

Eduardo Almeida Mota

**A Proposal for a Taxpayer Rating System to Improve Tax
Compliance**

Master's Dissertation

This final paper is submitted in part fulfilment of the requirements of Columbia University – School of International and Public Affairs for the degree of Master of Public Administration.

Advisor: Professor Arvid Lukauskas

New York

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I dedicate this final paper to my beloved wife, Luciene Pedrosa da Fonseca, for the support, love and patience throughout its elaboration and the whole course.

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Resumo

Mota, Eduardo Almeida; Lukauskas, Arvid. **Uma Proposta para um Sistema de Classificação de Contribuintes para Promover a Conformidade Fiscal**. Nova Iorque, 2017. 85p. Dissertação de Mestrado - School of International and Public Affairs, Columbia University – New York.

O mundo está vivendo um momento peculiar em relação ao contrato social vigente até então. A estrutura pública está sendo questionada a ponto de provocar profundas discussões sobre paradigmas seculares. A inclusão social promovida pelas redes sociais tem elevado o nível de exigência dos serviços públicos. Uma das principais razões para isso é a falta de confiança nas instituições públicas gerada por alguns comportamentos antiéticos, corrupção basicamente, ou mesmo pela própria ineficiência da máquina pública. Ineficiência que influencia negativamente, inclusive, nos índices de competitividade das nações. É necessário estabelecer um novo relacionamento, uma nova justificativa para a existência das estruturas públicas. Esta dissertação analisa o problema exclusivamente do ponto de vista da administração tributária, propondo uma nova forma de segmentar e classificar os contribuintes de acordo com seu comportamento em relação ao pagamento de tributos. A metodologia utilizada foi baseada numa abordagem qualitativa. A análise indicou que, em que pese o apelo mundial pela melhora nos sistemas tributários, há poucos mecanismos simples e objetivos para incentivar a conformidade. Embora o estudo aborde novas formas de atuação estatal, são necessários estudos aprofundados sobre outros pontos estruturantes específicos como whistleblower fiscal, certificação de profissionais contábeis, conformidade, análise de riscos e governança nas administrações tributárias. Como considerações finais, este estudo apresenta possíveis temas para pesquisas futuras.

Palavras-chave

Conformidade Fiscal; Classificação de Contribuintes; Administração Tributária.

Abstract

Mota, Eduardo Almeida; Lukauskas, Arvid (Advisor). **A Proposal for Taxpayer Rating System to Improve Tax Compliance**. New York, 2017. 85p. Master Final Paper – School of International and Public Affairs, Columbia University – New York.

The world is experiencing a peculiar moment in relation to the currently social contract. The public structure is being questioned and secular paradigms has been reconsidering in general. The social inclusion promoted by social networks has raised the demand for high quality in public services. One of the main reasons for this situation is the lack of confidence in public institutions generated by some unethical behavior, as corruption, or even by the inefficiency of public sectors. This inefficiency influences the indices of nations' competitiveness negatively. It is necessary to establish a new relationship between citizen and authorities, moreover, to establish a new justification for the existence of public structures. This work examines the problem exclusively from the tax administrations' point of view. It proposes a segmentation and classification of taxpayers according to their behavior when paying taxes. The methodology used was based on a qualitative approach. The analysis indicated that, despite the worldwide appeal for improvement in tax systems, there are few simple and objective mechanisms to encourage compliance. Although this work addresses new forms of state performance, in-depth studies are needed on other specific structuring points such as tax whistleblower, certification of accountant professionals, compliance, risk analysis, and governance in tax administrations. As final considerations, this study presents possible topics for future researches.

Keywords

Tax Compliance; Taxpayers Rating; Tax Administration.

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List of Abbreviations and Acronyms

BEPS – Based Erosion and Profit Shifting

CIAT – Inter-American Center of Tax Administrations

COFINS – Contribuição para o Financiamento da Seguridade Social

CONFAZ – Conselho Nacional de Política Fazendária

FTA – Forum on Tax Administration

GDP – Gross Domestic Product

GST – Good and Services Tax

IADB – Inter-American Development Bank (IDB)

ICMS – Imposto sobre a Circulação de Mercadorias e Serviços

ICMS-ST – Imposto sobre a Circulação de Mercadorias e Serviços – Substituição Tributária

IMA – Institute of Management Accountants

IMF – International Monetary Fund

ISO – International Organization for Standardization

ITCMD – Imposto Sobre Transmissão Causa Mortis e Doações

OECD – Organization for Economic Co-operation and Development

PEP – Programa Especial de Parcelamento

PIS – Programa de Integração Social

PROFISCO – Fiscal Modernization Project of the States

SELIC – Special System for Settlement and Custody

TADAT™ - Tax Administration Diagnostic Assessment Tool

VAT – Value-Added Tax

WTO – World Trade Organization

“Brazil will never reach its potential until we instill dignity in our tax system.”

Vinicios Leoncio¹

1 Introduction

The fiscal conformity program aims to establish a positive and innovative paradigm of relationship between the tax administrations and the taxpayers through reliability, transparency, simplicity, and correct incentives to stimulate the spontaneous payment of tax obligations². The purpose is to transform the tax administration in one institution even more responsive and sensitive to the great majority of taxpayers, who acts within the legality and duly fulfill their tax duties.

The most modern tax administrations in the world - New Zealand, Sweden, Australia, Singapore, UK, and Chile between others (OECD 2009), have been reforming their administrations and tax processes in order to overcome the so-called paradigm of repression and crime in tax, moving towards the paradigm of the better service for citizens. The focus is to facilitate and assist the taxpayer to comply with tax laws.

¹ The Brazilian tax lawyer Vinicios Leoncio, fed up with the gargantuan bureaucracy that requires Brazilians to photocopy, notarize, authenticate and stamp a superabundance of documents related to their life, Mr. Leoncio is taking aim at a central element of Brazil's red tape: the tax code. Embarking decades ago on a lonely crusade, he began documenting the absurdities of Brazil's methods of collecting taxes (Romero, 2015).

² The same idea developed in this introduction was used to compose the explanatory statement of the Tax Compliance Program Project Law of São Paulo State Treasury, more information in https://portal.fazenda.sp.gov.br/Noticias/Documents/Exposiçãode%20Motivos_LTCCT_10jul17.pdf, accessed in July 17, 2017.

This idea, actually, is not an innovation. James Alm³ insists on the importance of overcoming the "crime paradigm" that, since the 1960s, has governed most economic research. It is a question of going beyond the idea that the behavior of the individual is based on a rational choice that always seeks to maximize utility and that, by extension, to increase tax collection, almost exclusively by mechanisms of detection and punishment. As well said by Erich Kirchler, it is necessary moving from "cops-and-robbers" to a "service-and-client" view (Alm, Martinez-Vazquez and Torgler 2010).

Empirical researches conducted in Latin America by this author shows that, even in countries with low compliance rates, evasion never grows to levels predicted by an analysis. These researches takes into account only financial elements. There are, therefore, other factors that must be taken into account if we really want to understand the reasons why taxpayers comply with tax norms. Kirchler, Muehlbacher, Kastlunger, and Wahl listed some variables: level of actual income, tax rate, audit probability, and fines (Kirchler, et al. 2010). Thus, the association between economics and other disciplines, such as social theory, psychology, and political science, is fundamental (Santi 2013). In this line, countries like India (Das-Gupta, Ghosh and Mookherjfe 2015), are developing entire tax reforms based on the strategy to establish circles of changing and incentives to increase tax risk and discourage tax avoidance.

³ James Alm is Dean of the Andrew Young School of Policy Studies at Georgia State University in Atlanta, Georgia. Professor Alm teaches and conducts research in the area of public economics. Much of his research has examined the responses of individuals and firms to taxation, in such areas as tax compliance, the tax treatment of the family, tax reform, the line item veto, social security, housing, indexation, and tax and expenditure limitations. His work has been published in leading economics journals, and he is the author of six books. He has also worked extensively on fiscal and decentralization reforms overseas, including projects in Bangladesh, Indonesia, Jamaica, Grenada, Turkey, Egypt, Hungary, China, the Philippines, the Russian Federation, Uganda, Nigeria, India, Colombia, Nepal, Ukraine, Pakistan, and South Africa. He is currently Editor of *Public Finance Review* and an Associate Editor of *Review of Economics of the Household* and *economics-ejournal*. More information in http://econ.tulane.edu/profile_alm.shtml, accessed in July 17, 2017.

In common, there are several academic papers claiming for the necessity of a turnover in this relationship (administration – taxpayers). The aim of this work is to present how and upon what bases it has been developing the alternative approach for tax administrations in São Paulo⁴, the biggest state from Brazil.

1.1 Brazil on the global stage

The 2016-2017 global competitiveness report (World Economic Forum 2016) has brought Brazil at the 81st position over 138 countries. It was 76th in previous version and the tendency is to fall even more. However, in the year of 2006, Brazil was better than now. It had occupied the 65th position and had been gradually gained positions until 2012, when the country reached its best ranking (48th position). Comparing Brazilian, Russian and Indian recent performances, it is possible to visualize that while Brazil handled a period of development from 2006 to 2012, the two other countries have confronted a time of retraction. This scenario remained until 2014 when Brazil started its trend to decline as the same time as Russia and India started to get better indices and better positions.

According to this competitiveness report, tax rates, corruption, tax regulation, inefficient government bureaucracy, and policy instability are the five most problematic factors for doing business in Brazil (World Economic Forum 2016).

Considering the development of the “Lava-Jato” police operation, corruption (2nd) and policy instability (5th) are facts that have been gaining strong cultural and social appeals. However, trying to maintain the focus, this study will remain on tax rates, tax regulations and the inefficiency of the government bureaucracy.

⁴ <http://www.saopaulo.sp.gov.br/en/>

2 The bases of the Brazilian tax system

2.1 The article 18 of the Brazilian Constitution

Brazil is a federative republic politically organized in four spheres of government by its Constitution⁵, “Article 18 - The political and administrative organization of the Federative Republic of Brazil comprises the Union, the States, the Federal District and the Municipalities, all of them autonomous, as this Constitution provides” (BRAZIL 2017).

Besides Brazil is recognized as a republic since 1889, its federalism is not exactly like the American federalism, neither can be compared with French government system. In USA, for example, the federalism was organized based upon the thirteen original colonies that jointed to create one country – down-top organism. Things happened quite different in Brazil. The country was divided in fifteen captaincies under a central government – top-down Portuguese Empire organization. Actually, the republic was a *coup d’etat* where the dominant oligarchies remained in power against the empire. It is easy to understand why the Brazilian federalism is not the same as the American federalism. The original top-down reasons that had surrounded the establishment of the Brazilian Republic remains until now on the currently administrative organization. The main consequence is that the states are not fully autonomous, neither completely dependents ruling under a rigid hierarchical structure.

The constitution of 1988, defined and regulated the Brazilian political organization in three different spheres: Federal, States, and Municipal governments. In this structure, the Federal District accumulates states and municipal competencies. It states borders to act, structure of

⁵ For more information, there is a very good explanation with a wide view of the whole system made by Vera and Danilo Nogueira on the web site: <http://translationjournal.net/journal/36taxes.htm>, accessed in April 16, 2017.

power, and general rules. All the whole political organization is almost completely detailed in the charter.

Moreover, since autonomy is directly related to the budget, in order to guarantee the autonomy of the entities the constitution has created, it detailed all the possibilities for the tax system of these three spheres. It specified Federal, State, and Municipal Taxes (Federal District can implement and manage states and municipal taxes). And, although the constitution sets the principles and directions describing the whole tax system, it is not simple to handle everything directly from it. Furthermore, being coherent with the context that it was wrote, it also tried to regulate the Tax Revenue Sharing (Section VI) and also define general rules for the Financial Order.

2.2 The “perfect” logic of ICMS (VAT)

Conceived in that way, the charter tried to create a perfect logic for the tax system in its administrative structure aiming to provide a juridical stability ambiance. However, economic relations do not follow this logic. Economy follows the rules of market and market are based on the circulation of goods.

The Brazilian Constitution says the tax on transactions relating to the circulation of goods is the State’s responsibility: “Article 155. the states and the federal district shall have the competence to institute taxes on: (CA No. 3, 1993; CA No. 33, 2001; CA No. 42, 2003) II – transactions relating to the circulation of goods and to the rendering of interstate and intermunicipal transportation services and services of communication, even when such transactions and renderings begin abroad” (BRAZIL 2017).

Making this duty as non-cumulative⁶, the chart demanded that the amount due in each transaction concerning the circulation of goods or rendering of services shall be compensated by the amount charged (and paid) in the previous transactions. Historically, Brazil and Honduras were some of the early countries to adopt the VAT system - they adopted it in 1964, only four years after the first country adopted⁷.

Called “*ICMS – Imposto sobre Circulação de Mercadorias e Serviços*,” it was constructed over the same principles of VAT – Value Added Tax or GST – Goods and Services Tax, mostly known as the European tax⁸.

⁶ Paragraph 2. The tax established in item II shall observe the following:

I – it shall be non-cumulative, and the tax due in each transaction concerning the circulation of goods or rendering of services shall be compensated by the amount charged in the previous transactions by the same or by another state or by the federal District;

II – exemption or non-levy, except as otherwise determined in the law:

a) shall not imply credit for compensation relative to the amount due in the subsequent transactions or renderings of services;

b) shall cause the annulment of the credit for the previous transactions; (BRAZIL 2017)

⁷ Data from OECD (2016), Consumption Tax Trends 2016: VAT/GST and excise rates, trends and policy issues, OECD Publishing, Paris. <http://dx.doi.org/10.1787/cct-2016-en>, pg 182.

⁸ A value-added tax (VAT) is a broad-based tax levied on the sale of goods and services to consumers or businesses by registered businesses. In general, a business must be VAT-registered unless its turnover is below a minimum threshold (set so as to reduce administrative and compliance costs relating to very small businesses where the tax revenue foregone is perceived to be low). The central design feature of a VAT, and the feature from which it derives its name, is that the tax is collected on the value added at each stage of production and distribution. Each business in the supply chain collects VAT from its customers on the value of its outputs and is entitled to deduct the tax it has paid on its purchases and must account and remit the difference to (or receive a refund from) the tax authorities. In this respect, the VAT differs from a retail sales tax which taxes consumption through a single-stage levy imposed in theory only at the point of final sale. However, as with a retail sales tax, the ultimate base of a VAT is final consumption.

There are two main approaches for operating the staged collection process:

- Under the **invoice credit method** (which is a “transaction based method”), each trader charges VAT at the rate specified for each supply and passes to the purchaser an invoice showing the amount of tax charged. The purchaser is in turn able to credit that input tax against the output tax it charges on its sales, remitting the balance to the tax authorities and receiving refunds when there are excess credits. This method is based on invoices that could, in principle, be cross-checked to pick up any overstatement of credit entitlement. By linking the tax credit on the purchaser’s inputs to the tax paid by the purchaser, the invoice credit method is designed to discourage fraud. 32 of the 33 OECD countries employing a VAT use the invoice credit method.

