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Improving VAT/GST

Designing a Simple and Fraud-Proof Tax System

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Improving VAT/GST: Designing a Simple and Fraud-Proof Tax System

Why this book?
As governments worldwide are looking for ways to raise revenue in order to finance their budgets, consumption taxes such as value added taxes (VAT) and goods and services taxes (GST) are increasing in prominence and now exist in over 150 countries.

Improving VAT/GST: Designing a Simple and Fraud-Proof Tax System compares the VAT/GST systems of 15 countries around the world, with all continents represented, plus the EU VAT regime. The analysis is organized in a way that allows interesting and specific details of each VAT system to be identified, while at the same time rendering them comparable despite their structural differences. In detail, it examines topics such as neutrality, VAT groups and head office (including branch transactions), financial services, anti-avoidance rules, advance rulings, VAT gap, compliance costs and costs of collection. It identifies best practices and provides readers with some thoughts on future directions of VAT/GST. The main focus is set on making VAT/GST systems both simple and fraud proof.

The relevant knowledge about different VAT/GST systems provided in this book can be a fundamental resource to help practitioners to optimize their tax planning solutions, to provide legal certainty to their clients and to ensure the avoidance of both double taxation and double non-taxation in VAT/GST matters.

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Table of contents

Preface xxv

Abbreviations xxvii

Chapter 1: Argentina 1
Ricardo Tavieres and Rodolfo Feito

1.1. Neutrality principle and the VAT system 1
1.1.1. Argentinian VAT system 1
1.1.2. Compliance with OECD guidelines on neutrality 5
1.2. VAT groups and head office – branch transactions 7
1.3. VAT treatment of financial services 7
1.3.1. Credits: granting, negotiation and management 8
1.3.2. Negotiation and management of receivables and guarantees related to the issue of debt 9
1.3.3. Services associated with deposits, current accounts, payments, transfers and movements of funds in general 9
1.3.4. Services related to the sphere of money 9
1.3.5. Services related to shares, securities and derivative financial instruments 10
1.3.6. Other financial services 10
1.3.7. Services (premiums) associated with the provision of insurance 10
1.4. Anti-avoidance rules 11
1.4.1. Withholding and collection regimes 11
1.4.2. Old tools, new realities – A step ahead in the digital age 12
1.4.2.1. Current developments in electronic commerce 12
1.4.2.2. The challenge of collecting taxes from network operations 12
1.4.2.3. Custody of public funds at a time of technological advances 13
1.4.2.4. Questioning this procedure 14
1.4.3. Dishonest use of apocryphal invoices 15
1.4.3.1. Invoicing 15
1.4.3.2. Electronic invoicing 16
1.4.3.3. Invoices class “M” 17
1.4.4. Law against tax evasion 18

1.4.5.	Special regime for small taxpayers	19
1.5.	Advance rulings	19
1.6.	VAT gap	20
1.7.	Compliance costs and costs of collection	20
1.8.	Conclusion	21
Chapter 2:	**Australia** *Rebecca Millar and Lorenna Moon*	23
2.1.	Neutrality	23
2.1.1.	General	23
2.1.2.	Exemptions and scope of GST	27
2.1.2.1.	Input taxed supplies	27
2.1.2.2.	Specific restrictions on input tax credits	28
2.1.2.3.	Holding companies	30
2.1.2.4.	Public bodies	31
2.1.3.	The right to deduct and refunds	33
2.1.3.1.	The right to deduct and limitations thereon	33
2.1.3.2.	Partial apportionment	35
2.1.3.3.	Relevance of actual use: Post-acquisition adjustments	38
2.1.3.4.	Rounding	39
2.1.3.5.	Other post-acquisition adjustments for input tax	39
2.1.3.6.	Establishment costs	41
2.1.3.7.	VAT impact on cash flow (impact on working capital)	42
2.1.3.8.	Bad debts	45
2.1.3.9.	“Overcharged” or wrongly “charged” GST	46
2.2.	VAT groups and head office – branch transactions	47
2.2.1.	GST groups	47
2.2.1.1.	Basic GST grouping rules	47
2.2.1.2.	Grouping in the public sector	49
2.2.1.3.	Consequences of group membership	50
2.2.1.4.	Territorial scope	52
2.2.1.5.	Measures against abuse	53
2.2.2.	Intra-entity dealings	54
2.2.2.1.	Optional branch registration	54
2.2.2.2.	Reverse charge for inbound services	55
2.2.2.3.	Intra-entity transfers of goods	58
2.2.2.4.	Place of taxation rules	58
2.3.	Financial services	60
2.3.1.	GST treatment of financial supplies	60
2.3.1.1.	Inclusions	60
2.3.1.2.	Exclusions	62

