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Preparing for take-off

Tax lawyers are the unassuming superheroes of Brazil. According to the World Bank, a Brazilian company on average takes longer to prepare, file and pay taxes than anywhere else across the globe. Alongside national charges, there are regional taxes imposed by 27 states and more than 5,500 municipalities. Predictably, there is one word on every policymaker's mind: Reform.

ITR brings you practical insight, in English and Portuguese, into some of the most significant recent developments from the Brazilian tax world.

The guide takes on a journey across a range of topics on reform, considering the main objectives and challenges that lay ahead. In addition, the much-debated opinion regarding the offsetting of tax losses in the termination of companies is also discussed.

Brazil is simultaneously undergoing the most radical changes to its transfer pricing (TP) regime in decades. By taking a novel approach, policymakers have sought to adapt the country's historically formulaic TP framework to align with international standards.

This guide explains the importance of Brazil's convergence towards the OECD's model and evaluates its merits. Meanwhile, further trends, inspired by global



Prin Shashiharan
Commercial editor
ITR

adherence, including the tax implications of increased cost-sharing agreements and the utility of US-inspired tax transactions to resolve disputes, are analysed.

Digital technology continues to transform the order of business in Brazil. Manufacturers have stepped up their investment in research and development and the government has incentivised innovation through the form of tax-deductible financial credits.

The guide considers how Brazil has dealt with the growing digitalisation of its economy, while looking deeper at how beneficial tax laws are helping fintechs disrupt traditional banks. In contrast, the gap between legislation and reality is also discussed, especially when taxing transactions involving digital goods and services.

Brazil's tax world is set to blossom in the 2020s. We hope that you enjoy hearing from the tax experts leading the progression in our first Brazil Special Focus.

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Assessing Brazil's tax landscape in 2020

The first edition of ITR's Brazil Special Focus comes at a precarious time for the country's economy, with the long-awaited matter of reform unexpectedly being overshadowed by a sudden global pandemic. **Romero J S Tavares** of **PwC Brazil** introduces the key topics that will dominate the tax landscape in 2020.

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Globalising the transfer pricing landscape

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The long expected Brazilian tax reform – objectives, challenges and pitfalls

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Committing to a futuristic tax model

Marcos Joaquim Gonçalves Alves and **Alan Flores Viana** of **MJ Alves e Burle Advogados e Consultores** explain how tax policy in Brazil should evolve to incentivise compliance, while encouraging good practices by taxpayers.

Tax transactions – a model widely referred to as “offers in compromise” (OIC) in US law – can be considered as one of the most prominent themes explored in the Brazilian tax policy agenda. Inserted into the Brazilian legal system with immediate effect through Provisional Measure No. 899/2019, the use of tax transactions to resolve tax disputes has received surprisingly little media attention due to hysteria of the impending tax reform.

Brazil's tax policy dilemma

The importance of tax transactions stems from the complexity of the Brazilian tax system and the large number of disputes caused by it. Widely known to be unfair and laborious, Brazil's taxpayers are expected to spend at least 1,958 hours per year on tax reporting issues, according to the World Bank's Doing Business 2018 report.

In this context, a peculiar reality was created in Brazil. According to data from the Attorney General's Office of the National Treasury (PGFN), a federal government agency responsible for collecting unpaid federal tax debts, the stock of federal public debt collected in lawsuits filed by the state in the judiciary reached the sum of approximately BRL 2.196 trillion (\$438.3 billion) in November 2018.

To provide context, the union's overdue public credits were unpaid until November 2018, which led the state to file tax collection lawsuits against approximately 4.5 million taxpayers, divided between individuals and companies. Of this sum, BRL 23.9 billion was recovered in 2018 by the PGFN, which represents approximately 1.04% of the total amount to be recovered, without considering the structural cost involved in collecting such debt.