- Under the **subtraction method** (which is an “entity based method”), the tax is levied directly on an accounts-based measure of value added, which is determined for each business by subtracting the VAT calculated on allowable purchases from the VAT calculated on taxable supplies. Of the OECD countries employing a VAT, only Japan uses the subtraction method. (OECD 2016)

This structure was thought aiming tax justice. In theory, one can say that this logic is perfect. Only merchants who had some profit into the operation would be supposed to pay some tax (OECD 2015). Additionally, the actor would have to pay a percentage throughout the exactly amount of his profit. If he did not earn any profit, he has nothing to pay. The objective is to tribute only the final consumption.

Nonetheless, it has not been working properly in Brazil. This orientation seems to observe the justice when the amount of tax to be paid is calculated over the profit earned in each transaction. The evil side of this construction is the infinity possibilities to create false transactions to virtually diminish the profit earned and, consequently, the base upon this tax is calculated⁹. This aspect will be more detailed ahead.

Another dysfunction can be observed between states interactions. As each state has its own tax regulations, define the exceptions and aliquots - between max and min aliquots defined by the Senate¹⁰ - this logic has been distorted by the administration and by the taxpayers. Several law offices have been elaborating aggressive tax planning systematically in order to avoid every tribute that is due.

⁹ “Like any tax, VAT is prone to fraud and its refund mechanism may be open to abuse by taxpayers. Delays in processing refunds, therefore, may be the result of concerns over potential fraud. Even when claims reach the finance division responsible for approving them and making payment, there can be delays in transmission. Additional procedural checks at this stage—prompted by a fear of the system being abused—are common”. (The World Bank 2017 – pg 73)

¹⁰ Article 155

V – the Federal Senate may:

a) establish minimum rates for domestic transactions, by means of a resolution on the initiative of one-third and approved by the absolute majority of its members;

b) establish maximum rates for the same transactions to settle a specific conflict involving the interest of the states, by means of a resolution on the initiative of the absolute majority and approved by two-thirds of its members;

(BRAZIL 2017)

2.3 Preview attempts to improve the ICMS system

The last legal movement trying to reorganize this structure was the institution of the “substitute taxpayer”. From the administration’s point of view, in order to facilitate the audits and the control over taxpayers, it was created an institute where the manufacturer, importer, some business defined in law, or any other institution is designated as the one responsible for remitting the estimated future ICMS that would be due on all transactions, from production (or earlier) until consumption. In summary, the manufacturer can be responsible to pay the total taxes that would be due by the whole chain at the time of the first sale (Iacia 2016).

Considering that the basic rules of ICMS are not simple, this operation resulted in more complex rules, more confusion, and more bureaucracy to explain and declare business operations.

Paradoxically, results were the same for the public administration: confusion, complexity, and more time spent to audit these operations. At the end, the goal was the incredible complexity to understand how this tribute was organized. The calculus to achieve the amount due is not simple and depends on several indexes and assumptions from government. Naturally, it is not feasible to preview all possible situations that can occur in real operations and, usually, taxpayers have to pay little more money than it would be due in a plan, or direct consumerism tax system.

As state governments had refused to reimburse these differences, the Brazilian Supreme Court of Justice was provoked and has decided the question in favor of taxpayers¹¹. Since there is no simple methodology to calculate this return, the justice has accepted the calculations presented

¹¹ 1. Fixação de tese jurídica ao Tema 201 da sistemática da repercussão geral: “É devida a restituição da diferença do Imposto sobre Circulação de Mercadorias e Serviços – ICMS pago a mais no regime de substituição tributária para frente se a base de cálculo efetiva da operação for inferior à presumida”.

2. A garantia do direito à restituição do excesso não inviabiliza a substituição tributária progressiva, à luz da manutenção das vantagens pragmáticas hauridas do sistema de cobrança de impostos e contribuições (RE 593849/MG, 2017).

by the contributors against that from the government. As Supreme Court have been obligating governments return money to taxpayers, the fiscal government health is under risk¹² (STF-RE 593849 2016).

Another pernicious aspect about this system can be observed in transactions where the sequence transaction is under exemption (is not taxed). It occurs in exportations¹³ for instance, and generates what is called “Crédito Acumulado” (Accumulated Credit)¹⁴.

Besides the law declares in which situation it would be possible to refund these credits, considering the complexity of the instruments to proof the regularity of the operations, it is almost impossible to receive this money back, even for consistent taxpayers. Moreover, the audit process to analyze the right to receive these credits can take years. To use these accumulated credits before the audit is finished, contributors have to contract bank guarantees of 150% over the amount they are asking to refund. This requirement makes the request economically unfeasible.

2.4 ICMS war

Another inefficiency generated by the Brazilian tax system is the well-known Brazilian tax war. The Minerva Program of George Washington University (The Institute of Brazilian Business &

¹² <http://www.migalhas.com.br/Quentes/17,M1247605,31047-STF+e+devida+a+restituicao+do+ICMS+pago+a+mais+em+substituicao> Accessed in July 27, 2017.

¹³ Article 155

X – it shall not be levied:

a) on transactions involving goods to be shipped abroad, nor on services to be delivered to parties abroad, and tax charges and credits in preceding transactions involving such goods or services shall continue in effect (BRAZIL 2017).

¹⁴ “In principle, when input VAT exceeds output VAT the amount should be paid as a refund to a registered business within the time period stipulated in the legislation. In practice, however, only 93 of the economies covered by *Doing Business* allow for a VAT cash refund in this scenario. Some economies restrict the right to receive an immediate cash refund to specific types of taxpayers such as exporters, embassies and non- profit organizations. (...) In some economies businesses are only allowed to claim a cash refund after rolling over the excess credit for a specified period of time (for example, four months). The net VAT balance is refunded to the business only when this period ends.” (The World Bank 2017)

Public Management 2017), is one institution that try to understand this phenomenon. Leonardo De Gregório, tax auditor at the Sao Paulo state treasury, wrote a paper bringing a very complete and clear explanation about the tax war between Brazilian states (Gregório 2015).

He begins with a simple description about ICMS/VAT structure, “Thus the “not-cumulative” system of ICMS/VAT works throughout the chain of production and marketing, always discounting the tax paid on the previous sales which will be due in the subsequent sales”, and complement showing the following diagram to illustrate the Brazilian VAT/ICMS:

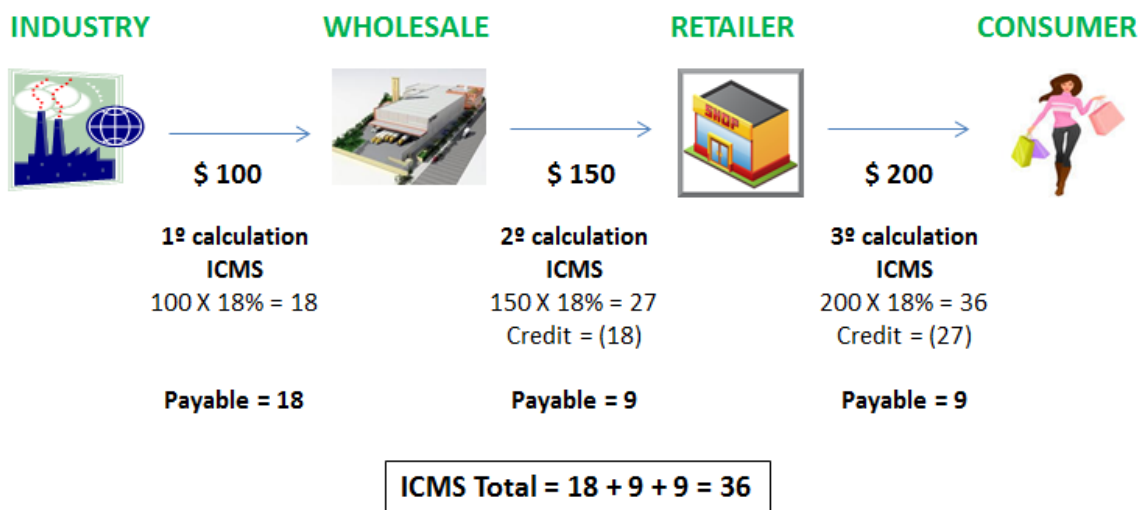


Figure 2-1 Brazilian VAT/ICMS Scheme

States have been promoting tax benefits and exceptions in order to attract big industries. They argue that it is necessary to incentive creation of jobs and to stimulate the development of poor areas. Nonetheless, sometimes, legal tax exceptions are not enough to attract industries and some states ignores the constitution¹⁵ and offers illegal exceptions – yes, against the Brazilian

¹⁵ Article 155

XII – A supplementary law shall:

g) regulate the manner in which, through deliberation by the states and the Federal District, tax exemptions, incentives and benefits shall be granted and revoked; (BRAZIL 2017)

constitution. This scenario compels governments and private companies to play one of the most unfair and destructible game for the whole country.

2.5 Strategies to survive in this ambience

After a long dictatorial period, the Constitution of 1988 established strong guarantees against possible government abuses¹⁶. In order to provide sufficient legal certainty to improve the business ambience, the tax system received the same treatment. Paradoxically, states and companies have been using these warranties to maintain illegal situations running under a false aspect of legality. Let us imagine the state A launch a law A against the constitution creating some illegal benefits for the company A. The process to discuss whether this law follows the constitution or not has to be started by some state that presented a question about its legality, let us say state B. Usually, the Brazilian Supreme Court take years to rise a solution and during this time, the law A (legal or not) is effective and supports the benefits gave by the state A to the company A, meanwhile state B faces prejudices.

Playing with these rules, in some cases, as soon as the Supreme Court declares the illegality of the law A – just to remember, that had established some illegal benefit for company A - the state A, owner of this law, can revokes the norm and edits another one in its place, let us say, law A2. As the Brazilian legal structure obeys the roman system - quite different from common law system - this new norm has a totally new legal life. The legal process to verify its constitutionality only would take place if this “new” law A2 would be questioned again by another state, even though it regulates the same subject. It is necessary to start another legal

¹⁶ From the constitution: Article 146. A supplementary law shall: II – regulate the constitutional limitations on the power to tax (BRAZIL 2017). Obeying this statement, in 2008 was launched the “Código de Defesa do Contribuinte” – Contributors defense code, as it was defined in the 939 supplementary law from Abril 3 2003, more information in https://portal.fazenda.sp.gov.br/servicos/codecon/Downloads/cartilha_codecon.pdf, accessed in July 16, 2017.

process at the Supreme Court. When the Supreme Court would finally decide some legal process about the law A that englobes law A2, this decision can be contested in several new processes and in numerous ways.

Since both actors, private and public sectors, know the justice usually take years to analyze its processes, the state B prefers to launch its own laws also conceding illegal benefits to attract the same company A for its territory. This looping can take place continually and that is the core of the tax war between Brazilian states.

In this context, the public-sector strategy to minimize possible damages is quite simple: an infringement notice is issued and a fine is charged for the company A over the transactions that are being questioned by the state B.

This crazy run leads to a situation where private companies and public institutions have huge litigating's expenditures. Some private companies have realized that closing their operations in Brazil would diminish their general costs since the uncertainty mitigates the capacity of planning in the middle and long term. For the public sector, it is a disaster as this movement means loses in investments and jobs.

Another interesting fact is that, nowadays, there is no way to testify the efficacy of this "war strategy" for the public sector. Under the shield of data's secrecy, states do not make public the results of their strategies. There is no control about how much money effectively enter in the public budget from this fines and infringement notices and neither serious studies about the gains provided by the illegal benefits gave to attract companies.

Shallow data¹⁷ from the São Paulo State Treasury allows to estimate that around only 7% of the assessments has become effective and was really paid in the last five years.

2.6 Consequences for the Public Administrations

The income of states is based on three tributes: transfer by death and donation of any property or rights - ITCMD, transactions relating to the circulation of goods and to the rendering of interstate and intermunicipal transportation services and services of communication, even when such transactions and renderings begin abroad - ICMS, and ownership of automotive vehicles - IPVA¹⁸.

Approximately 85% of the state budget are comprised by the ICMS. When the country's GDP increases, the consumption increases and the states' income increases too. Under this scenario, the concession of any corporate benefit is a big deal without too much impact in the state finance. Naturally, benefits conceded in large scale are a recipe for disaster when the winter comes. That is the current situation in Brazil. Since 2015 the country is facing a huge recession with several recent cases of public sector bankruptcies¹⁹.

¹⁷ This is estimated considering the number of notices emitted, the amount initially expected, and the numbers of money effectively collected.

¹⁸ Article 155. the states and the federal district shall have the competence to institute taxes on: i – transfer by death and donation of any property or rights; ii – transactions relating to the circulation of goods and to the rendering of interstate and intermunicipal transportation services and services of communication, even when such transactions and renderings begin abroad; iii – ownership of automotive vehicles. (BRAZIL 2017)

¹⁹ Rio de Janeiro <https://www.forbes.com/sites/timworstall/2016/06/18/hosting-olympics-bankrupts-another-place-rio-de-janeiro-declares-financial-disaster/#2c3250a65856>,
<https://www.theguardian.com/world/2016/jun/17/rio-de-janeiro-financial-emergency-olympic-games-2016>, accessed in April 12, 2017;

Minas Gerais e Espírito Santo <https://www.theguardian.com/world/2017/feb/10/brazil-espírito-santo-striking-police-charged-revolt>, <http://www.reuters.com/article/us-brazil-violence-espírito-santo-idUSKBN15O1ZT>, accessed in April 12, 2017;

Rio Grande do Sul <http://plus55.com/brazil-politics/2016/12/brazil-economic-recovery-plan>,
<https://www.wsj.com/articles/brazils-rio-de-janeiro-state-misses-debt-payment-1464191036>, accessed in April 12, 2017.

Considering the public budget had not been conceived to preview profits to generate reserve resources that could be used in time of crisis, the domestic budget control - understood as “the minimal estimate of income and expenditure for a set period of time”, or the minimal condition to set autonomy and a natural component that support countries sovereignty - has directly relation with tax income. And only tax income. If it goes down, public administrations have to adapt their expenditures, projects and investments have to be stopped or diminished. The state and the population suffer (Rapoza 2017)²⁰.

3 Practical Case of Gammig

3.1 AMBEV S.A.

To illustrate how complex is the play between big companies and Brazilian states, let us analyze the annual report delivered by the AMBEV S.A. to the Securities and Exchange Commission in 2016 (AMBEV S.A. 2016).

