidelines set forth by the OECD Model Treaty, especially if it aims to become a full member of that multinational organization. Precise rules should be set for each treaty, clarifying whether technical service and technical assistance payments fall under the category of business profits under Article 7 (preferable), or royalties under Article 12. Moreover, the treaty definition of the term “technical service” should not be overly broad to ensure it does not in practice cancel the application of Article 7. Stated differently, Brazil should cease withholding tax on items of income that derive from routine transactions undertaken by multinationals, such as management fees and other service fees that do not entail a transfer of technology.

Adopting these guidelines should reduce the number of cases currently being adjudicated and provide a clearer picture for foreign investors to determine their cost of doing business in the country. Besides, the total amount of expenses incurred by the Brazilian federal government in litigating these matters at the various tribunals likely offsets the amount of fiscal revenues it collects from withholding tax on these outbound payments.

C. Value Added Tax

Even though it necessarily entails a constitutional amendment, normally a tortuous and excruciatingly slow process, the Brazilian government should strive to consolidate federal (PIS and COFINS), state (ICMS) and municipal (ISSQN) levies assessed on consumption, including the supply of goods and rendering of services, into one single national VAT (*imposto de valor agregado*, IVA) pursuant to the destination principle and as embraced in most other Latin American jurisdictions. The new federal indirect levy would be collected at des-

322. See OECD, TRANSFER PRICING IN BRAZIL TOWARDS CONVERGENCE WITH THE OECD STANDARD – HIGHLIGHTS 12 (2019), <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-in-brazil-towards-convergence-with-oecd-standard-brochure.pdf>.

323. *Id.* at 19.

tinuation (rather than at origin), thereby greatly reducing fiscal wars between competing local jurisdictions.

VAT paid to suppliers (input credits) would be fully creditable against VAT charged on invoices issued to clients (output credits), with the local company remitting the difference to the government the following month. The new levy should be assessed on most transactions at a single general rate, anywhere between 15% and 20% (comparable to rates adopted throughout the region), with targeted exemptions granted for qualified exports and lower tax rates assigned to sales of certain basic products.

If not feasible, a more modest reform should entail combining PIS and COFINS into a single federal contribution on goods and services (*contribuição sobre bens e serviços*, CBS), specifically targeted to raise revenues for social security programs. The new federal CBS should be assessed at a relatively low rate, allowing states and municipalities to continue—for the time being—to separately assess ICMS and ISSQN, respectively.

Notwithstanding, the Senate has been debating the merits of a constitutional amendment (PEC) to reform the nation's tax system since July of 2019.³²⁴ The revised reform bill now calls for the establishment of a so-called dual VAT model, combining the two federal levies into a single federal CBS, while consolidating the state ICMS and municipal ISSQN into a new subnational levy known as *imposto sobre bens e serviços* (IBS).³²⁵ In addition to the dual VAT, a selective tax (*imposto seletivo*) would be enacted to replace the current federal excise tax (IPI), imposing tax on selected items such as cigarettes and alcoholic beverages.³²⁶ A sole subnational VAT should, in principle, lessen the propensity often displayed by state and municipal officials to engage in costly fiscal wars vying to attract businesses.³²⁷

324. See Senado Federal, Proposta de Emenda à Constituição No. 110, de 2019 [Proposed Amendment to The Constitution No. 110, of 2019], <https://legis.senado.leg.br/sdleg-getter/documento?dm=7977850&ts=1654087970632&disposition=inline>.

325. *Id.* See also *Reforma tributária dá novo passo com imposto dual; entenda o que pode mudar*, G1 (Oct. 5, 2021), <https://g1.globo.com/economia/noticia/2021/10/05/reforma-tributaria-da-novo-passo-com-imposto-dual-entenda-o-que-pode-mudar.ghtml>.

326. *Id.*

327. *Id.* See Lima & Gerbelli, *supra* note 207.