The data made available by the National Council of Justice is equally startling. According to the Justice in Numbers 2019 report, tax enforcement

proceedings represented approximately 39% of the total pending cases and 73% of the foreclosures pending before the judiciary, with a congestion rate of 90%. In other words, for every 100 tax enforcement proceedings that were processed in 2018, only 10 were written off. Disregarding these lawsuits, the judiciary's congestion rate would drop by 8.5% points, from 71.2% to 62.7% in 2018.

In a world that is attempting to move towards the elimination or, at least, reduction of litigation, this data is alarming. In addition, such data demonstrates a focus on using old and inefficient methods to promote tax debt collections while the global trend is moving in the opposite direction towards the non-judicialisation of conflicts. Such a global trend adopts an approach based on quick and effective conflict resolution methods – such as alternative dispute resolution (ADR), among which the tax transaction stands out.

This article assesses the empirical data on the existing tax debt collection status in Brazil and aims to ask: will we face this problem with eyes in the rear view mirror, or do a structural reflection with eyes on the future? The answer is neither easy nor simple, as everything takes place in an increasingly globalised and complex world.

However, any proposal under debate must assume the necessary response to the question raised above, clearly inserted in the context of Brazilian tax policy: where does Brazil want to go? What are the tax policies that the country intends to adopt to face this situation?

An alternative model

The analysis of this article focuses on one of the possible solutions: the use of tax transactions. It can be described as a model within the ADR-genre, which is qualified by the absence of third parties, and where the negotiations are carried out directly between taxpayers and the state.

The inherent policy challenges in such a tax dispute resolution method is adapting itself to the legal system, which was designed through political choices made when an alternative way of resolving conflicts was not considered. Legislative innovations, such as the one created by Provisional Measure No. 899/2019, should therefore be adapted to the constitutional norms and, most importantly, to change the Brazilian social culture of inclining towards litigation.

This challenge is interlocked by several legal concepts raised, in many interpretations, to the status of dogmas, which makes it difficult to advance the necessary legislative changes. As an example, we can highlight the principle of the unavailability of the tax credit, the principle of legality and the extent of the acts of public servants responsible for the concessions made during the transaction.

A preliminary consensus can be verified in the text of Provisional Measure No. 899/2019, in as much as it provides for the express availability of amounts owed to the

state, except for those that constitute the principal amount of the tax due. In other words, only the amount of monetary restatements and additions could be the subject of the transaction, with the possibility of diluting the final amount of the transaction in monthly instalments, respecting the maximum number of instalments stipulated in the provisional measure.

However, there is an aspect still debated about the limitations applicable to the discretion that the public servant would have when faced with a transaction request submitted by a taxpayer.

This is due to the fact that, after delimiting the object of what can be transacted by Provisional Measure No. 899/2019 or any subsequent legislation, there will be several options available to the public agent to transact with a taxpayer, adapting it to each specific case. For example, it will give the civil servant the freedom to analyse the specific case presented by a taxpayer, define what will be the percentage of debt reduction applied, as well as the opportunity to determine what will be the debt settlement period and remaining debt balance after the reductions are applied.

According to the dominant scholar opinion, there are two different types of administrative acts available under Brazilian administrative law. On one hand, 'linked administrative acts' has its uses and applications delimited by the legislation itself, i.e. there is no room for interpretation. On the other hand, 'discretionary administrative acts' – although expressly provided for by law – allows for the margin of interpretation by a public servant who analyses a specific case.

When it comes to tax transactions, a discretionary administrative act would delimit what would be the debt reduction percentage and what would be the payment deadline for the remaining balance. Thus, there would be an interpretive margin to be used by a public servant responsible for negotiating with a taxpayer.

Freedom with objective standards

These findings highlight the interpretative discretion left by Provisional Measure No. 899/2019 for a public agent responsible for analysing a transaction request, as well as the need for such freedom to be delimited by objective parameters.

However, which parameters should be used to delimit such a discretionary administrative act?