2.3.2.	Outsourcing of activities	62
2.3.3.	VAT/GST deduction	63
2.3.3.1.	Absence of special rules for attribution or apportionment	63
2.3.3.2.	Full ITC where non-creditable use is insignificant	63
2.3.3.3.	Reduced input tax credits	64
2.3.4.	Special topics	67
2.3.4.1.	Debt collection and factoring	67
2.3.4.2.	Funds management	68
2.3.4.3.	Financing element of hire purchase and leasing	69
2.3.5.	Litigation	70
2.3.6.	Developments – Economic impact	70
2.3.6.1.	Developments	70
2.3.6.2.	Economic impact	71
2.3.7.	GST treatment of insurance	72
2.3.7.1.	The decreasing adjustment mechanism	72
2.3.7.2.	Other indirect taxes on insurance	75
2.4.	Anti-avoidance rules	76
2.4.1.	General anti-avoidance rule	76
2.4.2.	Specific anti-avoidance rules	79
2.5.	Advance rulings	80
2.5.1.	Scope	80
2.5.2.	Validity of private ruling requests	82
2.5.3.	Administration of private ruling requests	83
2.5.4.	Effect of rulings	85
2.5.5.	Access to courts	87
2.6.	VAT gap	89
2.6.1.	General	89
2.6.2.	Fraud investigation procedure	93
2.6.3.	Post-script on the VAT gap	94
2.7.	Compliance costs and costs of collection	95
2.7.1.	General	95
2.7.1.1.	Administration and collection of GST	95
2.7.1.2.	Registration	96
2.7.1.3.	Tax invoices and adjustment notes	99
2.7.1.4.	Accounting for GST	101
2.7.1.5.	Refunds	104
2.7.1.6.	Record keeping	105
2.7.1.7.	Audits	105
2.7.1.8.	Costs of administration and compliance	106
2.7.2.	Penalties	106
2.7.3.	Cost of doing business	107

2.8.	Conclusions	108
2.8.1.	Assessment of Australia's GST	108
Chapter 3:	**Brazil** *Celso Grazioli and Elidie Bifano*	111
3.1.	Neutrality	111
3.2.	VAT groups and head office – branch transactions	116
3.3.	Financial services	116
3.4.	Anti-avoidance rules	117
3.5.	Advance rulings	120
3.6.	VAT gap	127
3.7.	Compliance costs and costs of collection	131
3.7.1.	Penalties	132
3.8.	Conclusions	133
Chapter 4:	**Chile** *Sandra Benedetto*	135
	Introduction	135
4.0.	Taxable transactions	136
4.1.	Neutrality	138
4.1.1.	General	138
4.1.2.	VAT refunds	140
4.2.	VAT groups and head office – Branch transactions	142
4.3.	Financial services	143
4.4.	Anti-avoidance rules	144
4.5.	Advance rulings	146
4.6.	VAT gap	146
4.7.	Compliance costs and costs of collection	147
4.7.1.	General	147
4.7.2.	Penalties	149
4.7.3.	Cost of doing business	151
Chapter 5:	**China** *Wei Cui and Alan Wu*	153
5.1.	Neutrality	153
5.1.1.	Guideline 1: The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation	153

