

Brazil's Tax Reform
The preamble of a new tax policy
October, 2019

With the approval of the labor & employment reform followed by the social security reform, key steps for the modernization of the business environment and public administration, respectively, all the attention is now with the tax reform. The short-term scenario suggests that a potential approval should take place in the coming months, worst case scenario until the first quarter of 2020.

The central points of the proposals in Congress are simplification of the tax system and reduction of compliance costs. The core ideas are the elimination of ten indirect taxes, introduction of a Federal and/or State good and services tax, a Federal selective tax on blue chip industries, elimination of city taxation on services and technology and consolidation of the corporate income taxes into one single tax.

In terms of background to explain where we are today, in the mid 60's, right after the 1964 military coup, Brazil approved a tax reform that sought to centralize the administration of tax revenues and reduce the power of States. The outcome was the facilitation of public investments and the highest global growth rates in the 70's. Brazil became the second country to adopt a VAT structure following France. With the end of the coup, Brazil approved the 1988 tax reform aiming at eliminating federal political and economic centralization imposed by the militaries and promote economic growth after a decade of recession. To an extent, the 1998 tax reform was successful, yet the current consensus among the political class, corporate Brazil and society is that the 1988 tax model is no longer functional and that the public administration spends excessively based on pillars of an inefficient tax system. However, the current high tax burden as a proportion of Brazil's GDP, one of the greatest in the world, prevents that any tax reform come to be translated into greater taxation.

This clash of perspectives has set the agenda in the past years. Despite the consensus, we can expect a highly complex discussion ahead of Brazil. The complexity derives from the fact that Brazil is a continental country organized as a Federation meaning that success will ultimately depend on a solid political arrangement intended to address a number of different interests. The Union, States and Cities have the constitutional power to tax. Several key actors are part of the debate: Federal, State and City lawmakers and groups of interest across the country fighting for tax subsidies and benefits. The real discussion in Brasília is how to apportion and distribute the power to tax and what will be the impact on the balance of economic power.

The conclusion for U.S. and foreign investors in Brazil is optimistic. The international and domestic markets project that the Brazilian tax system will go through a substantial transformation and simplification to reduce compliance costs and improve the quality of the business environment. Corporate Brazil, Businesses & Industrial Associations & Federations, lawmakers, tax specialists and tax authorities have been in the process of promoting extensive debates across the country. There is a consensus that the next tax reform should have a relevant economic impact as a new model is expected. Once implemented this model should redefine the Brazilian tax policy and its landscape for the coming decades.