Unfortunately, this congressional initiative has gone through numerous revisions over the past four years,³²⁸ but has yet to attain concrete results. The continued delay can be explained in large measure due to chronic fragmentation within the government, highlighted by the fact that some members of the Senate oppose the PEC as it defers certain critical matters (such as the fixing of rates associated with the new levies) to a subsequent complementary law, enhancing the sense of judicial uncertainty.³²⁹

D. Tax Litigation

To monitor the amount of time and effort spent by company executives and their counsel in litigating tax debts, Brazilian law should enable taxpayers to reach a binding conciliation with the tax authorities (following the example set by Mexico),³³⁰ at least with respect to simple matters. This settlement program would cover, for instance, debts entailing the utilization of credits to offset tax liabilities, which unnecessarily slows down proceedings at the administrative and judicial levels. As prevalent in common law jurisdictions, it may benefit Brazil's judicial system and speed up proceedings to adopt a more robust rule whereby decisions issued uniformly and on similar fact patterns help set precedent to guide judges in future cases.

By eventually reducing the number of tax assessments adjudicated at the administrative and judicial levels, judges will be able to administer their resources more efficiently. In particular, they can focus their attention on effectively interpreting and applying the law on more intricate matters, rather than spending valuable time issuing rulings on minor issues that do not advance a better understanding of the law. Utilization of tax credits, for instance, would be better managed by audit inspectors and accountants. This, in turn, should greatly expedite

328. Senado Federal, *supra* note 324. A total of 253 amendments to the constitutional bill have been proposed since the PEC was first filed on July 9, 2019. See *Proposta de Emenda à Constituição n° 110, de 2019* (2019), <https://www25.senado.leg.br/web/atividade/materias/-/materia/137699/pdf>.

329. Marcela Mattos, *Comissão do Senado Adia Votação de PEC da Reforma Tributária pela 4ª Vez e Relator Fala em 'Boicote,' G1* (May 31, 2022), <https://g1.globo.com/politica/noticia/2022/05/31/comissao-do-senado-adia-votacao-de-pec-da-reforma-tributaria-pela-4a-vez-e-relator-fala-em-boicote.ghtml>.

330. See DESAFIOS DO CONTENCIOSO TRIBUTÁRIO BRASILEIRO, *supra* note 298, at 5.

proceedings and lead to a final resolution of tax disputes in a more timely manner, positively enhancing the sense of justice for all involved.

CONCLUSION

When observing a duck swim in a tranquil lake located within the famous Ibirapuera Park, surrounded by the urban jungle that is city of São Paulo, one cannot help but notice the duck's graceful movement, yet being completely oblivious to the relentless back and forth motion of its webbed feet underneath. By the same token, any successful reform to streamline Brazil's tax system will require an inordinate amount of coordinated effort (entailing oftentimes heated debates) on the part of federal, state, and municipal officials, mostly held outside of the public's view.

Over the years, the Brazilian government has attempted to simplify its fiscal regime in an effort to increase revenues and tackle very challenging social and economic issues. These attempts have, for the most part, been disorderly and futile. Enacting a new or modifying an existing levy usually requires a constitutional amendment, something that is nearly impossible to achieve given the multiplicity of political parties with divergent objectives forming part of the national political landscape. Moreover, the inability to effectively amend the Federal Constitution in a timely fashion has directly resulted in a proliferation of contributions and levies in Brazil at the federal, state, and municipal levels. The resulting outcome is the creation of one of the most elaborate yet incomprehensible tax systems on earth, only surpassed perhaps by India.

Having said that, legislators were successful in amending the country's civil code in 2019, enabling the incorporation of single-owner entities called *sociedade limitada unipessoal*.³³¹ Accordingly, multinationals were offered a useful tool to streamline their corporate structures in Brazil. Nothing prevents these government leaders from doing the same in the tax arena, to reduce "the Brazil cost" and thus, attract more foreign investments.

331. Lei No. 13.874, de 20 de Setembro de 2019, art. 1.052. § 1, Diário Oficial da União [D.O.U.] de 20.9.2019, Edição extra-B (Braz.).

For the sake of the country’s financial equilibrium and future economic growth, Brazil must enact long-term comprehensive legislation enabling it to successfully escape from this “tax madhouse,” rather than rely on hastily arranged short-term remedies that only complicate fiscal collections. A lesson that former President Jair Bolsonaro learned the hard way. Despite promoting various measures during the summer of 2022 which were designed to lessen the impact of fuel prices on the general population by means of lower ICMS rates—and hopefully garner enough favorable polling going into the presidential elections—Bolsonaro was not able to overcome (after two rounds) the resurgence of Luiz Inácio Lula da Silva who will, once again, become President beginning January 1, 2023.