5.1.2.	Guideline 2: Businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation	156
5.1.3.	Guideline 3: VAT rules should be framed in such a way that they are not the primary influence on business decisions	159
5.1.4.	Guidelines 4-6: Treatment afforded to foreign businesses under the VAT system	159
5.1.5.	Benchmarking of Chinese VAT system	160
5.2.	VAT groups and head office – Branch transactions	160
5.2.1.	VAT groups	160
5.2.2.	Transactions between head office and branches	162
5.3.	Financial services	165
5.3.1.	Scope of financial services and insurance	166
5.3.2.	Exemptions and exclusions	167
5.3.3.	How are financial services taxed?	168
5.3.4.	Future developments – Transition from business tax to VAT	169
5.4.	Anti-avoidance rules	170
5.4.1.	General anti-avoidance	170
5.4.2.	Specific anti-avoidance rules in the VAT context	173
5.5.	Advance rulings	175
5.6.	VAT gap	180
5.6.1.	Legislative measures	181
5.6.2.	Invoice and reporting measures – Golden Tax System	183
5.6.2.1.	Issue of VAT special invoice	184
5.6.2.2.	Authentication VAT special invoices	185
5.6.2.3.	Cross-checking and inspecting VAT special invoice	185
5.6.2.4.	Invoice re-checking	185
5.7.	Compliance costs and costs of collection	186
5.8.	Conclusions	187

Chapter 6:	**India** *Ramarathnapuram Muralidharan and Monika Arora*	189
	Introduction	189
6.1.	Neutrality	190
6.2.	VAT groups and head office – branch transactions	193
6.3.	Financial services	195
6.4.	Anti-avoidance rules	197
6.5.	Advance rulings	198

6.6.	VAT gap	199
6.7.	Compliance costs and costs of collection	201
6.8.	Conclusions	203
Chapter 7:	**Japan** *Yumi Nishiyama and Kotaku Kimu*	205
	Introduction	205
7.1.	Neutrality	206
7.1.1.	General	206
7.1.2.	Exemptions	207
7.1.3.	Right to deduct	208
7.1.3.1.	Limitations to input tax deduction	208
7.1.3.2.	Special rule for input tax deduction: “the 95% Rule”	208
7.1.3.3.	Newly established business/cessation of business	209
7.1.3.4.	Reverse charge and deduction	210
7.1.3.5.	Period limitation	210
7.1.3.6.	VAT impact on cash flow	210
7.2.	VAT groups and head office – branch transactions	211
7.2.1.	VAT groups	211
7.2.2.	Head office – branch transactions	211
7.3.	Financial services	211
7.3.1.	General	211
7.3.2.	Outsourcing of activities	212
7.3.3.	VAT deduction	212
7.4.	Anti-avoidance rules	212
7.4.1.	Concept of anti-avoidance rule	212
7.4.2.	General anti-abuse rules	213
7.4.3.	Specific anti-abuse rules	213
7.5.	Advance rulings	214
7.6.	VAT gap	214
7.6.1.	Categories of VAT gap	214
7.6.2.	Typical fraud case	216
7.6.3.	Measures taken against the fraud scheme by the government	217
7.6.4.	Fraud investigation procedure	218
7.7.	Compliance costs and costs of collection	218
7.7.1.	General	218
7.7.2.	Data on the cost of VAT	219
7.7.3.	JCT administration	219
7.7.4.	VAT registration	221
7.7.5.	VAT audit and bookkeeping	221