In the item 8 letter A, the company summarizes legal proceedings related with state tax incentive problems:

Over the years, we have received tax assessments relating to supposed ICMS differences that some States considered due in the tax substitution system in cases where the price of certain products sold by a factory reached levels close to or above the price table basis established by such States. We are currently challenging those charges before the courts. In 2015, we received new tax assessments related to the same issue, in the approximate amount of R\$332 million. In August 2016, we received a new assessment, issued by the State of Minas Gerais, in the amount of R\$1.4 billion, regarding the same matter. Considering this new assessment and others received in 2016, our management estimates the amount related to this issue to be approximately R\$4.5 billion as of December 31, 2016, classified as a possible loss and, therefore, for which we have made no provision. We have recorded provisions in the total amount of R\$1.7 million for proceedings where we consider the chances of loss to be probable considering specific procedural issues.

²⁰ <https://www.forbes.com/sites/kenrapoza/2017/05/01/brazil-economy-struggles-with-unemployment-reforms/#7c94eac412b8> accessed in July 28, 2017.

Afterwards, the report explains about the exceptions:

State Tax Incentives of the Conselho Nacional de Política Fazendária (National Council on Fiscal Policy), or CONFAZ

Many states in Brazil offer tax incentive programs to attract investments to their respective regions, pursuant to the rules of the National Council on Fiscal Policy, or CONFAZ, a council formed by the Treasury Secretaries from each of the 27 Brazilian States. We participate in ICMS Value-Added Tax Credit Programs offered by various Brazilian States which provide (1) tax credits to offset ICMS Value-Added Tax payables and (2) ICMS Value-Added Tax deferrals. In return, we are required to meet certain operational requirements, including, depending on the State, production volume and employment targets, among others. All of these conditions are included in specific agreements between us and the relevant state governments.

There is an ongoing dispute regarding whether these benefits are constitutional when granted without the prior approval of each Brazilian State participating in the CONFAZ. Some States and Public Prosecutors have filed Direct Actions of Unconstitutionality (Ação Direta de Inconstitucionalidade) before the Brazilian Supreme Court to challenge the constitutionality of certain state laws granting tax incentive programs unilaterally, without the prior approval of the CONFAZ.

Since 2007, we have received tax assessments from the States of São Paulo, Rio de Janeiro, Minas Gerais and other States, challenging the legality of tax credits arising from existing tax incentives received by us in other States. As of December 31, 2016, the aggregate amount of these assessments was R\$1.8 billion. We consider these proceedings to have a possible (but not probable) risk of loss. Such estimate is based on management assessments, but should we lose such proceedings, the expected net impact on our income statement would be an expense for this amount. Moreover, we cannot rule out the possibility of other Brazilian States issuing similar tax assessments against us in the future relating to other state tax incentive programs of which we avail ourselves. In 2011, the Brazilian Supreme Court ruled that 14 state laws granting tax incentives without the prior approval of the CONFAZ to be unconstitutional, including one granting incentives to us in the Federal District, from which we have ceased to benefit from since such decision was issued. In a meeting held on September 30, 2011, the CONFAZ issued a resolution suspending the right of the States to claim the return of the tax incentives incurred by the beneficiaries of the state laws declared unconstitutional. There are a number of other lawsuits before the Brazilian Supreme Court challenging the constitutionality of incentives laws offered by some states without the prior approval of the CONFAZ, which may impact our state tax incentives.

In 2012, the Brazilian Supreme Court issued a binding precedent proposal (Proposta de Súmula Vinculante No. 69/2012), which would automatically declare as unconstitutional all tax incentives granted without prior unanimous approval of the CONFAZ. In order to become effective, such proposal must be approved by two-thirds of the members of the Supreme Court. We do not expect that the Supreme

Court will vote on this matter before Congress votes a bill of law aimed at regulating this issue. There are currently a number of different proposals before Congress, which generally provide for (1) existing tax incentives to be grandfathered for a number of years; (2) new tax incentives to be approved by a majority of the States (rather than unanimously); and (3) a reduction on interstate ICMS Value-Added taxes in order to decrease the relevance of tax benefits on interstate transactions. However, no assurance can be given that the Brazilian Supreme Court will not vote on the binding precedent proposal before the matter is ultimately regulated by Congress. It is also unclear whether the Supreme Court decision would forgive the already availed incentives or establish a transition period.

In the item 10 – Additional Information, the company explains the contracts it participates. The report admits some “possible irregularity”; however, it justifies the utilization of the unconstitutional benefit arguing that it is the usual practice of most companies since these benefits are granted by the state:

There is also a controversy regarding whether these benefits are constitutional when granted without the approval of every State of the country. Although the Brazilian Supreme Court has already declared part of Pará State’s benefit law unconstitutional, almost every State has specific legislation on this topic and even the State of Pará may still grant benefits which were not included in this decision. Accordingly, as far as the tax benefits are granted based on the state legislation, most companies apply for and use those benefits when granted. (AMBEV S.A. 2016)

The situation described above is very similar to the hypothetical situation evolving state A/company A, and Law A/A2 commented in the item 2.5.

At the end of the AMBEV report the company shows a provision of possible losses in Legal Proceeding that the company have been taken part: “ICMS-ST Unconditional Discounts”, “ICMS fiscal war”, “ICMS-PRODEPE”, and “ICMS-ST Trigger”. The possibility to something wrong with this game is so high that is necessary to preview these possible losses.

3.2 The legal regulation

Tax benefits are regulated by the supplementary law (Brazilian Constitution article 155 – XII, g). The Complementary Law 24 from January 24 of 1975²¹ demands that any benefits have to be approved by a convention of the National Council of Tax Policy – CONFAZ. Furthermore, the same law announces that this convention has to be approved by the unanimous consent of all states and the Federal District (article 4, paragraph 2nd). The innocent original idea was to create incentives for states that need help to achieve superior development levels based upon some unanimous agreement. If some state think this benefit could bring some loss for its own interests, there will not be unanimously and the proposed benefit would have to be abandoned.

Taking the AMBEV S.A. case as an example, since Pará state has been grant benefits without the approval of all others states, it seems that this controversy has its fundaments in favor of the other states and the company is playing with the law²². This is a perfect real practical case of the tax gaming inside de Brazilian borders with the utilization of litigating time. It is important to highlight that this is about one case and one big company in the area of beverages. Brazil has around 650 companies listed on the stock exchange. The number of all states contributors pass over a trillion. On the other hand, there are one federal government, one district capital, twenty-seven states and more than 5,000 municipals. As the New York Times (Romero 2015) mentioned, it is absolutely insanity try to understand all norms and regulations.

²¹ http://www.planalto.gov.br/ccivil_03/leis/LCP/Lcp24.htm.

²² Although the Brazilian Supreme Court does not give a final decision, it recognized extremely plausible the arguments against this benefit conceded by the Pará state (REPERCUSSÃO GERAL NO RECURSO EXTRAORDINÁRIO 851.421 DISTRITO FEDERAL, 2015). For more information: <http://redir.stf.jus.br/paginadorpub/paginador.jsp?docTP=TP&docID=9268904>.

3.3 Consequences for the Brazilian competitiveness rating

In this scenario, how far companies are compelled by the government to play this “litigating game”? How to measure the responsibility of the actors? How can government act to change this situation?

This perverse system had been increasing its importance in the Brazilian competitiveness. As mentioned in the introduction, in the Global Competitiveness Report 2016-2017 (World Economic Forum 2016, World Economic Forum 2016), the World Bank ranked Brazil on the 81st position over 138 countries analyzed. Five worst Global Competitiveness Index are: public trust in politicians, effect of taxation on incentives to invest, effect of taxation on incentives to work, total tax rate % profits, and ethical behavior of firms. Trust, tax, and ethic. It was a foregone conclusion that, between the most problematic factors for investing in Brazil²³, these subjects could have appeared.

Tax rates, corruption, tax regulations, inefficient government bureaucracy and policy instability. Excepting corruption, the other four factors were equally mentioned as situations faced by AMBEV S.A. when dealing with Brazilian business issues.

Another international report, Doing Business (The World Bank 2017), shows a rank of how easy is doing business in countries. Brazil occupies the 181st position over 190 countries rated. For this study, paying taxes is the worst Brazilian index with the time spent in hours per year in the heart of the problem: expressive 2,038 hours.

The study used the following methodology:

²³ From the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

Using a case scenario, Doing Business records the taxes and mandatory contributions that a medium- size company must pay in a given year as well as measures of the administrative burden of paying taxes and contributions and dealing with postfiling processes. This case scenario uses a set of financial statements and assumptions about transactions made over the year. Information is also compiled on the frequency of filing and payments, time taken to comply with tax laws, time taken to comply with the requirements of postfiling processes and time waiting for these processes to be completed. The ranking of economies on the ease of paying taxes is determined by sorting their distance to frontier scores on the ease of paying taxes. These scores are the simple average of the distance to frontier scores for each of the four component indicators – number of tax payments, time, total tax rate and postfiling index – with a threshold and a nonlinear transformation applied to one of the component indicators, the total tax rate¹. If both VAT (or GST) and corporate income tax apply, the postfiling index is the simple average of the distance to frontier scores for each of the four components: the time to comply with a VAT or GST refund, the time to obtain a VAT or GST refund, the time to comply with a corporate income tax audit and the time to complete a corporate income tax audit. If only VAT (or GST) or corporate income tax applies, the postfiling index is the simple average of the scores for only the two components pertaining to the applicable tax.²⁴

And the results classified Brazil in the 181 position. Comparing to similar economies, Brazil sustains the worst classification when it measures the distance to score:

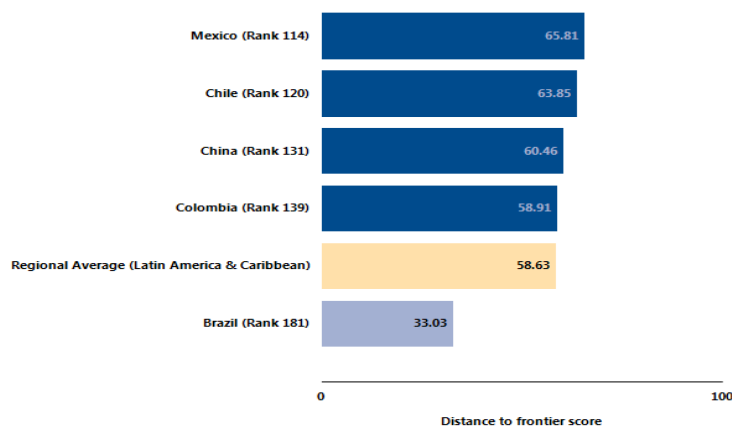


Figure 3-1 Brazil - Distance to frontier score²⁵

²⁴ World Bank. 2017. Doing Business 2017: Equal Opportunity for All. Washington, DC: World Bank. DOI: 10.1596/978-1-4648-0948-4. Page 95. License: Creative Commons Attribution CC BY 3.0 IGO

²⁵ World Bank. 2017. Doing Business 2017: Equal Opportunity for All. Washington, DC: World Bank. DOI: 10.1596/978-1-4648-0948-4. Page 96. License: Creative Commons Attribution CC BY 3.0 IGO

In detail, companies spend 1189 hours per year to comply the obligations related with the ICMS (VAT) tax, and the time to complete a corporate income tax audit is around 35.1 weeks. These indicators compound 25% of the rating score. It is not necessary to explain how the inefficiency in the tax administration contributes to difficult the new investments in Brazil.

4 Current business strategies

Most companies design its plans of operations considering the results in the middle and long term. For its turns, states usually offer benefits for the long term aiming the short term. For example, some states bargain twenty years of ICMS exemptions with one or two years of jobs during the construction of a fabric. Considering the latest changes in the economy and capital flows patterns, industries can produce in any place of the world and sell for everywhere, since it organizes a powerful logistic framework. Market size of some place have been getting decreasing relevance for the purpose of plants installation strategy.

Special installment programs - *Programa Especial de Parcelamento*²⁶ or PEPs - Are examples of external factors that companies are considering when planning their investments. Once a year, the state of São Paulo launches its own *PEP*. This program allows contributors who is holding an assessment from any infringement pay the duties with huge discounts – usually around 80% if it would be paid in cash. Furthermore, it is also possible to divide the amount due in 60 monthly payments.

Obviously, the focus of this program is to increase the state's income in the very short time. This strategy, that aims to increase the collection, can also be useful to help contributors that are

²⁶ <http://www.saopaulo.sp.gov.br/spnoticias/sp-pacote-fiscal-pessoas/> (in Portuguese) accessed in July 16, 2017.

facing financial difficulties. However, as the government has been applying this program every year, the real effect is to promote some kind of reward for the contributors that do not have a good compliance program. The strategy actually is harmful for the good contributors who pay its obligations on time. By being launched every year, this program incentives bad behaviors and creates a big tricky in the medium and long terms: companies assume that frequency as a constant state action and incorporates in its business planning. When it occurs, it is established a vicious circle leading contributors to understand this program as a regular benefit and incorporate it in its business planning.

Let us go back to the AMBEV S.A. case. Undoubtedly, it is not necessary to talk about the voracity of the capital. However, concerning the discussion about the companies' responsibility against the governments' inefficiency, it could be appropriate to analyze recent declaration where the company says that it will not install a plant in Rio de Janeiro because there is no certainty about the tax benefits anymore²⁷.

Since Rio de Janeiro is facing an enormous financial emergency, in December was sanctioned one law limiting tax benefits²⁸. From that time and beyond, each new grant has to be approved by the State Deputies in the Rio de Janeiro's Legislative Assembly. Four months after that, the company said that (in a free translation), "facing this new scenario, the investment in Rio became inviable within the currently strategy of the company."²⁹ In other words, the company said that if

²⁷ Pamplona, Nicola. *Com incerteza sobre incentivo fiscal, Ambev desiste de fábrica no Rio*. Folha de São Paulo, April 04, 2017. <http://m.folha.uol.com.br/mercado/2017/04/1875398-ambbev-desiste-de-nova-fabrica-no-rio-por-falta-de-incentivo-fiscal.shtml>, (in Portuguese) accessed in July 16, 2017.

²⁸ <http://alerjln1.alerj.rj.gov.br/CONTLEI.NSF/b24a2da5a077847c032564f4005d4bf2/1f460ed89710ac538325808200549988?OpenDocument>. Accessed in July 16, 2017.

²⁹ "A cervejaria Ambev informa que a incerteza em relação ao processo de aprovação de seu investimento em uma fábrica de alumínio no Rio de Janeiro, inclusive em função da manutenção da decisão judicial que impede a concessão de novos benefícios no Estado, torna imprevisível a implantação da referida fábrica", disse a empresa, em comunicado.

they will not have the guarantee of maximum gains, they do not want to play with Rio de Janeiro anymore.

Again, states usually use long term benefits of twenty years or more, to obtain some gain in the short term. Usually less than four years, the length of the political mandate. In this specific case, this company declared and defended that the construction and the installation of one fabric in Rio de Janeiro could generate a thousand of jobs, during the construction. But there is no information about the future of these jobs after the construction is finished. There was not offered some sustainable plan of jobs.