Indeed, faced with the daunting and long overdue task of reformulating the country’s fiscal framework, the next President should endeavor to imitate a lotus flower, leaving behind a muddy and incoherent past in favor of a transparent and cohesive future. More to the point, the executive branch should strive to collaborate with its legislative counterpart enacting broad reforms that establish, once and for all, a simple yet effective scheme—preferably more reliant on taxing income rather than consumption—that will ensure a steady stream of revenues, at the lowest possible administrative cost. No tax reform, however, can deliver unless government budgets are held in check, and a greater number of companies are actively engaged in the formal economy. In commemorating its two hundred year anniversary as a sovereign state, Brazil should ultimately aspire to fully integrate into its tax legislation the “Order and Progress” (*Ordem e Progresso*) slogan so prominently displayed on its national flag.

ANNEX

Acronym	Official Name	Enabling Legislation / Presidency	Description
ADI	<i>Ação Direta de Inconstitucionalidade</i>	Constituição Federal de 1988, art. 102(I)(a) / José Sarney	Direct Action for the Declaration of Unconstitutionality. Filed with the Federal Supreme Tribunal (STF), an ADI entails an action directed to declare a law or normative act contrary to the Constitution.
CAP	<i>Método do Custo de Aquisição ou de Produção Mais Tributos e Lucro</i>	Lei No. 9.430, de 27 de dezembro de 1996 / Fernando Henrique Cardoso	Safe harbor rule applied to exportation of services, whereby a 15% profit margin is added over the costs of acquisition or production (plus taxes and duties) to determine the transfer price between related parties.
CARF	<i>Conselho Administrativo de Recursos Fiscais</i>	Lei No. 11.941, de 27 de maio de 2009 / Luiz Inácio Lula da Silva	Administrative body within the Ministry of Finance, responsible for rendering decisions on appeals primarily brought by taxpayers against federal tax assessments issued by the Brazilian federal tax authority (RFB).
CBS	<i>Contribuição sobre Bens e Serviços</i>	Proposta de Emenda à Constituição No. 110, de 2019 / Jair Bolsonaro	Proposed single federal contribution on goods and services, intended to eventually replace existing federal levies on revenues (PIS and COFINS); if enacted, the federal CBS (along with the sub-national IBS) would be comparable to the value added tax (VAT) implemented worldwide.
CIDE	<i>Contribuição de Intervenção no Domínio Econômico</i>	Constituição Federal de 1988, art. 149 / José Sarney	Federal contribution imposed on Brazilian companies utilizing services rendered by non-residents. CIDE applies to outbound payments of royalties, as well as to administrative and technical services rendered by non-residents, but not to software licenses. Amount due equals 10% of remittance overseas.
CLT	<i>Consolidação das Leis do Trabalho</i>	Decreto-Lei No. 5.452, de 1 de maio de 1943 / Getúlio Vargas	As its official name implies, Brazil's labor laws were first consolidated into a single code during the decade of the 1940s, under the guidance of populist leader Getúlio Vargas.
CNI	<i>Confederação Nacional da Indústria</i>	Decreto-Lei No. 1.402, de 5 de julho de 1939 / Getúlio Vargas	National Confederation of Industry. Its main purpose is to defend and promote public policies that favor all sorts of industrial production throughout the country.
COFINS	<i>Contribuição para o Financiamento da Seguridade Social</i>	Lei Complementar No. 70, de 30 de dezembro de 1991 / Fernando Collor de Mello	Federal social security funded by businesses operating in Brazil. COFINS delivers unemployment insurance and social security benefits to sectors of the population with less financial means.