7.7.6.	Filing tax returns	222
7.7.7.	Penalty	223
7.8.	Conclusions	223
7.8.1.	Economic impact of VAT	223
7.8.2.	Innovation	225
7.8.3.	Key features of simple and fraud-free VAT system	225
Chapter 8:	**Mexico** *César Augusto Domínguez Crespo*	227
	Introduction	227
8.1.	Neutrality	227
8.1.1.	General	227
8.1.2.	Exceptions to neutrality	229
8.1.3.	Right to deduct/VAT refunds	233
8.2.	VAT groups and head office – branch transactions	236
8.3.	Financial services	236
8.3.1.	General	236
8.3.2.	Outsourcing of activities	237
8.3.3.	VAT deduction – Method	238
8.3.4.	Litigation	239
8.3.5.	Developments – Economic impact	240
8.4.	Anti-avoidance rules	240
8.5.	Advance rulings	242
8.6.	VAT gap	244
8.7.	Compliance costs and costs of collection	244
8.7.1.	Penalties	248
8.7.2.	Cost of doing business	249
8.8.	Conclusions	250
Chapter 9:	**New Zealand** *David White and Eugen Trombitas*	255
9.1.	Neutrality	255
9.1.1.	General and scope of GST	255
9.1.2.	Right to deduct	256
9.1.3.	GST impact on cash flow	257
9.2.	Groups and head office – branch transactions	259
9.2.1.	Groups	259
9.2.2.	Head office – branch transactions	262
9.3.	Financial services	263
9.3.1.	General	263

9.3.2.	GST-exempt regime	263
9.3.3.	Zero-rating regime	264
9.3.4.	Taxable regime	265
9.3.5.	Deductions	265
9.4.	Anti-avoidance rules	266
9.4.1.	General	266
9.4.2.	General anti-abuse rules (GAAR)	267
9.4.3.	Specific anti-abuse rules (SAAR)	269
9.4.4.	Interaction between GAARs and SAARs and the impact on taxpayers	270
9.5.	Advance rulings	271
9.5.1.	General	271
9.5.2.	The process	272
9.6.	VAT/GST gap	274
9.6.1.	General	274
9.6.2.	Fraud investigation procedure	277
9.7.	Compliance costs and costs of collection	278
9.7.1.	Administration and collection of GST	278
9.7.2.	Compliance and collection costs	282
9.7.3.	Penalties	285
9.8.	Conclusions	285

Chapter 10:	**Norway** *Espen Qvist*	289
10.1.	Neutrality	289
10.1.1.	General – The Norwegian VAT system	289
10.1.2.	Exemptions/scope of VAT	290
10.1.3.	Right to deduct/VAT refunds	290
10.1.4.	Statute of limitation period	291
10.1.5.	VAT impact on cash flow (impact on working capital)	292
10.2.	VAT groups and head office – branch transactions	293
10.2.1.	VAT groups	293
10.2.1.1.	General	293
10.2.1.2.	Territorial scope	293
10.2.1.3.	Material consequences	294
10.2.2.	Head office – branch transactions	294
10.2.2.1.	General	294
10.3.	Financial services	295
10.3.1.	General	295
10.3.2.	Debt collection	296

10.3.3.	VAT deduction – Method	297
10.3.4.	Litigation	297
10.3.5.	Developments – Economic impact	297
10.4.	Anti-avoidance rules	298
10.5.	Advance rulings	298
10.5.1.	BFU	298
10.5.2.	Request	299
10.5.3.	Access to courts – Disputes on rulings	299
10.6.	VAT gap	300
10.7.	Compliance costs and costs of collection	300
10.7.1.	Organization	300
10.7.2.	Obtaining registration	300
10.7.3.	Compliance problems for foreign businesses	301
10.7.4.	Electronic compliance	301
10.7.5.	Electronic invoicing and e-archiving	302
10.7.6.	Penalties	303
10.8.	Conclusions	303

Chapter 11:	**The Russian Federation** *Irina Popova*	305
	Introduction	305
11.1.	Neutrality	306
11.1.1.	General	306
11.1.2.	VAT deductions	307
11.1.3.	Reverse charge	308
11.1.4.	Simplification measures	308
11.1.5.	VAT refunds	309
11.2.	VAT groups and head office – branch transactions	310
11.2.1.	Concept and categories	310
11.2.2.	Taxpayer registration and permanent establishment	311
11.2.3.	VAT groups	311
11.2.4.	Head office – branch transactions	312
11.3.	Financial services	313
11.3.1.	Taxable transactions	313
11.3.1.1.	Supply of goods (work, services) on the RF territory	313
11.3.1.2.	Transfer of goods (work, services) on the RF territory for own needs	316
11.3.1.3.	Performance of construction works for own consumption	317
11.3.1.4.	Importation of goods into the RF territory	317