5 Tendencies and perspectives for VAT/ICMS in 2017

5.1 Brazil

Considering this catastrophic panorama of the Brazilian tax system, lots of complex alternatives are being discussed. In December 2016 President Temer announced efforts to pursue tax reform in 2017. From Reuters³⁰, “Temer's advisers have floated a proposal to unify the federal PIS and Cofins taxes to fund social security. The government could also negotiate with states to unify an inter-state tax known as ICMS, a measure considered crucial to reduce legal uncertainties.”

CITAR A FONTE

The negotiation between states to unify the ICMS is crucial not just to reduce uncertainties, it is important because the ICMS is the main tax over mercantile operations. More than think about innovations and possible solutions, if it would be achieved, it would be necessary to unify 27

"Diante desse cenário, o investimento no Rio torna-se inviável dentro do atual fluxo de planejamento da companhia." From <http://m.folha.uol.com.br/mercado/2017/04/1875398-ambev-desiste-de-nova-fabrica-no-rio-por-falta-de-incentivo-fiscal.shtml>, accessed in July 16, 2017.

³⁰ <http://www.reuters.com/article/us-brazil-economy-temer-idUSKBN1411ED>, accessed in July 16, 2017.

understandings about how it would be executed and how states would get financial help since their income revenue are almost totally based in this system.

It is not simple. The question was brought up to the surface when the Mato Grosso's Governor said in a recent interviewing (February 2017) about the innovative tax reform he is proposing, in a free translation: “in the absent of the perspective of one central and national agreement about the ICMS, one of the main challenges of the Brazilian tax reform, we are trying this model”.³¹

CITAR A FONTE

Briefly, the model tried to simplify the ICMS regulation of Mato Grosso state. But it was not ratified by the legislative assembly and the original project received several amendments. The original main concept was totally modified.

As usual, states have been exploiting illegal benefits to attract industries for its territory.

Actually, the Supreme Court decision about the regularity of the benefits has a structural component putting huge responsibility on the first instance judges' shoulders.

The ridiculous complexity of the Brazilian tax legislation does not exist without a reason. The majority of laws are about the auxiliary obligations, the way imposed by administration to contributors inform the operations from what they are able to have credits and how they calculate the amount of money due to the state. This complexity was constructed to combat games,

³¹ *Detentor do sistema de cobrança do Imposto sobre Circulação de Mercadorias e Serviços (ICMS) mais complexo do País, o governo de Mato Grosso tenta emplacar na Assembleia Legislativa um projeto que simplifica o tributo. Na falta de perspectiva de um acordo de reforma centralizada e nacional do principal imposto estadual – e um dos principais desafios para a reforma tributária –, o modelo a ser adotado pode servir de piloto para uma eventual iniciativa dos demais Estados.*

Em fase de audiências públicas, a proposta se antecipa à discussão da reforma tributária no Congresso e propõe uma reforma geral na legislação e nas alíquotas do ICMS do Estado, que hoje, de tão complexas, vêm derrubando a participação do imposto no total da arrecadação nos últimos anos. Excerpt from the interview to Adriana Fernandes in <http://economia.estadao.com.br/noticias/geral,mato-grosso-pode-ter-novo-modelo-de-icms,70001671089>, accessed in July 16, 2017.

evasions, and frauds. After 52 years of VAT/ICMS system - created as ICM and changed to ICMS, Brazilian Tax Administrations are looking for the best practices to promote a new turnover compliance for the taxpayers.

Although technological improvements, intelligence operations, integration of different institutions, and all the transparency that could be applied in this process, the creative thinking that operates to find legal or illegal ways to evade tributes have been escalating the sophistication of schemas and, not rarely, the results are impressive. Besides the gaming to get benefits, every kind of simulation, dishonest agreements, and false transactions are common. Entire simulated chain businesses or fake industries are created to provide false credits and reduce duties.

Incrementing this complexity, there are several cases of corruption with roots in the inefficiencies of the system. Corruption cases are feed by excessive bureaucracy, which impels the gaming. This game provides the conscience-stricken forgiveness for fraud and evasion. This circle generates more bureaucracy and inefficiency. As Cohen, Eimicke, and Heikkila well said: “Because government fraud robs the taxpayers of their money, we sometimes build regulatory safeguards that cost more money to construct and maintain than they can ever save or recover” (Cohen, Eimicke and Heikkila 2013).

This situation is so vicious as could be a bad governance trap (Dervis and Özer 2005).

5.2 OECD

As ICMS has continued to be the main tribute of the states, national trade in goods and services has likewise expanded rapidly in an increasingly globalized economy. One consequence of these developments has been the greater interaction between state tax systems, along with growing risks of double taxation and unintended non-taxation in the absence of national ICMS coordination.

Basic ICMS principles are generally the same across states insofar as they are designed to tax final consumption in the jurisdiction where it occurs according to the destination principle. Nevertheless, since the late 1990s tax authorities and the

business community have recognized that ICMS rules require greater coherence to avoid burdens on national trade. They have also recognized that a co-operative approach is required to solve common problems.

Replacing the words ICMS by VAT, national by international, and making few adjustments of concordance, the two paragraphs above will match exactly with the two first paragraphs of the International VAT/GST Guidelines published by OECD in 2015³². It is not a mere coincidence. As a mental exercise, let us imagine Brazil as the Globe and its twenty-seven states as a sovereign country each one. Now, compare the Brazilian tax system with the design of a tax final consumption as proposed by OECD in its Guidelines. There are multiple similarities.

The currently worries are narrow focused on the electronic commerce and possible distorted competition caused by the VAT in cross-border trade. It was necessary to amplify this vision.

It is interesting to clarify that the AMBEV S.A. case explored previously is different from the approach called the race to bottom (Dervis and Özer 2005). By this theory, in briefly, corporations could move their production facilities to the lowest tax host countries. The authors suggest that one solution could be a free and open trading system facilities in a globalized economy. The OECD have made predictions to where globalization is conducting the world and concluded the consumerism taxes are real trending. Recently, the OECD Tax tweeted:

“#CostaRica would benefit from shifting social security contributions towards other types of taxes, particularly #VAT <http://oe.cd/CostaRica>.” (OECD Tax 2017).

³² 1. As Value Added Tax (“VAT”)1 has continued to spread across the world, international trade in goods and services has likewise expanded rapidly in an increasingly globalised economy. One consequence of these developments has been the greater interaction between VAT systems, along with growing risks of double taxation and unintended non-taxation in the absence of international VAT coordination.

2. Basic VAT principles are generally the same across jurisdictions insofar as they are designed to tax final consumption in the jurisdiction where it occurs according to the destination principle. Nevertheless, since the late 1990s tax authorities and the business community have recognised that VAT rules require greater coherence to avoid burdens on global trade. They have also recognised that a co-operative approach is required to solve common problems (OECD 2015).

The Guideline 2.3 of this OECD document establishes a suggestion related to the game described before: “VAT rules should be framed in such a way that they are not the primary influence on business decisions” (OECD 2015). The explanation is quite simple, “businesses may try to restructure their supply chain or operations to achieve the neutrality that does not otherwise exist.”

This is exactly what had happened between Rio de Janeiro and AMBEV. The company had planned to restructure its supply chain in order to obtain, in this case, not a neutrality, but a superior advantage. Without this superior advantage, the company are reviewing its plan, and Rio de Janeiro had become less profitable.

Another practical problem that can be used as an argument to support the establishment of one central organism with effective power over tax administrations is the cigarettes industries and the contraband trade between Brazil and Paraguay. Some duties are used to influence customer behavior and it is the case of cigarettes in Brazil. The total tax reach around 300% of the production price and achieves around 80% of the consumer price. Looking for tax exemptions, industries of tobacco finished its operations in Brazil and reallocated to the neighbor country. Beyond the discussion about possible illegal subsids conceded by the Paraguay’s government, the problem is the contraband trade (Gutierrez 2016) between these two countries.

How could be classified these advantages? It is not a tariff, tariffs are duties charged over the imports. Could it be classified as a subsidy? In this case, WTO should regulate and impose some sanction over the countries that grant some VAT benefit? If the benefit was a result of an agreement between the company and the government, as it is in the most situations in Brazil, could OECD deal with this situation? How?

5.3 IADB

Globally, international organizations have already recognized the importance of a health tax administration to support countries' development. In 1963 OECD published the early version of The OECD Model Tax Convention that formed the basis to launch the BEPS Project. In 2002, it was created the Forum on Tax Administration (FTA) with tax commissioners from 46 OECD and non-OECD countries (OECD 2016).

The consumption taxes tend to increase in the world as the globalization improve the mobility of the companies' operations. Building a task force to deal with this kind of problems as related above can be so difficult as to create one to deal with public goods (International Task Force on Global Public Goods 2006). When the institutions finally have achieved the maturity to develop some global code for good governance (Jørgensen and sørensen 2012) or some task force to deal with global tax governance (Dietsch and Rixen 2016), it could be too late.

Citizens' expectations and demands are growing. Governments already awarded about this fact have been adopting several innovation initiatives of transparency that could be incorporate by others countries. Government Digital Service (www.gov.uk) could be one possible study case.

More effective, the Inter-American Development Bank³³ – IADB is launching a new version of the PROFISCO PMIMF – Integrated Modernization Program of the Finance Ministry. This program is specific for the improvement of tax systems and tax administrations.

In Brazil, it was called PROFISCO (Programa de Modernização dos Fiscos), and the access to this program requires the accomplishment of some goals that are previously agreed by the country authorities and the international organism. These requirements could be used as a tool to

³³ <http://www.iadb.org/en/projects/project-description-title,1303.html?id=BR%2DL1349> accessed in July 16, 2017.

create standards for every country that want adhere to that program. These countries would have to match some obligations in order to be able to receive loans for its own projects. Establishing goals and instituting measurements of achievement are some examples. The strategy would work more or less as the IMF strategy upon financial issues.

To improve this action, it would be recommendable some interaction between The World Bank, OECD, and IADB. The first two actors have the soft power to impose obligations and the last one has the technical knowledge to indicate which obligation would achieve better results. For example, for the next PROFISCO in 2018, it could be applied some OECD³⁴ or IMF measurement tools.

5.4 IMF

As OECD pointed in its Consumption Tax Trends 2016 (OECD 2016), that the VAT/ICMS efficiency has huge potential for additional revenues by improving its performance of collection. In other words, by improving the efficiency of the tax administrations. Under this conception, The World Bank, The International Monetary Fund and others partners (called Multi-donor Trust Fund) created in 2001 the TAX ADMINISTRATION DIAGNOSTIC ASSESSMENT TOOL – TADAT™, to help tax authorities measure its maturity.

The IMF is heading an effort to change the current behavior of tax administrations. To do that, it is necessary to deeply understand how these structures work. The institution has been investing time and money to develop the TADAT™, that is a “means to provide an objective and standardized assessment of the relative strengths and weaknesses of the administration of a

³⁴Measures of taxpayers’ satisfaction with the services provided and overall perceptions of revenue body administration and their trend over time; Rates of taxpayers’ compliance achieved (e.g. for filing, reporting and payment for the major taxes), and their trend over time; Increased use of self-service channels; Cost efficiency: the ratio of costs to net revenue over time; Reductions in compliance/administrative burden; and Perceptions of employee engagement/satisfaction, measured by staff surveys, and their trend over time (OECD 2015).

country's tax system" (Multi-donor Trust Fund - IMF 2013). It is a tool to provide a diagnosis of tax administrations' performance around the world. Another of its purposes is to provide the basis for reform strategies aiming tax administrations' new ways of dialogue with private sector. The key is to put focus on the tax system's maturity³⁵. It will be better explored ahead.

From the official web site³⁶ we can list its main objectives:

- (i) Identifying the relative strengths and weaknesses in tax administration systems, processes, and institutions.
- (ii) Facilitating a shared view on the condition of the system of tax administration among all stakeholders (e.g., country authorities, international organizations, donor countries, and technical assistance providers).
- (iii) Setting the reform agenda, including reform objectives, priorities, initiatives, and implementation sequencing.
- (iv) Facilitating management and coordination of external support for reforms, and achieving faster and more efficient implementation.
- (v) Monitoring and evaluating reform progress by way of subsequent repeat assessments.

³⁵ The Tax Administration Diagnostic Assessment Tool (TADAT is a registered trademark) is designed to provide an objective assessment of the health of key components of a country's system of tax administration. This framework is focused on the nine key performance outcome areas (POAs) that cover most tax administration functions, processes and institutions. The assessment of these performance outcome areas is based on 28 high-level indicators that are each built on 1 to 4 dimensions that together add up to 47 measurement dimensions, making TADAT™ a comprehensive but administrable diagnostic tool. More information in <http://www.tadat.org/index.html>. (Multi-donor Trust Fund - IMF 2013)

³⁶ <http://www.tadat.org/overview/overview.html>

5.5 From national to subnational approach.

In specific case of Brazil, although the Federal Constitution determines that international relations have to be performed exclusively by the federal sphere, it is highly recommendable that these international organizations (IMF, World Bank and OECD) play close to the state's tax administrations, amplifying their influence over the subnational level. However, these institutions usually have more proximity with the federal ministry and ignores the States and Municipalities. Besides the discussion of income tax (federal competence), it is very important to analyze and understand the ICMS tax system since the impact of this tax remains exactly over trade and mercantile relations.

On the national level, the approach is quite easy. Sovereign countries have its own financial (expenditures) and tax (incomes) systems. It is the core part of the sovereign's definition. However, while International Monetary Fund – IMF has a huge influence on the financial systems and over the public expenditures, it is not possible to identify one institution that had the same level of influence about the income systems, tax systems.

Sometimes, it is necessary to provide external resources to help countries that are facing financial difficulties. Some resources can be earned by launching government bonds and selling them to private investors in the market, borrow some money from other governments or from international organizations such as IMF (Nelson 2013). In this case, to be able to receive external loans these countries have to follow the IMF propositions. In that way, the control takes place under the natural soft power of these contracts.

This procedure was designed by John Maynard Keynes after the second world war in the context of the Bretton Woods Conference (Dervis and Özer 2005). The IMF propositions are not mandatory, but leads to a non-official standardized global financial system. The negotiation is

quite simple, if you want to receive the money, you do have to follow the rules. Furthermore, as IMF has specialized teams to analyze financial programs and release some opinion about the accounts, international risk classification agencies usually use the same information, between others, when ranking investment grades.

The key point is to provide resources and try to establish patterns in order to control the quality of the government expenditures. Although this systematic has been working for years, it cannot be used anymore as the only one tool to guide the development on the countries were this program was, or is, applied.

As it was said previously, control the domestic budget is a condition to achieve autonomy. However, this international assistance can act as an antidevelopment trap³⁷ if the government administration does not have, or are not in any developing process of, an efficient system to afford its own income. Getting back to the states situation, since their budget is almost completely composed of VAT/ICMS taxes, to be effective, it could be useful if the diagnose of countries' governance would measure the quality of their tax income and the respective tax administration.