To answer this question, one must invariably refer to the constitutional text, where it is stated that one should search desirable parameters for overcoming a potential punitive legal relationship, and create a cooperative relationship between the state and a taxpayer.

If such a cooperative path is chosen, Brazilian tax policy may leave out a reactive and punitive stance in order to induce behaviours desired by the Federal Constitution.



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He has completed degrees from University Center of Brasília and the Pontifical Catholic University of Rio de Janeiro, as well as gaining a specialisation in tax law from the Brazilian Institute of Tax Studies.

Strictly speaking, the tax policy may become an instrument for implementing the constitutional objective of achieving a better and fairer society.

For example, there could be a discretion in fixing the percentage of reduction of fines and an interest could be guided by evidence of certain subjective behaviours foreseen in accordance with constitutional principles.

In other words, if a taxpayer carries out compliance policies and practices that promote the constitutional desire to protect the right to life, social relations, social responsibility, protection of the environment and other socially desirable attitudes, such a taxpayer would be treated differently when requesting for a tax transaction.

Constitutional social principles could therefore be used as an objective parameter for a public servant discretion when analysing a potential tax transaction.

A better tomorrow

The proposal of this article is to establish a new tax law paradigm. One that induces a better society, stimulating the

adoption of desired practices and attitudes, and the formation of a socially responsible and engaged citizen.

A good taxpayer is one who helps the state to achieve, among other objectives:

- Construction of a free and fair society (where women can occupy governance positions; where selection processes and policies respect LGBTQ+ diversity; where people can develop internal policies against racism, homophobia, and machismo);
- Implementation of life respecting policies (where a day-care centre can be offered; where there can be assistance to pregnant mothers and single mothers);
- Ensuring national development (adopting sustainable policies; carrying out selective waste collection; using renewable energies; reducing the use of waste in order to attain environmental goals of international agreements);
- Eradicating poverty and marginalisation, and reducing social and regional inequalities (creating ex-convicts work admission programmes; providing social projects for low income people; creating cultural projects for children

during after-school hours; planning educational projects as a way of helping studies; providing sports projects for needy people; creating projects to collect clothes and food for distribution in needy areas);

- Promoting welfare, without prejudice of origin, race, sex, colour, age and any other forms of discrimination (creating programmes to combat prejudice through lectures, incentives for diversity, social integration programmes); ensuring the transparency of salaries offered without discrimination by position; creating projects for immigrants and refugees (offering Portuguese classes; technical courses; cultural incentives, jobs for needy people – such as gastronomic fairs; craft fairs, etc.); and
- Promoting social rights (creating vaccination programmes within the company and basic healthcare; extending maternity and paternity leave time; creating flexible schedules for mothers and fathers with young children; distributing food and personal hygiene items for homeless people, orphaned children, elderly homes etc.; creating a team to help and guide destitute people; creating bonuses for vacation or leisure for employees who reach their goals; promoting events such as June festivities, children's day, free Christmas for needy people;

creating social spaces to carry out activities to promote health, culture and leisure; rescuing and enhancing the social role of the elderly, their knowledge and experiences through actions that incentivise forms of social participation for elderly people).

By adopting such types of tax policy, the existing model of a 'punishment-based' relationship between a taxpayer and the state will be gladly abandoned, to give rise to a 'contribution-focused' relationship.

The public agent would no longer be able to freely assign the percentage of interest and fine reduction. They would have to effectively follow objective criteria set out in the constitutional text to assess a taxpayer's performance quality by objectively assigning them a score that would lead to a discount on his tax transaction.

This policy creates a stimulus for compliance with the Federal Constitution's subjective principles. The detachment from this conflicted past will bring positive results for taxpayers, who will have – at the very least – security and legal predictability. It will also bring benefits for the state, which from a greater effective tax collection may, if it looks closely at the future, encourage collaborative behaviour by taxpayers through a new tax policy that will not make us miss the existing model.



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