11.3.2.	Operations (transactions) which are not considered to be the object of taxation	318
11.3.3.	Exemptions	318
11.3.3.1.	VAT exemption on financial services	319
11.4.	Anti-avoidance rules	322
11.4.1.	Legislation	322
11.4.2.	Practice	323
11.5.	Advance rulings	324
11.6.	VAT gap	324
11.7.	Compliance costs and costs of collection	325
11.7.1.	VAT collection	325
11.7.2.	VAT compliance	325
11.7.2.1.	VAT liability	325
11.7.2.2.	VAT documentation	325
11.7.2.2.1.	VAT invoice	325
11.7.2.2.2.	VAT registers	326
11.7.2.2.3.	Returns and payments	326
11.7.2.3.	Communication with the tax authorities	327
11.7.2.3.1.	Desk tax audit procedure	327
11.7.2.3.2.	Field tax audit	327
11.7.2.3.3.	Disputes with the tax authorities	328
11.8.	Conclusions	328

Chapter 12: Singapore 331
Soo How Koh

	Introduction	331
12.1.	Neutrality	332
12.1.1.	Scope of tax	333
12.1.2.	Right to deduct/GST refunds	334
12.1.3.	Attribution of input tax to taxable supplies	335
12.1.4.	Limitation to right to deduct	336
12.1.5.	Partial exemption	338
12.1.6.	Refund of GST/Impact on cash flow	340
12.1.7.	Recovery of GST by non-residents	341
12.1.8.	Bad-debt relief	342
12.1.9.	Credit notes	344
12.2.	VAT groups and head office – branch transactions	345
12.2.1.	Group registration	345
12.2.2.	Head office – branch transactions	347
12.3.	Financial services	348
12.3.1.	Right to deduction for financial services industry	351

12.3.2.	Litigation and economic impact	353
12.4.	Anti-avoidance rules	354
12.5.	Advance rulings	355
12.5.1.	Scope	355
12.5.2.	Matters to be considered in advance ruling	355
12.5.3.	Effects of rulings	358
12.5.4.	Fees for advance ruling	359
12.5.5.	Access to courts – Disputes on rulings	361
12.6.	VAT gap	363
12.6.1.	General	363
12.6.2.	Compliance and enforcement	364
12.6.2.1.	GST Assisted Self-Help Kit (ASK)	364
12.6.2.2.	GST Assisted Compliance Assurance Programme	366
12.6.3.	Voluntary disclosure	366
12.6.4.	Fraud investigation procedures	367
12.6.5.	Offences and penalties	368
12.7.	Compliance costs and costs of collection	370
12.7.1.	Benchmarking the Singapore GST system	370
12.7.2.	Costs of collection	371
12.7.3.	Registration for GST	372
12.7.4.	Responsibilities of a GST-registered business	373
12.7.5.	Accounting periods	374
12.7.6.	Filing returns and paying GST	375
12.7.7.	Payment and refund of GST	376
12.8.	Conclusions	377

Chapter 13:	**South Africa** *Jennifer Roeleveld*	379
	Introduction	379
13.1.	Neutrality	379
13.1.1.	General	379
13.1.2.	Exemptions/scope of the tax	380
13.1.3.	Right to deduct/VAT refunds	381
13.1.4.	Statute of limitation period	383
13.1.5.	VAT impact on cash flow	383
13.2.	VAT groups and head office – branch transactions	384
13.3.	Financial services	386
13.3.1.	General	386
13.3.2.	Outsourcing activities	387
13.3.3.	VAT-deduction method	387
13.3.4.	Debt collection	388