Indeed, each country has its own tax system, there is no any global pattern neither standardize rules to be followed. In specific case of Brazil, this concern is increased by the fact that each one of the twenty-seven states acts independently, almost like a country, when regulating the ICMS. Furthermore, beyond possible inefficiencies of several different models, this absence of patterns also facilitates national and international frauds, and evolution of sophisticated schemas to avoid

³⁷ Paul Collier describes four antidevelopment traps that countries are cached in his book *The Bottom Billion – Why the poorest Countries are Failing and What Can Be Done About It* (Collier 2007).

taxes³⁸. The World Bank Doing Business report (The World Bank 2017) is a very good indicator of these inefficiencies, but, and again, it is only one indicator.

The Inter-American Development Bank – IADB, as it was said, provides several financial programs to incentive the development of the Brazilian states administrations. This institution could operate under the same strategy as used by the IMF. It could use the soft power to imply some standards. In this context, TADAT™ can be useful to fill this gap.

5.6 New attitude upon old bases

Achieving an advanced service-oriented tax system can be the best alternative that will provide foundations and create minimum conditions to accelerate the development of countries. It is like an adaptation of the Government 3.0³⁹ as the Republic of Korea has been implementing with success (four times awarded by OECD⁴⁰). To do that, this new system must focus on establish simple rules, improve taxpayers' satisfaction, make easy compliance, construct an efficient classification of contributors by its level of risk, and promote standard solutions for the same problems achieving a large range of contributors.

The problem is that there is a common sense about the necessity to construct an efficient classification of contributors (IMF, The World Bank, and others), but nobody explains how exactly it would work. There are some initiatives in Japan, Australia, New Zealand, and Ireland (not coincidence almost the same supporters for the multi-donor trust of IMF), however, nothing in real operation yet.

³⁸ The World Bank and the OECD had started some initiative to discuss this subject.

<https://blogs.worldbank.org/category/tags/beps> and <http://www.oecd.org/tax/beps/>

³⁹ <http://www.moi.go.kr/eng/sub/a03/Government30/screen.do> Accessed in August, 2017

⁴⁰ <https://www.oecd.org/governance/observatory-public-sector-innovation/countryprofiles/korea/>

Returning to Brazil, since 2006 the whole country has been implementing Electronic Invoice Systems⁴¹. Nowadays, every transaction related to the ICMS has an electronic register, and the tendency is to improve the services related. The scenario is well explained by Álvaro Bahia⁴²:

The electronic invoice (NF-e) is transforming every year the relation between the taxpayer and the tax administration, and B2B processes of Brazil. This is mainly due to the tax cooperation of the Brazilian tax administrations and the bold and innovative management strategy of ENCAT (National Meeting of State Tax Coordinators and Administrators), which have been adopted in the development and improvement processes of the various electronic tax documents of Brazil.

Since the launching of the electronic invoice, in 2006 and other types of electronic tax documents (DF-e), such as Electronic Bill of Lading (CT-e), the Electronic Tax Manifest (MDF-e), And the consumer electronic invoice(NFC-e), we have focused on creating more than a “simple” migration from the concepts of paper documents to electronic format. We are permanently seeking the implementation of creative innovations to enable the exponential evolution of the Tax Administration processes and all the other actors that are interrelated with the electronic invoicing.

This is how, from the year 2010, we have developed innovative concepts such as the NF-e Events (NF-e 2G), going through the Fiscal Cloud, launched in 2012 and more recently the concept of Fiscal IoT (Fiscal Internet of Things). It is represented by a set of actions that will integrate the electronic documents to artifacts that enable the tracking of cargo vehicles and their respective merchandise, with an “integrating system”, based on the Virtual Sefaz of Rio Grande do Sul, called National State Operator (ONE in Portuguese). It is part of the infrastructure of another important project of ENCAT, the Brazil-Id System (www.brasil-id.org.br).

Through the ONE, we have already carried out more than 6.2million of automatic Transit Records Events in the invoices, cargo manifests, and electronic bill of ladings. These events are captured by almost one hundred license plate reading antennas, which use OCR technology (Optical Character Recognition) and identification via Radio Frequency (RFID) installed by the state finances secretariats and the National Land Transport Agency (ANTT) on the main Brazilian highways. (Bahia 2017)

⁴¹ Nota Fiscal Eletrônica – more information:

⁴² <https://www.linkedin.com/in/álvaro-bahia-373b7a31>

Brazil is pursuing the state of the art in tax technology, even though, it is necessary to rebuild some processes and reorganize tax administrations. The current risk analyses are based in old measures and ancient procedures. For instance, companies are classified by their income (high or low), kind of production (market segment), size (number of shops/fabrics), and others criteria that are not direct associated with the relationship tax payer – tax administration (payments and consistency).

Contradictory, since every Brazilian tax interaction is electronic, it would be possible to improve the relationship giving fast feedbacks to contributors and offering new services for the general public. Of course, transforming this new approach in a real new relationship will demand huge investments in big data, intelligence, and the construction of a completely new cultural paradigm of how the administration deal with taxpayers.

Here are some examples the OECD mentions showing different approaches that countries have been testing around the world:

- (i) Forward Compliance Arrangement (Australia);
- (ii) Annual Compliance Arrangement (Australia);
- (iii) Centers of Expertise (Canada);
- (iv) Early determination on an uncertain tax position, “Rescrit” (France);
- (v) Foreign reporting requirement measurement system database (Canada);
- (vi) Cooperative Approach to Tax Compliance (Ireland);
- (vii) Compliance Agreements with “very large businesses” (The Netherlands);
- (viii) Simultaneous Assessment and Control (Norway);
- (ix) Project Management Approach to handling tax avoidance (UK);
- (x) Industry Issue Resolution (US);

- (xi) Pre-Filing Agreements (US); and
- (xii) Limited Issue Focused Examination (US). (OECD 2009)

5.7 Building a reliable relationship.

Nobody likes to pay taxes, but since we have to pay, there are several researches and studies aiming to understand and to develop innovative ways to incentive this behavior. Professor Sven Steinmo, a professor at the Robert Schuman Centre for Advanced studies and Director of Willing to Pay?⁴³, has an interesting point of view about the relation between tax and citizens:

All modern welfare states face a set of very difficult challenges as they adapt to the demographic, economic and fiscal pressures of the early 21st century. These include: a) fiscal pressures of an aging ‘core’ population; b) political challenges of maintaining public support for adequate social welfare and education in the context of growing ethnic diversity; c) growing public frustration with and even distrust of bureaucratic state institutions and political authority; d) intense pressures to reduce (or at least not increase) taxes for politically powerful constituencies; and e) the continuing pressures to move from manufacturing-based economies towards service-based economies. These competing pressures deeply constrain the political choices available to policy makers in all advanced democratic nations. It is simply not true, however, that these forces push all democratic states in the same direction. Quite the contrary: the empirical evidence suggests that modern democracies are maintaining quite different policy trajectories – even in the face of broadly similar political, economic and fiscal pressures. (Steinmo 2016)

During his researches, he has been discovering that the most important reason why people are willing to pay taxes is how they perceive the reliability of the institutions. As he said in the article wrote by Ellen Halliday on May 2017:

“Institutions vary between states, and the quality of an institution affects overall tax compliance. Good institutions build norms for tax compliance. Bad institutions lead to non-compliance. In Sweden, those who put into institutions are also likely to get something out. In Italy, the institutions are far less reliable. As a result, ‘there is a lot less trust in the institutions of southern Europe,’ said D’Attoma. ‘Nobody likes [tax avoidance], but when everybody does it, that’s how culture develops’.” (Halliday 2017)

⁴³<http://willingtopay.eu> accessed in July 16, 2017

Of course, analyzing the willing to pay tax is too complex to be exhausted in this work (Kirchler, et al. 2010). However, we can assume that the first step to improve the quality of the relationship between taxpayers and administration is to build a trustworthy institution, or, at least, construct the perception of one.

6 Six Steps to Raise a New Paradigm

6.1 The early background

Several studies try to understand and elaborate details about the factors that influence taxpayers to comply with their duties. Professors Lisette van der Hel – van Dijk and Maarten Siglé elaborated the following table to summarize their research:

Economic factors	Sociological & Psychological factors	Corporate (governance) characteristics
Tax rate	Personal norms	Board of directors composition
Manager compensation	Social norms	Tax risk management
Detection probability	Distributive justice	Tax advisors
Penalties	Horizontal equity	External auditors
Book-tax conformity	Vertical equity	Profitability
Risk appetite	Retributive justice	Ownership
Uncertainty	Procedural justice	
Complexity of the law	Trust	

Figure 6-1 Factors Influencing Corporate Tax Compliance (Dijk and Siglé 2015)

Before that, in 2004, the OECD published the guidance note - Compliance Risk Management: Managing and Improving Tax Compliance (OECD 2004). In this document, it was explored some practices adopted by countries and made some operational suggestions. At that time, they did not reach specific answers about the taxpayers' behavior, but they launched the initial basis to establish a new paradigm:

There is no easy answer to what influences taxpayer behaviour either towards compliance or non-compliance. However, research undertaken by Australian academic Dr Valerie Braithwaite suggests that the factors identified in the Model of Taxpayer influences combine to cause individual taxpayers (individuals or businesses) to adopt sets of values, beliefs and attitudes that can be described as ‘motivational postures’. These postures, two broadly non-compliant and two broadly compliant, characterise the way individuals relate to a revenue authority and the tax system it administers. They are represented in Figure 4.2. (OECD 2004).

The figure 4.2, mentioned in this passage, became very famous between the tax administrations and academic authors. It summarizes factors influencing the taxpayers’ behavior in four aspects: social, psychological, economic, and business or industry factors. Considering its importance, the figure will be reproduced here:

Figure 4.2 A spectrum of taxpayer attitudes to compliance

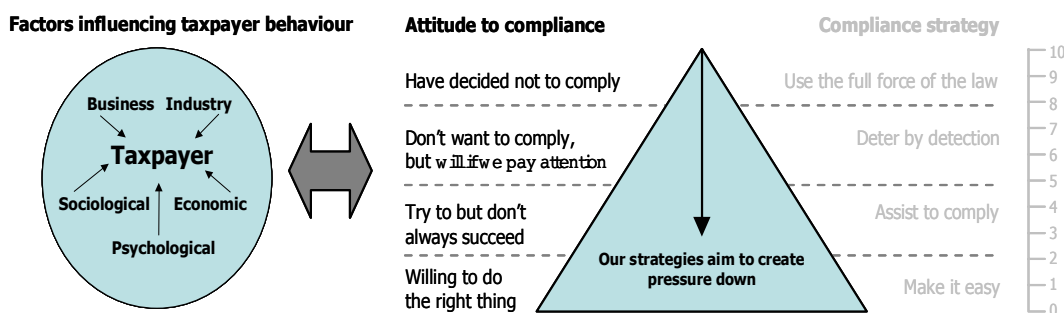


Figure 6-2 OECD spectrum of taxpayer attitudes to compliance

In summary, the OECD defined four categories of taxpayers based on the attitude to compliance:

- (i) Disengaged – who have decided not to comply;
- (ii) Resisters - who don't want to comply but who will if they can be persuaded that their concerns are being addressed;
- (iii) Triers - who are basically willing to comply but who have difficulty in doing so and don't always succeed;
- (iv) Supporters – who is willing to do the right thing.

Important to highlight the authors prevent that these attitudes do not reflect fixed characteristics of a person or a group. It reflects the interaction in some specific period of time and determined situation. At the other side of that pyramid are the actions to be adopted under a compliance strategy:

- (i) Disengaged – use the full force of the law;
- (ii) Resisters – deter by detection;
- (iii) Triers – assist to comply;
- (iv) Supporters – make it easy.

The same document suggests some key points to determine the treatment strategies for tax administrations:

- (i) Compliance programs need to provide a graduated response to compliance behavior—making it easy for those who want to comply and applying credible enforcement to those who don't.
 - (ii) Acting at all times with integrity and in a manner perceived to be fair and reasonable will encourage voluntary compliance.
 - (iii) Treatment needs to address the underlying drivers of compliance behavior.
 - (iv) Enhanced capacity to influence taxpayer compliance behavior often comes through strategic alliances and partnerships with other agencies, industry bodies and tax advisers.
 - (v) Sustainable improvement in compliance can only be achieved by influencing and changing social and personal norms.
 - (vi) The most effective strategies are likely to be multi-faceted and systemic.
- (OECD 2004)

It is essential to establish objective criteria when the Tax Administrators are developing some risk analyses methodology. It is also essential that these criteria were constructed under the stability provided by the law. It will be beneficial for all the components inserted in the relation and the outside actors. The idea is to create an ambiance of trust that make the taxpayers knows and truly believe they are inserted in a fair context.

Besides the age of this text, it was publicized in 2004, this statement is compatible with the results achieved in the Professor Steinmo research. People needs to feel enclosed in a fair ambiance where institutions are reliable.

These three following paragraphs condense the main concepts:

The model shows that for the majority of taxpayers who choose to pay the correct amount of tax on time, the provision of ongoing assistance will be the most helpful response to encouraging continuing compliance. However, as we move up the continuum from taxpayers who are 'willing to do the right thing' to taxpayers who 'have decided not to comply', taxpayers must be made aware that the authority will detect their non-compliance and take credible enforcement action. Credible enforcement means the taxpayer will be in a worse position after the enforcement action than they would have been if they had complied in the first instance. Achieving this will require sufficient resources to maintain a sustained effort.

Revenue authorities must have at their disposal the tools to permit them to impose sanctions upon taxpayers for non-compliant behavior. However, the research clearly shows us that taxpayers respond better to compliance efforts if they perceive that they have received procedural justice. In other words, they perceive that they have been treated fairly by the authority and can accept that the authority has the power to take the course of action that it has. If the model of compliance is consistently and appropriately applied, this in itself represents a significant step towards demonstrating procedural justice and, in turn, building community confidence.

Compliance is most likely to be optimized when a revenue authority pursues a citizen-inclusive approach to compliance through policies that encourage dialogue and persuasion, combined with an effective mix of incentives and sanctions. The following discussion outlines principles that have been derived both from the research literature and the practical experience of revenue authorities. An enduring challenge for a revenue authority is to convert these principles of fair treatment into concrete operations and routines in the day-to-day practices of its officers. (OECD 2004)

The idea is to build a simple, understandable, and feasible relationship based on the trust between the administration and taxpayers aiming to raise a new paradigm.

6.2 Create appropriate sanctions for simple errors

In August 2016, São Paulo state started to develop an ambitious idea to change its course of action. Called Fiscal Conformity Program, “Nos Conformes”⁴⁴ in Portuguese, the project aims to establish a new level of trust between tax payers and tax administration.