CPL	<i>Método do Custo de Produção Mais Lucro</i>	Lei No. 9.430, de 27 de dezembro de 1996 / Fernando Henrique Cardoso	Safe harbor rule applied to importation of services, whereby a 20% profit margin is added over the costs of production to determine the transfer price between related parties.
CSLL	<i>Contribuição sobre o Lucro Líquido</i>	Lei No. 7.689, de 15 de dezembro de 1988 / José Sarney	Social contribution on net profits. Its tax base is comparable to the tax on net income applicable to legal entities (IRPJ).
CTN	<i>Código Tributário Nacional</i>	Lei No. 5.172, de 25 de outubro de 1966 / Humberto Castello Branco	The National Tax Code regulates the country's tax system, by establishing general norms of tax law applicable to the federal government (<i>união</i>), Federal District, states and municipalities.
ECD	<i>Escrituração Contábil Digital</i>	Instrução Normativa RFB No. 1.774, de 22 de dezembro de 2017 / Michel Temer	Brazil's electronic tax filing system is referred to as Digital Accounting Bookkeeping. ECD was set up to secure transmission of accounting books and related data by cracking down on tax avoidance while strengthening transparency.
FGTS	<i>Fundo de Garantia do Tempo de Serviço</i>	Lei No. 5.107, de 13 de setembro de 1966 / Humberto Castello Branco	Severance indemnity fund designed to protect workers against dismissals without just cause (<i>despedidas sem justa causa</i>). Local companies are obligated to make monthly deposits equivalent to 8% of the employee's salary to this fund.
IBS	<i>Imposto sobre Bens e Serviços</i>	Proposta de Emenda à Constituição No. 110, de 2019 / Jair Bolsonaro	Proposed single sub-national tax on goods and services, envisioned to eventually replace the current state tax on goods and selected services (ICMS) as well as the current municipal tax on services (ISSQN); if enacted, the IBS would form part of a dual VAT system, along with the national CBS.
ICMS	<i>Imposto sobre Operações Relativas à Circulação de Mercadorias e Prestação de Serviços de Transporte Interestadual e Intermunicipal e de Comunicação</i>	Constituição Federal de 1988, art. 155(II) / José Sarney	State taxes imposed on commerce and certain services. Each of the country's twenty-six states (as well as the Federal District in Brasília) impose ICMS on the movement of goods, transportation, communication services, and supply of goods. Rates fluctuate by state, depending on the product sold or service rendered. ICMS acts as a non-cumulative tax, assessed on the value added.
INSS	<i>Instituto Nacional do Seguro Social</i>	Decreto No. 99.350, de 27 de junho de 1990 / Fernando Collor de Mello	Employers are obliged to make social security contributions, generally at a flat rate of 20%, along with additional social charges, reaching as high as 28.8% of total payroll.