13.3.5.	Funds	388
13.3.6.	Financing arrangements	388
13.3.7.	Litigation	389
13.3.8.	Developments – Economic impact	390
13.4.	Anti-avoidance rules	390
13.4.1.	General anti-abuse rules (GAAR)	391
13.4.2.	Specific anti-abuse rules (SAAR)	392
13.4.3.	Critical issues in the interaction between GAARs and SAARS and the impact on taxpayers	393
13.5.	Advance rulings	395
13.5.1.	Advance tax rulings	396
13.5.2.	VAT rulings	399
13.5.3.	Administration of advance ruling requests	400
13.5.4.	Effect of rulings	401
13.6.	VAT gap	401
13.6.1.	The definition of VAT gap	401
13.6.2.	Types of taxpayers for VAT purposes	402
13.6.3.	Type of non-compliance	402
13.7.	Compliance costs and costs of collection	403
13.7.1.	Accounting basis and tax periods	404
13.7.2.	Returns and payment of VAT	404
13.7.3.	Interest and penalties	405
13.7.4.	Refunds	405
13.7.5.	Objections and appeals	405
13.7.6.	Time limits	406
13.8.	Conclusions	406

Chapter 14:	**Switzerland** *Claude Grosjean and Niklaus Honauer*	409
14.1.	Neutrality	409
14.1.1.	General	409
14.1.2.	Exemptions/scope of VAT	411
14.1.3.	Right to deduct/VAT refunds	412
14.1.4.	Statute of limitation period	413
14.1.5.	VAT impact on cash flow (impact on working capital)	414
14.2.	Groups and head office – branch transactions	415
14.2.1.	Groups	415
14.2.2.	Head office – branch transactions	418
14.3.	Treatment of financial services	419
14.3.1.	General	419

14.3.2.	Outsourcing activities	420
14.3.3.	VAT deduction – Method	420
14.4.	Anti-avoidance rules	421
14.4.1.	Unwritten rules	421
14.4.2.	Written rules	423
14.5.	Advance rulings	423
14.5.1.	Scope	423
14.5.2.	Validity and effect of advanced ruling requests	424
14.5.3.	Administration of advance ruling requests	424
14.6.	VAT gap	425
14.6.1.	Definition of the VAT gap	425
14.6.2.	Tax fraud	427
14.6.3.	Criminal provisions	428
14.7.	Compliance costs and costs of collection	430
14.7.1.	The responsible authority for VAT	430
14.7.2.	Taxable persons	430
14.7.3.	VAT audits	430
14.7.4.	Rights and obligations connected to VAT registration	431
14.7.5.	Invoice	433
14.7.6.	VAT refund	433
14.7.7.	Reverse charge	434
14.7.8.	Liability for tax payable	434
14.7.9.	Infringement of procedural obligations	435
14.7.10.	Costs of collection	435
14.7.11.	Compliance costs	436
14.8.	Conclusions	436

Chapter 15:	**Ukraine** *Viktoria Tymoshenko*	437
	Introduction	437
15.1.	Neutrality	437
15.1.1.	Taxable activities	437
15.1.2.	Date of VAT output and VAT input recognition	438
15.1.3.	Place of taxation rules	439
15.1.4.	Exempt supplies	440
15.1.5.	Right to deduct/VAT refunds	442
15.1.5.1.	Input tax credits	442
15.1.5.2.	Reverse charge	443
15.1.5.3.	VAT refund	443
15.1.6.	Statute of limitation period	444
15.1.7.	VAT impact on cash flow (impact on working	