The program was released with the project of law number 57/2017⁴⁵. This was the first step to create the necessary structure for the public sector and the right ambiance for the private sector. The aim of this project is to normalize the interest rate applied over obligations not fulfilled by taxpayers. In some cases, the rate applied reached 20% per month against a general Short-Term Interest Rates (SELIC rate⁴⁶) that it was not greater than 16% in the last five years.

Furthermore, the project proposed to establish reasonable limits for fines. Before that, it was possible to apply fines of 300% over the value wrongly declared by the taxpayers. This movement in direction to create appropriate sanctions for simple errors is the first signal that administration wants and is acting to change the relationship.

6.3 Adopt visible actions against bad behaviors

This is an important step to construct the structure that generates results immediately. The first result is to show evidences of the consequences that a bad risk management can generate, the

⁴⁴ <http://www.saopaulo.sp.gov.br/sala-de-imprensa/release/alckmin-lanca-pacote-de-conformidade-fiscal-para-beneficiar-pessoas-fisicas-e-juridicas/> in Portuguese, accessed in July 16, 2017.

⁴⁵ Projeto de Lei nº 57 de 2017 <https://www.al.sp.gov.br/propositura/?id=1000028167> in Portuguese, accessed in July 16, 2017.

⁴⁶ <https://www.bcb.gov.br/Pec/Copom/Ingl/taxaSelic-i.asp> accessed in July 16, 2017.

second is to give appropriate visibility to the treatment that are given to the contributors who do not follow the rules.

In May 2017, some specific actions took place against organizations that had been operating in the shadow of the tax law to avoid paying taxes. Besides São Paulo State Treasury usually performs this kind of action, it had never explored the media and visibility as it had done in this operation. This time was different. The application of the adequate approach by the press agents resulted in large and free positive media reports for the tax administration.

Three operations were successful and repeatedly mentioned by media during a whole week: “Game Over”, “Monte Cristo”, and “De Olho Na Bomba”⁴⁷. The companies that were evaded asked for help to regularize their situation and the negotiation to build an agreement is still in progress.

6.4 Incentive good behaviors

Typically, tax authorities act auditing and applying fines over contributors’ errors without even analyze if these mistakes were intentional, it happens because of the objective liability (Congresso Nacional 1966). However, I would be useful to examine this situation under the classical conditioning behavior theory discovered by Pavlov in the last century. Called

⁴⁷ <http://g1.globo.com/jornal-hoje/videos/t/edicoes/v/operacao-game-over-investiga-venda-de-videogame-com-notas-frias/5926201/>;
<https://economia.uol.com.br/noticias/estadao-conteudo/2017/06/09/game-over-investiga-sonegacao-de-impostos.htm>;
<https://portal.fazenda.sp.gov.br/Noticias/Paginas/Operação-Game-Over-combate-sonegação-fiscal-no-setor-de-videogames.aspx>; <http://veja.abril.com.br/economia/operacao-combate-sonegacao-em-venda-de-videogames-em-sp/>;
<https://portal.fazenda.sp.gov.br/Noticias/Paginas/Fazenda-deflagra-operação-De-Olho-na-Bomba-para-fiscalizar-postos-de-combust%C3%ADveis-da-Capital.aspx> ;
http://www.ovale.com.br/conteudo/2017/06/nossa_regiao/9799-operacao-monte-cristo-investiga-redes-da-farma-conde.html;
<http://radiopiratininga.com.br/gaeco-deflagra-operacao-monte-cristo-para-combater-sonegacao-fiscal-no-vale-do-paraiba/>; <http://www1.folha.uol.com.br/mercado/2017/05/1885111-fabricante-da-dolly-e-alvo-de-operacao-por-inadimplencia-e-fraude-no-icms.shtml> , all in Portuguese and accessed in July 16, 2017;

behavioral psychology, this scientist had demonstrated how to create desirable behaviors using appropriate stimulus. There are two possibilities when doing that: the first is act as the authorities usual do nowadays, only trying to punish negative behaviors, the second is to incentive positive actions through positive incentives at the same time that the negative behaviors receive severe treatment.

6.5 Build, keep and make transparent historical records

Increasing the visibility of the taxpayers' historical registers is important to highlight business that have a good financial control and a good compliance policy. The main problem of this step is the costs to construct and support the technological infrastructure. However, since the majority of the information is already available in digital format, and the tax administration is obligated to maintain records of all transactions, in the Brazilian case, the cost to store and organize this data also already exists and remains under the public responsibility.

Build and keep is the earlier phases. The next evolution is to make the information available or, at least, visible for the contributors.

6.6 Build partnerships, with everyone

As mentioned in pg. 30, Álvaro Bahia give a good example to explain how community partnerships are helping authorities to trace and check transactions.

More than a simple transit registry, these readings performed through the ONE, which operates integrated to the MDF-e System, allow the States Operations Centers (COE), responsible for controlling the physical flow of goods destined to their territories, to access all information contained in these cargo units. They include information on the goods transported, their route, weight, information on the driver's CPF/CNH and even the value and number of the insurance policy for the cargo contained in that vehicle. This fantastic integration of information, unique in the world, has enabled the creation of the concept of "Inspection of Cargo Vehicles in motion", which starts as soon as the cargo vehicle exits the loading site, even before the goods enter the federal territory of destination. (Bahia 2017)

Ahead in the same text, he complements the information highlighting the importance of the interaction between different government bodies. As the information is digital, it can be available on the same time for several institutions. Nevertheless, the interaction between community partnerships go beyond government agencies and sharing information. These interactions could be established with universities with the specific purpose of the development of new solutions and innovative approaches, audit systems, and law propositions.

6.7 Apply the TADAT™

As it was mentioned previously, a group formed by the IMF, The World Bank, and Multi-donor Trust Fund elaborated a Tax Administration Diagnostic Assessment Tool, that is available since December 2013. The program presents nine performance outcome areas to be pursued by the tax administrations listed as the following:

- (i) **The integrity of the registered taxpayer base:** Without complete and accurate information about the taxpayers registered with the tax administration, and an understanding of the profile of those who choose to remain outside, it is not possible to provide effective and efficient services to support voluntary compliance and take action against non-compliance.
- (ii) **The extent of understanding about the compliance risks in the tax system:** Without this, it is not possible to organize and manage the tax administration in a way that maximizes the collection of tax within the law.
- (iii) **The quality of support provided to taxpayers to promote voluntary compliance:** Usually, the majority of taxpayers will seek to meet their tax obligations if they are given the information they need in a way that is most useful to them.

- (iv) **The extent to which taxpayers meet their filing obligations:** The cornerstone of tax administration operations is the documentation that taxpayers are required to provide the tax administration. The extent to which this is provided when it is required has a significant impact on the cost structure and efficiency of the tax administration.
- (v) **The extent to which taxpayers meet their payment obligations:** If taxpayers do not pay their tax obligations, or they pay late, the fiscal outcomes of the government are affected. Arrears collection is expensive and time consuming.
- (vi) **The accuracy with which taxpayers declare their tax obligations:** A major source of revenue under-performance is mis-declaration in tax returns, whether as a result of an innocent mistake or deliberate tax evasion or fraud.
- (vii) **The adequacy of tax dispute resolution:** Resolution of tax disputes in a way that is seen as independent, speedy and fair is critical to efficient closure of the tax cycle and positive public perceptions of the integrity of the tax administration.
- (viii) **The efficiency of tax administration:** The extent to which tax collection methods are efficient, tax administration revenue accounting systems are sound and a focus is maintained on the most important tax streams directly contributes to government fiscal outcomes both in terms of revenue contribution and cost of collection. Efficient administration also contributes to lower compliance costs for business and economic efficiency.
- (ix) **The level of accountability and transparency:** The extent to which the tax administration is transparent in the conduct of its activities and accountable for its operation and performance directly contributes to public and business

perceptions of the integrity of the tax system and, more generally, to the soundness of all public-sector institutions. (Multi-donor Trust Fund - IMF 2013)

The application of this methodology has been suggested by the Inter-American Development Bank, but it is not mandatory, yet.

7 A new propose to segment taxpayers

7.1 Bases for a new relationship

São Paulo State's Treasury employs more than 10,000 workers. It is responsible for the second public budget in Brazil, succeeding only the federal one. Under this condition, it is a reference for the others bureaucratic systems at this area. Every initiative is analyzed and followed (the most times) by others Brazilian's States. For instance, São Paulo State adopted a system to measure the public employees' performance in 2009. After two years, more 17 Brazilian's States followed São Paulo initiative and had adopted the same system.

Now it is time to improve the administration itself. In order to be aligned with the best practices in the world, São Paulo State Treasury launched the project of law to institute the Transparency of Tributary Compliance Criteria. The first action to demonstrate the willing to promote changes was to open it for the purpose of the public consulting. It took place from July 11 until August 11 of 2017 and received several contributions. This is one phase of the whole Fiscal Conformity Program.

The idea is to construct a rating of taxpayers supported by the civil society, academia, government, and the taxpayers themselves. The benefits of that initiative are:

Decreasing risks of

- (i) providers' discontinuity;
- (ii) unintentional tax liabilities;
- (iii) credit.

Increasing of

- (i) legal reliability;
- (ii) competitive advantages to taxpayers that are up to date with the Treasury;
- (iii) promotion of a supply chain in compliance with the Treasury.

The big challenge is that all documents, researches, initiatives, programs, every study in this area suggest that tax administrations would have a good risk management program. However, as this strategy is in its earlier life, it is difficult to understand how exactly to execute the plan, which criteria can be used, or how precisely it has to be applied to reach this goal. There are few academic material about it:

We conclude that the most important assumptions underlying co-operative compliance strategies are the contributions to taxpayer compliance by improving perceived procedural justice, reducing taxpayer uncertainty and improving tax risk management by taxpayers. These assumptions can draw on some theoretical substantiation, but none of them can claim a solid grounding from empirical evidence. This emphasises the need for both effect measurement by tax authorities and scholarly (empirical) research. This lack of empirical, scholarly research seems to be an overarching characteristic of advise and persuade strategies. Further research should, therefore, focus on finding ways to empirically testing the assumptions of advise and persuade strategies in general and co-operative compliance strategies more specifically. (Dijk and Siglé 2015)

São Paulo is a pioneer. And being a pioneer means to assume huge risk of failure.

7.2 Backbone and pillars

Every radical change in old paradigms demands huge negotiation with large groups. Tax administrations deals with money, any change can cause lots of anxiety if it would not be conducted properly. The working team of this project has adopted the strategy to provide rigid

foundations to support the idea before any contact with people outside the team. Assuming the negotiation would take place between adversaries and friends at the same time, it was necessary to establish the appropriate ambiance, focusing in interests, not positions (Fisher, Ury and Patton 2012). The goal was to construct an agreement, nobody in the team had pursued an individual victory.

Aiming to be the most objective as possible, the tributary rating was built under one core backbone and four structural pillars. Curiously, after the project had be launched, it was verified that its bases were aligned with the TADAT™⁴⁸ document (Multi-donor Trust Fund - IMF 2013), and the OECD recommendations (OECD 2004).

The backbone is trust relationship, and the pillars are: simplicity, fair competition, transparency, and legal reliability.

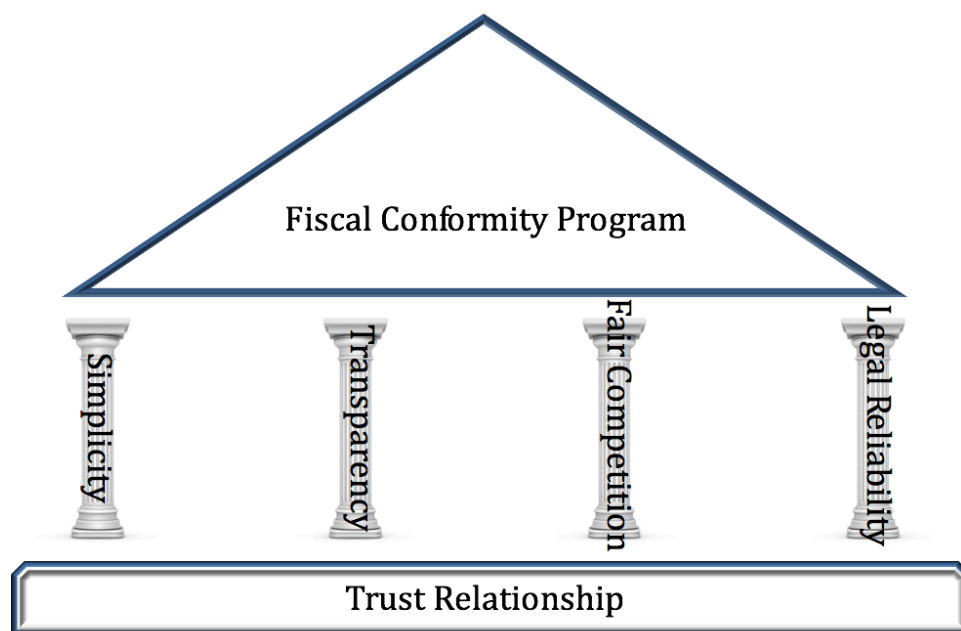


Figure 7-1 Structure for the new relationship

⁴⁸ <http://www.tadat.org/index.html>

7.2.1 Trustful relationship

The prevalent attitude in many tax administrations appears to be that all taxpayers are potential criminals. The key administrative problems are then identifying and controlling taxpayers and catching those who cheat. These tasks are indeed important, and this emphasis is understandable in a country undergoing rapid transition, but problems of tax enforcement cannot be solved simply by calling in the “tax police.” Extensive research in a number of countries shows that there is much to be gained from viewing taxpayers more as clients—perhaps not very willing clients, but still clients—than as would-be criminals (Bird 2010).