IOF	<i>Imposto sobre Operações de Crédito, Câmbio e Seguro, ou Relativas a Títulos ou Valores Mobiliários</i>	Decreto No. 6.306, de 14 de dezembro de 2007 / Luiz Inácio Lula da Silva	Financial transaction tax imposed on credit transactions (including loans and insurance), foreign exchange operations, and all sorts of financial investments (securities); rates vary depending on the transaction.
IPI	<i>Imposto sobre Produtos Industrializados</i>	Decreto-Lei No. 34, de 18 de novembro de 1966 / Humberto Castello Branco	Federal tax on industrial products, formally called tax on consumption (<i>imposto de consumo</i>) up until the mid-1960s. IPI is an excise tax levied monthly on goods imported or manufactured within Brazilian territory.
IRPF	<i>Imposto de Renda das Pessoas Físicas</i>	Lei No. 9.250, de 26 de dezembro de 1995 / Fernando Henrique Cardoso	Federal levy on net income reported by individuals, first imposed on a permanent basis in the year 1922. Maximum rates of IRPF reached as high as 65% in the mid-1960s, but has settled at 27.5% since 1999.
IRPJ	<i>Imposto de Renda de Pessoas Jurídicas</i>	Lei No. 9.249, de 26 de dezembro de 1995 / Fernando Henrique Cardoso	Federal levy on net income reported by legal entities assessed at graduated rates, reaching as high as 25%.
IRRF	<i>Imposto sobre a Renda Retido na Fonte</i>	Instrução Normativa RFB No. 1.455, de 6 de março de 2014 / Dilma Rousseff	Tax withheld on an item of income. Outbound payments linked to the rendering of technical services, royalties, and interest are subject to IRRF. The general rate of withholding is 15%, unless paid to a resident of a low tax jurisdiction, in which case the rate increases to 25%.
ISSQN	<i>Imposto sobre Serviços de Qualquer Natureza</i>	Constituição Federal de 1988, art. 156(III) / José Sarney	Municipal tax charged on a monthly basis on gross income derived from the rendering of a broad spectrum of services; rates vary between 2% and 5%, depending on the municipality and/or nature of transaction.
JCP	<i>Juros sobre o Capital Próprio</i>	Lei No. 9.249, de 26 de dezembro de 1995 / Fernando Henrique Cardoso	Brazilian legislation enables local companies to pay a notional interest on net equity (JCP), which is treated as a dividend or profit distribution for corporate and accounting purposes, but as a deductible interest payment for income tax purposes, subject to withholding tax if paid to a non-resident.
PEC	<i>Proposta de Emenda à Constituição</i>	Constituição Federal de 1988, art. 60 §2 / José Sarney	Proposals to amend the Federal Constitution of 1988 require a qualified majority of three-fifths of the votes in both houses of Congress.
PERT	<i>Programa Especial de Regularização Tributária</i>	Lei No. 13.496, de 24 de outubro de 2017 / Michel Temer	Federal tax amnesty program established in 2017, enabling taxpayers to pay-off debts recorded as of April 30, 2017, reducing the amount of penalties and interest owed.
PIS	<i>Contribuição para o Programa de Integração Social</i>	Lei Complementar No. 7, de 7 de setembro de 1970 / Emílio Garrastazu Médici	Federal social security funded by businesses operating in Brazil. PIS was promulgated in the early 1970s by the military dictatorship governing Brazil at that time.

PPI	<i>Programa de Parcelamento Incentivado</i>	Decreto No. 52.485, de 11 de julho de 2011 / Dilma Rousseff	Tax amnesty program established in 2011 by the Municipality of São Paulo, whereby taxpayers were able to reduce interest by 100% and penalties by 75% if the tax debt was paid-off in a single payment.
PRORELIT	<i>Programa de Redução de Litígios Tributários</i>	Lei 13.202, de 8 de dezembro de 2015 / Dilma Rousseff	Federal tax amnesty program established in 2015, enabling taxpayers to settle debts recorded as of June 30, 2015, reducing the amount of penalties and interest owed.
REFIS	<i>Programa de Recuperação Fiscal</i>	Lei No. 11.941, de 27 de maio de 2009 / Luiz Inácio Lula da Silva	Federal tax amnesty program established in 2009, enabling taxpayers to pay-off debts recorded as of November 30, 2008, reducing the amount of penalties and interest owed.
RFB	<i>Receita Federal do Brasil</i>	Decreto No. 63.659, de 20 de novembro de 1968 / Artur da Costa e Silva	National federal tax administration that forms part of the Ministry of Finance. Established in 1968, the RFB consolidated the Departments of Internal Revenue, Customs, and Income Tax.
SPED	<i>Sistema Público de Escrituração Digital</i>	Decreto No. 6.022, de 22 de janeiro de 2007 / Luiz Inácio Lula da Silva	Digital bookkeeping system which greatly reduced the number of hours spent by local companies to file tax returns and make payments; nonetheless, compliance costs in Brazil remain one of the highest in the world.
STF	<i>Supremo Tribunal Federal</i>	Constituição Federal de 1988, art. 102 / José Sarney	Federal Supreme Tribunal in charge of guarding and interpreting the Constitution. STF is responsible for deciding matters related to the Constitution or about which there is doubt or controversy through special legal actions that evaluate the constitutionality of laws and matters, such as the ADI.
TJLP	<i>Taxa de Juros de Longo Prazo</i>	Medida Provisória No. 684, de 31 de outubro de 1994 / Itamar Franco	Long-term interest rate. TJLP represents the basic cost of financing granted by the National Development Bank (<i>Banco Nacional do Desenvolvimento</i>). The annual TJLP rate was initially set at 26.01% at the end of 1994, and is 7.01% as of the third quarter of 2022.