Following the same line explored by Mr. Richard Bird, the backbone of the project is the turning point in the main tax policy strategy - tax police to tax orientation, changing the way taxpayers are treated by the administration. To do that, it is fundamental to start a new relation based upon trust and confidence, it is essential to develop mutual trust. Dijk and Siglé proposed the following schema for a co-operative strategy with mutual trust in the center:

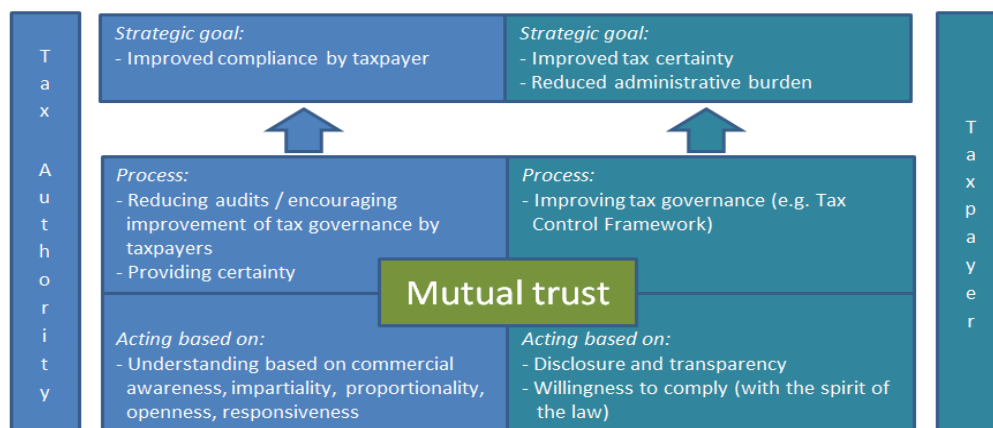


Figure 7-2 The common denominators of co-operative compliance strategies (Dijk and Siglé 2015)

Essentially, the idea is to create all necessary conditions to support a better ambience and stimulate the synergy between public and private sectors. In 2009, the OECD states some key issues and activities connecting trust relationship, between others, and compliance:

61. The consensus is that building and improving the relationship between the tax administration and the large taxpayer is critical in promoting transparency and a cooperative approach to compliance. Most of the respondents have indicated that improving and building a relationship based on transparency, trust, and mutual

understanding would have a positive impact on large business compliance. This trend is consistent with the recommendation made in the OECD “Study into the Role of Tax Intermediary” about the tax administration and the large business engaging in an “enhanced relationship”.

62. Building a new form of relationship with large business is one of the key strategies adopted by the participating countries to influence and promote large taxpayer compliance. In its 2006 “Large business and tax compliance” booklet, the ATO stressed that a strong and healthy relationship between the Tax Office and large businesses is essential to the efficient and effective operation of Australia’s tax system.

63. In 2005 the Netherlands Tax and Customs Administration (NTCA) introduced the “horizontal monitoring” approach to conclude what is known as “Compliance Agreements” with very large businesses (“ZGO”) to confirm certain basic principles of an enhanced relationship. Key elements of this enhanced relationship are mutual trust, transparency and understanding (transparency from the taxpayer and a speedy and irrevocable opinion or ruling by the NTCA). Under the “Compliance Agreement”, the taxpayer has to actively disclose issues that could have significant tax consequences and to establish an internal control framework (Tax Control Framework) (OECD 2009)

As every turnover strategy, it will be necessary to bypass every point of resistance to build this new relationship.

The next four pillars will determine the path to achieve compliance in São Paulo.

7.2.2 Simplicity

This is a hard objective to pursue. From time to time it is necessary to stop the process of creation, revalidate principles, then, under some circumstances, to give up about what seems to be a good idea in order to maintain the simplicity.

This first pillar is the base to define only three clear and objective criteria to segment taxpayers. It will be the basis to establish seven different segments: – A+, A, B, C, D, and E for the rating and one position out of the segmentation for the new business: NC – *Novo Contribuinte* (New Contributor). The lower risk group will be classified under the letters A+ and A. The group of contributors under the almost certain risk will be classified below the letter E. Of course, new

contributors need some time to be classified. It is very important to emphasize that there will be only three criteria, objective and so clear as it would be possible.

There are several collateral gains when pursuing simplicity. As the IMF states:

The elimination of excessive regulation can both facilitate economic growth and impede corruption. There is considerable research evidence that market restrictions facilitate rent-seeking activities, particularly when restrictions require government approval based on the exercise of discretion by the official who has the authority to grant approval (Krueger 1974; Ales and Di Tella 1999; Johnson, Kaufmann, and Ziodo-Lobaton 1997). For this reason, the streamlining of regulatory approval (including through the use of technology) can play an important role, at least where the exercise of discretion is not essential. For instance, computerized processing of documents can strengthen integrity significantly in key areas, such as customs services (Crotty 2010). (International Monetary Fund 2016)

The problem with this pillar is the other side of the simplicity. It will be necessary to balance between the strategy that try to cover all the exemptions, or start simple and small, and growing up gradually. Furthermore, real life is not simple. The simplicity will generate some practical questions to solve. For instance, in Brazil small business are not obligated to adopt all accounting books. It will be necessary to implement some alternative to attest their consistency and maintain the simplicity. The project need to start from a pilot to learn with from its owns failures.

7.2.3 Transparency

Constructing the project in a transparent way since the beginning makes all players, public and private sectors, assume it as a composition, an agreement, something equally constructed to benefit both sides. Listening private sectors and creating the opportunity to propose adjustments, more than that, accepting what was proposed would allow to overcome the traditional Top-Down power system (Coleman 2014).

Similar to the simplicity's pillar, transparency is easy to understand and hard to apply. Several cultural distortions – corruption for instance, exist under the shield of secrecy of the tax data.

Again, the IMF states several collateral gains of the transparency:

Although transparency is a general prerequisite for the proper functioning of the market, it is also a core component of an effective anti-corruption policy. Transparency plays a critical role in ensuring the efficient allocation of resources by allowing the market to evaluate and impose discipline on government policy, and by increasing the political risk of unsustainable policies (Kopits and Craig 1998).

In addition to these important functions, transparency can play a key role in preventing corruption and promoting good governance. By providing the public with access to information relating to government decisions and financial transactions, transparency can effectively deter illicit behavior. Indeed, a number of studies demonstrate a positive correlation between corruption and the lack of public budget transparency. The more transparent the budget in a given country, the less corrupt the country is perceived to be (Renzio and Wehner 2015; Sedmihradská and Haas 2013). (International Monetary Fund 2016)

Although it is common to think on public sector when we talk about the increasing of transparency, this pillar sustains both sides. It is imperative that taxpayers make their transactions more visible and comprehensible. As it could be read above in the first sentence and as it was concluded by Dijk and Siglé in their work:

Within a co-operative compliance program, taxpayers are required to provide disclosure and transparency. It is assumed that this will increase taxpayer certainty, since disclosure and transparency enable tax authorities to provide this certainty. The wish or need for certainty of taxpayers and the ability of tax authorities to provide certainty are therefore important prerequisites of a co-operative compliance strategy. (Dijk and Siglé 2015)

The challenge will be to establish criteria that are simple, transparent, and can resist against judicial inquiries after it was explained for the taxpayers that, eventually, think they are victims of some injustice.

7.2.4 Fair competition

The logic is to classify and give different treatments for each group of contributors. This new segmentation helps to organize the way how the administration deals with different behavioral

layers of contributors. It will allow to concentrate efforts in contributors who plays unfair games or postpone tax payments to get some cash flow advantages.

Explaining and making transparent the reasons why contributors are classified in one or another layer stimulates good competition and exposes who is playing unfair games. As it was also said by Dijk and Siglé: “According to the OECD (2013), tax authorities should make the first move to improve the working relationship. By giving taxpayers consistent, objective and fair treatment, it is expected that taxpayers will reciprocate with improving their own behavior.” (Dijk and Siglé 2015)

7.2.5 Legal reliability

The first warranty to guarantee reliability is that this classification does not return to the past. It will be applied focusing only on the future actions and having its starting point the time when the law will be approved by the legal assembly. The second warranty is the law itself. Since this system operates in the administrative procedures level, it not would be required a regulation by the law. However, since the Brazilian context, as explained on the background item, is not favorable to construct the backbone of trust, by using the strength of the law to define general structure, it will be sent the right message to both sides, private and public sectors. The strategy is serious and it will operate under the protection of the law.

7.3 Criteria

Observing the pillars of simplicity and transparency, it was used three criteria. They are direct, simple, and easily understandable. Operating with three useful criteria - and only these three – it is possible to segment taxpayers in six groups. The initial criteria are:

- (i) **Compliance**, payment of declared taxes, whether tax collections fully correspond to what was declared - check any pending debts;

- (ii) **Consistency** between the invoices issued and the bookkeeping declared, whether the fiscal receipts emitted match what was declared to the Revenue Office - look for indications of tax evasion;
- (iii) **Commitment (compliance) of suppliers**, preference for suppliers who represent mostly taxpayers with tax regularity (A +, A, B or C), whether the acquisitions are made from suppliers in compliance with the criteria above - compliant and without accounting inconsistencies.

These criteria can be revised and actualized as the time goes by.

7.4 Rating

Based upon the criteria above, for example, to be classified in the group A+ the taxpayer must have to attempt the consistency, compliance, and have to maintain a supply chain mostly formed by contributors classified in the groups A+ and A. The segmentation in the others groups will take place according to the contributors own consistency, compliance, and its supply chain behavior.

The insertion of the supply chain behavior as a criterion will help the establishment of compliance systems for the whole market. It is a legal and sophisticated method to normalize all economic sectors. The idea is to minimize the possibility of some large company adopts corporate tax aggressive plan when comparing equity risks incentives (Rego and Wilson 2012) by establishing positive encouragements to comply.

The general terms of this classification can be easily visualized in the following illustration:

	A+	A	B	C	D	E
1 Compliance	✓	✓	✓	✓	⊘	Derogated, cancelled registrations, unfit
2 Consistency	✓	✓	✓	✓	⊘	
3 Suppliers' compliance	Mostly from groups A+ and A	Mostly from groups A+, A e B	Mostly from groups A+, A and B, to a lesser extent than from group A	Chain of suppliers doesn't qualify as B	Other cases	

Figure 7-3 Classification model ⁴⁹

7.5 Website prototype for transparency

In order to be transparent, this project previews the possibility of anyone who uses the internet have accesses to the rate of any contributor. To guarantee this right, the classification will be accessible for the general public through a web site link. From that, everyone will can check the current status, the historical of some specific contributor, and the tendency of its classification, according to the following prototype:

⁴⁹ Model of the segmentation proposed during the presentation for the Treasury's Secretary in June, 2017 - this slide was elaborated by Lucas Corbellini <https://br.linkedin.com/in/lucas-mottin-corbellini-8879b931>, reproduced here under his permission.

Ir para o conteúdo 1 | Ir para o menu 2 | Ir para a busca 3 | Ir para o rodapé 4

Portal do Governo | Portal da Transparência | Poupatempo

Fale Conosco

Governo do Estado de São Paulo
Secretaria da Fazenda

GOVERNO DO ESTADO DE SÃO PAULO

INÍCIO INSTITUCIONAL CIDADÃO EMPRESA ACESSO À INFORMAÇÃO NOTÍCIAS AJUDA

Você está em: Início > |

Transparency of Tributary Compliance Criteria

The Transparency of Tributary Compliance Criteria of the State of São Paulo represents a milestone in the Treasury-society relationship. Through an initiative such as this one, the State's Treasury adds value to regular taxpayers, promoting tributary compliance, fair competition and improving the business environment, which will lead to higher levels of investment, production, employment and income.

CNPJ: 99.999.999/0001-XX **Razão Social:** CLEANER INDUSTRIA QUIMICA LTDA **Data da Inscrição Estadual:** 09/06/2005

Grupo Atual: A+ **Descrição do Grupo:** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

Histórico

Data Processamento	Classificação	Tendência de Reclassificação
Maio/2017	A+	Neutro
Abril/2017	A+	Negativo
Março/2017	A+	Neutro

NEUTRO = Sem intercorrências negativas que possam afetar a classificação no próximo ciclo
NEGATIVO = Com intercorrências negativas que possam afetar a classificação no próximo ciclo

Figure 7-4 Prototype of the Website ⁵⁰

This historical register can be used by the general public in several ways. For instance, to evaluate the risk of discontinuity of suppliers in contracts, or to evaluate the credit risk for financial institutions and suppliers. Furthermore, this information adds value to fiscally accountable companies. The publicity also incentivizes the willing to integrate the A group, even for market visibility, access to simplified procedures to fulfill ancillary obligations, or other benefits that have a financial impact for the company. It is important to say that only general information will be public, data that could embarrass the taxpayer will be accessed only by the contributor itself.

By creating market value for companies, this segmentation can invert the logical of Tax War stimulating big and regular companies to install its plants inside the São Paulo state borders.

⁵⁰ Prototype of the web link to access the classification of contributors in São Paulo State Treasury.

7.6 Transition

It is necessary to establish some period for adaptations. During this time, taxpayers could be notified about their situation with the Treasury individually. It is imperious that they have enough time to regularize small issues that may influence their classification. This time has to be calculated according the activity. For instance, it can be allowed some extra time to specific sectors with complex supply chain, like medicines, that demand special treatment.

8 Building trust relationship based upon this new rating

8.1 Understanding the Treasury's point of view

We have talked about taxpayers' segmentation and classification dealing with only one side of the OECD pyramid. To be effective, it also will be necessary to reorganize the activities and duties developed by the tax auditors over each segment.

For years, the mantra of tax administrations was that contributors are criminals (Alm, Martinez-Vazquez and Torgler 2010) (Bird 2010), are enemies, and are always looking for some way to evade their duties. It is so deeply encrusted in the tax administrations' routine that all currently measurements about the auditors' efficiency are based on the numbers of fines applied and respective value intended. Even simple mistakes of auxiliary obligations receive several penalties and huge fines.

Since public employees are obligated to follow the rule of Law, some actions have to be detailed by the law to guarantee the reliability.

In briefly, these are the simplest administrative procedures and easily possible actions suggested, considering each segment:

- (i) **A+** - Rule of monitoring and self-regularization, entitled to Prior Fiscal Analysis without loss of spontaneity (fiscal audits as last resource).
- (ii) **A** - Rule of monitoring and self-regularization, with occasional fiscal inspections.
- (iii) **B** - Rule of monitoring and still out of the priority group for surveillance, but priority fiscal inspections are mandatory for the last two fiscal year
- (iv) **C** - Fiscal inspections with greater intensity
- (v) **D** - Focus of inspections, alongside group E, consuming most of the available supervisory capacity (fiscal inspections in rule for 5 fiscal years)
- (vi) **E** - Same as D, with possible operations alongside the Public Prosecutor's Office

8.2 Self-Regularization and prior fiscal analysis

Taxpayers A + and A will not have fiscal operations started without prior tax analysis (risk mitigation of tax liabilities). The process consists of analytical or field work by the fiscal agent, with the purpose of verifying the tax compliance, but without loss of spontaneity and without possibility of drawing up notice of infraction. The objective is to invest in orientation, fines would be applied only as the last resource.

Taxpayer may follow recommendations of the fiscal agent and regulate by themselves, or object the understanding through the Stability Guaranty Committee for the Application of Tax Legislation, which will act as a forum formed by experienced tax auditors. This committee will solve conflicts in order to avoid notices of infractions. The decision of the committee will be binding in relation to the specific case, moreover, its decision cannot be ignored in any future fiscal operation, under penalty of the nullity of the infraction's notice.

Once the analysis has been made by the Committee and the report has been partially or integrally maintained, the taxpayer will have 30 days to make adjustments and prove the collection of differences to the Treasury, without loss of the benefits of spontaneity – in other words, without penalties.

After the deadline and without proof of the adequacy and payment due by the taxpayer, fiscal body will open a tax operation based on the pre-tax verification report. From this moment, the spontaneity will not be applied anymore and fines can take place.

8.3 Participatory plan of action

Taxpayers of the A + Group will be able to participate in an institutional channel of dialogue with the Treasury, directly collaborating in the definition of priorities for actions to simplify ancillary obligations, automation of systems, procedures, and other projects in mutual interests.

The conformity program aims to create an institutional forum and opens dialogue as a way to improve the relationship channels and enables further transparent relationship between tax authorities and taxpayers. That is a radical changing in tax administration/taxpayers' relationship paradigm.

8.4 Monitoring, passive audits, and surveillance

Groups A+ and A will be monitored by the Tax Administration, as every other contributor.

However, since the presuppose to be classified in this layer is the high willing to pay, the administration has to be coherent with its own statements and prioritize other layers when directing human resources to execute detailed verifications. This strategy cannot be assumed as some kind of free pass to illegal practices by the contributors. Digital monitoring remains subsidizing fiscal intelligence. This sector will be responsible for analyzing suspected cases aiming to detect frauds and tax evasion.

Public sector in general do not have enough resources to analyze and audit all contributors.

Layers B and C will receive the preferential focus for audit jobs. In these cases, the relationship administration/taxpayers will not change. They will receive the same treatment as it is used today by the tax authorities. Nothing changes for them with one exception: massive use of electronic audits and automatic assessments. These are not layers to monitoring, these segments will remain under surveillance.

Layers D and E bring together contributors who hardly pay taxes and will receive most attention from authorities. For this purpose, in July 2017, it was created a specific law enforcement unit called CIRA – *Comite Interinstitucional de Recuperação de Ativos*. This unit brings together the Public Prosecution Service, the Civil Police, the State Attorney General’s Office, the Justice Department, and Tax Administration to act with the exclusive mission of assets recovery.

The strategy is to provide information in real time for taxpayers send electronical messages showing the inconsistencies found through fiscal mesh, allowing direct access to the data storage in the administration database by themselves, construct reliable taxpayers’ registers, and create the perception of the monitoring by sending feedbacks in real time. This plan is aligned with some OECD conclusions based on experiences and practices around the world:

As stated above (“approaches to address compliance issues” section), the trend is to move from post- filing of tax return examination to “real-time” evaluation of risk and compliance issue resolution. A number of countries have instituted various programs to provide certainty to large taxpayers and early identification and resolution of compliance issues. These initiatives are also implemented as part of the cooperative or “enhanced relationship” approach, discussed above. Some of the methods and programs, as described by the participating countries, to provide certainty to large taxpayers and address compliance on a “real-time” basis include:

Forward Compliance Arrangements;

Advance rulings (binding and non-binding);

Advance pricing agreements;

Pre-filing agreements or advance agreements;
Contemporaneous documentation requirement (for cross-border transactions);
The use of Client or Relationship Managers to provide clarity; and
Compliance Assurance Programs to resolve tax issues prior to the filing of a tax return.
(OECD 2009)

8.5 ICMS certification for accounting professionals

The next step forward to incentive the construction of a new relationship will be to development the official tax certification for professionals and companies. In Brazil, accountant is the professional responsible for accounting in business. It is necessary to get degree in accounting sciences.

Large companies have market power to contract and maintain good professionals in its team. An accredited certificate from the State Treasury Department would provide substantial support for new small and medium entrepreneurs. A common complaint is about the absent of specialized VAT/ICMS accounting professionals that they intend to hire. Moreover, an official certification process also would incentive professionals to invest in its continuously professional development.

From the administration perspective, after some time of operation and consolidation of the classification criteria, it will be necessary to reanalyze and update them. The different levels of certification can be used to set the distinction between companies. Several institutions can be used as benchmark after necessary adaptations. For all, it can be mentioned the IMA's Certification for Accountants and Financial Professionals in Business⁵¹, and the National Association of State Board Accountancy⁵² Certification.

⁵¹ <https://www.imanet.org/cma-certification?ssopc=1>

⁵² <https://www.aicpa.org/Press/PressReleases/2013/Pages/US-CPA-Exam-Testing-in-Brazil-Expands-to-All-of-South-America.aspx>

The idea behind the certification is to establish an effective proactive tool to identify noncompliance behaviors in this sector. The Brazilian constitution guarantee in its article 5, VIII – “the practice of any work, trade or profession, observing the professional qualifications which the law shall establish. freedom to exercise any profession.” (BRAZIL 2017).

An interesting phenomenon is generated from this statement. The law establishes minimal qualifications to exercise accountancy. It is responsibility of the regional or national councils of accountancy⁵³. There is an initial examination that qualify the professional to work. This qualification can be annulled only by some judicial decision after the due process of law. In other words, it is not easy to lose the license.

On the other hand, the presence of accountants is only mandatory in the time to open new business. After a company get all the authorizations to operate, there is no obligation anymore to maintain one accountant in its team of professionals. In numerous cases of tax fraud, the accountant, who would be responsible for the company books, usually claims that he just had acted to provide necessary advisory to the opening bureaucratic process and had no further contact with partners or employees. As the investigation rarely succeed in the constitution of the probes, in these cases the accountant hardly can be charged by the company’s errors and is even more hardly has its license canceled.

Some accountants have more than two hundred companies canceled for involvement in tax fraud and continue working normally. The official certification process could mitigate this situation by using the market “invisible hand” in its favor. It is a fact that the Treasury department cannot cancel the license of these professionals, nonetheless the department is not obligated to concede the certification for the same professionals under these circumstances. Considering that large and

⁵³ <https://online.crcsp.org.br/portal/index.asp> or <http://cfc.org.br/>

serious companies would make some effort to be classified as A+ or A, by establishing this certification and adjusting the criteria of classification, the market by its own will help to normalize this undesirable phenomenon.

8.6 Stop-loss tax credit system

Besides any discussion about aggressive tax plan and structured tax fraud, there are two common ways to commit tax fraud when we are talking about VAT/ICMS. The first is to find improperly methods to diminish the number of sell operations and, consequently, the number of debits. The second is to declare false buying operations and, thus, generates false credits to increase the tax to be refund. Both movements are done in order to reduce the amount of money that would be paid to the state.

However, these are simple tax frauds that, apparently, could be controlled by new technological audit mechanisms. São Paulo State Treasury have been adopting some specific actions in order to promote reliability to this segment registers⁵⁴. Additionally, this new rating of contributors, as proposed, acts directly over the first “aggressive tax plan” that improperly decrease debts.

Remembering, the first criterion of classification is the consistency of the taxpayer.

The case that try to increase credits can be divided in two common *modus operandi*. Companies that sell false credits do exist, but they are not feasible anymore and try to get easy money mixing real operations with false operations. In this situation, it is more difficult to catch the fraud. However, when it is discovered, the authors are penalized and the public sector receives the money back. The other possible fraud occurs when the whole company and all the operations are false. This evasion is relatively easy to discover, but is very hardy to recover some of the

⁵⁴ <http://www.seteco.com.br/fazenda-paulista-reduzira-cadastro-de-contribuintes-valor-economico/> in Portuguese, accessed in August 1, 2017

amount that was deviated from state. The Brazilian “Lava Jato” case have lot of example of these practices⁵⁵.

Part of this problem stems from the need to accelerate the bureaucratic process of starting business in Brazil. The country is ranked in the 175th position out of 190. It is necessary 79.5 days in average to start business here. IMF had already alerted about the problem, but the institution had correlated it only with corruption:

Improving government institutions has been an important component of structural reforms recommended by the IMF. Since an overly regulated economy provides opportunities for bribes, there is a strong incentive to delay economic reforms in a highly corrupt environment (Svensson, 2005). Indeed, measures of corruption tend to be highly correlated with indicators that measure the ease of doing business, such as the number of days it takes to start a business or the number of days needed to process imports (Figure 6).¹⁴ The IMF has often advised its members to improve their business climate by focusing, for instance, on reducing the regulatory burden (Brazil, Greece, Hungary) and improving transparency (Ukraine), which are seen as enhancing growth. (International Monetary Fund 2016)

Some improvements have been placing since 2015 that result in this statement from the Doing Business report, “Brazil made starting a business faster by implementing an online portal for business licenses” (The World Bank 2017). However, instead of improving the control mechanisms to make the initial verification process more efficient, the effort went in the opposite direction, and made the opening requirements of companies more flexible. One collateral effect was the absent of initial control to open business. This consequence facilitates starting false companies, structuring frauds, and organizing schemes to operates with false credits.

One tool to mitigate this problem without worse consequences for the Brazilian doing business ranking, could be the implementation of the stop-loss tax credit system. Briefly, it is just a limit for the companies transfer credits for other companies. It will work upon the same bases as the

⁵⁵ <http://lavajato.mpf.mp.br/entenda-o-caso> accessed in July 31, 2017, in Portuguese.

analysis of the credit and its stop-loss system (Lanz and Tomei 2014), just adding the position on the risk classification.

The concept is the same as it is applied to guarantee loans. The difference is that while the stop-loss financial credit system use a percentage of the amount effectively paid against the total loan, in this case it is 7%, the stop-loss tax credit will be based upon a composition between the monthly payments made by the company to the state and the relation between subscribed capital and the effective paid-in capital of each company. The parameter could be around twenty times the amount of paid-in capital and could vary according to the rating of the company: A+ more flexible, E more rigid rules. New companies will be allowed to transfer tax credits considering a proportion of their paid-in capital.

This solution will operate when business is already functioning. It will not affect the time to start the business and will be effective before the audits.

8.7 Detection of fraud schemes and the whistleblower tax program

“Whistleblowers are workers performing their jobs.” (Kohn 2017).

According to one world-wide study conducted by PricewaterhouseCoopers that interviewed fifty-four hundred chief executive officers, chief financial officers, and chief compliance officers to detect the depth of corporate crime, the whistleblower method is the most effective source of information in both detecting and rooting out corporate criminal activity (Kohn 2017).

Detection of frauds can occur by some active – Tax Intelligence Departments (Centro Interamericano de Administraciones Tributarias - CIAT 2009) - or passive detection method – informers. The Association of Certified Fraud Examiners explain the importance of the whistleblowers when detecting frauds:

Our data shows that, generally speaking, frauds that are detected through active methods

tend to be caught sooner and cause smaller losses than frauds that are detected passively. Of all detection methods, notification by law enforcement had both the highest associated median loss (\$1 million) and longest median duration (36 months). Of the active detection methods, the highest median loss (for IT controls) was \$150,000, while the longest median duration (for management review) was 18 months.

Thus, organizations might be able to reduce the duration and cost of fraud by implementing controls or processes that will increase the likelihood of active detection, such as active management review, attentive account reconciliation, and surveillance or monitoring techniques.

Source of Tips

As tips are the most common detection method (see Figure 21 on page 21), it is helpful to know who is likely to report fraud to the organization. Employees, who provided 51.5% of tips, are generally the focus of reporting mechanisms at most organizations. However, anti-fraud professionals should remember that more than 40% of all tips came from non-employees. Customers (17.8%), vendors (9.9%), and other parties were significant sources of tips. Thus, some organizations might cultivate more tips by promoting fraud reporting mechanisms to multiple audiences.

Additionally, 14% of tips came from anonymous sources. Some jurisdictions restrict organizations from promoting anonymous reporting mechanisms, but organizations who choose not to have them risk losing sources who are not comfortable revealing their identity. (ACFE - Association of Certified Fraud Examiners 2016)

The tax whistleblower program will require evasions greater than US\$6Milion, considering the last four years of operation, new and useful data, and unidentified tips. For that purpose, it will be used the Paulist invoice register – *Cadastro da Nota Fiscal Paulista*. The reward will be 10%, in the maximum, of the amount effectively recovery to the state balanced according to the real utility of the information presented. All the tips will be analyzed by the sector that will be created for this specific purpose in cooperation with the Justice Department and the Prosecutor's Office.

For some cases where frauds were eventually detected, it will be applied new ways of surveillance based upon market rules of governance and accounting. For instance, contributors in these situations will be obligated to follow the International Organization for Standardization

directive ISO 31000⁵⁶ - risk management standards, for the minimum period of five years, under the Treasury's supervision.

8.8 Internal tax compliance program

Associated with this huge paradigm changing in the relationship tax authorities/taxpayers, it is necessary to invest in effective internal controls of quality to guarantee a holistic, multifaceted, and efficient methodology. More than that, "Strong governance arrangements must be instituted to monitor and evaluate the implementation of the compliance program" (Russell 2010). It is also necessary to create mechanisms to monitor and evaluate outcomes.

All the Brazilian public sectors have their own internal affairs sector that is responsible for investigate and punish conducts' deviations. However, this is not the motivation of the internal tax compliance program and there not the competence of the correctional section to evaluate performance and outcomes. Generates better behaviors is its consequence. This conformity program was idealized to improve the relationship tax authorities - taxpayers and elevate the quality of the service for the customers, in this case, contributors. The internal compliance has to implemented on three fronts: Risk Analysis, Governance, and Compliance and the complete study of these subjects remains beyond of the scope of this work.

9 Conclusion

Private sectors, and population in general, are enough with public agent deviations and inefficiency. International organizations – IMF, The World Bank, OECD, IADB - aware of this situation, intend to promote changes in public administrations around the globe. Several

⁵⁶ "[ISO 31000:2009](#) on risk management is intended for people who create and protect value in an organization by managing risks, making decisions, setting and achieving objectives and improving performance. The standard's revision process discovers the virtues of keeping risk management simple" (International Organization for Standardization 2017).

academic studies (Jr., Bergman and Arnson 2017) suggest changes based on equal numerous researches (Alm, Martinez-Vazquez and Torgler 2010) and empiric results (Dijk and Siglé 2015). Complex formulas were constructed to create econometric models to understand and detect non-compliance behaviors (Erard and Feinstein 2010). However, transparency, reliability, and fair competition do not support any tax compliance program without the pillar of simplicity. Trustworthy relationship, basis for every compliance incentive, depends on these four pillars. They have to be built together, at the same time, looking to the same direction.

The fiscal conformity program of São Paulo State Treasury try to observes these fundamentals. They are important not only because experts are pursuing the establishment of a new trust relationship. More than that, when observing these bases, São Paulo authorities are trying to avoid judicial appeals and inquiries. The three criteria suggested are objective, direct, and simple: consistency, compliance, and commitment of suppliers. This strategy aims to reduce costs of litigating process and to create a sustainable and innovative structure for tax administrations.

Some actions mentioned in this paper (tax whistleblower, accountant certification, surveillance program with market standards, and compliance inside the tax administration) have to be better discussed. Although they are part of the overall tax compliance program, their detailing here would extrapolate the purpose of this master final paper, demanding future deeply researches inside another article context.

Finally, although under some platonic ideal scenario a tax reform could bring the definitive solution, it is interesting to emphasize that this classification of taxpayers does not demand any tax reform. That is a relief, considering Brazilian legal framework. This proposal is just a new way to organize procedures and apply the scarce public resources efficiently.

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