	capital)	445
15.2.	VAT groups and head offices – branch transactions	448
15.3.	Financial services	449
15.4.	Anti-avoidance rules	449
15.5.	Advance rulings	450
15.6.	VAT gap	450
15.7.	Compliance costs and costs of collection	451
15.7.1.	VAT payers and registration	451
15.7.2.	Tax audits	452
15.7.3.	VAT invoicing	452
15.7.4.	VAT return	454
15.7.5.	Penalties	454
15.7.5.1.	Late or non-filing of the tax return	454
15.7.5.2.	Late payment of tax	455
15.7.5.3.	Understated tax liabilities	455
15.7.5.4.	Tax evasion	455
15.7.5.5.	Interest for late payments	456
15.7.5.6.	Voluntary disclosures	457
15.8.	Conclusions	457
Chapter 16:	**VAT Neutrality from an EU Perspective** *Ine Lejeune and Jeanine Daou*	459
16.1.	Introduction	459
16.2.	Main features of the EU VAT system	463
16.2.1.	Definition of a taxable person	465
16.2.1.1.	General principle	465
16.2.1.1.1.	Independently	465
16.2.1.1.2.	Economic activity	466
16.2.1.2.	Exclusions	467
16.2.1.2.1.	Public bodies	467
16.2.1.2.2.	Holding companies	470
16.2.2.	Exemptions	471
16.2.2.1.	General principle	471
16.2.2.2.	Example: financial services sector	474
16.2.3.	VAT rates	476
16.2.3.1.	General principle	476
16.2.3.2.	Multiple v. single VAT rate	476
16.2.3.3.	Complexity due to the lack of harmonization	478
16.2.4.	Right to deduct/VAT refunds	480
16.2.4.1.	General principle	480
16.3.	Conclusion	482

Chapter 17: VAT Groups 485
Mandy Gabriël and Herman van Kesteren

17.1. Introduction 485
17.1.1. Several "group arrangements" in the VAT Directive 485
17.1.2. Focus on the (future of the) VAT grouping scheme 486
17.1.3. Basic principles of VAT grouping 488
17.1.4. (Un)justified advantages of VAT grouping 489
17.2. VAT grouping rules according to the European Commission 490
17.3. Current VAT grouping rules in the European Union 491
17.3.1. Not all Member States have introduced the VAT grouping rules 491
17.3.2. VAT grouping in Germany 492
17.3.2.1. Conditions 493
17.3.2.2. Consequences 494
17.3.3. VAT grouping in the United Kingdom 495
17.3.3.1. Conditions 496
17.3.3.2. Consequences 497
17.3.4. VAT grouping in the Netherlands 497
17.3.4.1. Conditions 498
17.3.4.2. Consequences 499
17.3.5. A comparison of VAT grouping in other Member States 499
17.4. Who can form a VAT group? 501
17.5. The notion of a "person established in the territory of that Member State" 505
17.6. All transactions between the members of a VAT group are outside the scope of VAT 509
17.7. All members and activities included 510
17.8. VAT grouping must be open to all sectors 511
17.9. The pan-European VAT grouping scheme 512
17.10 Conclusion and summary 515

Chapter 18: Head Office – Branch Transactions 519
Eleonor Kristoffersson

18.1. Introduction 519
18.2. The recognition of transactions between head office and branches 520
18.2.1. Goods 520
18.2.2. Services 521

18.3.	Allocation of supplies of services	522
18.3.1.	The supplier	522
18.3.2.	The recipient	525
18.4.	The recovery ratio	528
18.5.	The relevance of allocation of costs for transfer pricing purposes	528
18.6.	VAT groups and branches	529
18.7.	Final remarks	529

Chapter 19: Financial Services 531
Ad van Doesum and Gert-Jan van Norden

19.1.	Introduction	531
19.2.	*Ratio legis* of FS VAT exemptions	532
19.3.	Overview of the current FS VAT exemptions	536
19.3.1.	Insurance and reinsurance services	536
19.3.2.	Granting and negotiation of credit	538
19.3.3.	Credit guarantees	539
19.3.4.	Current accounts, payments and transfers	540
19.3.5.	Currency, bank notes and coins	543
19.3.6.	Shares and other securities	543
19.3.7.	Management of special investment funds	547
19.3.8.	Relation to other FS industry-specific taxes	550
19.4.	Effect of FS VAT exemptions	554
19.4.1.	Direct VAT effects and side effects of VAT exemptions	554
19.4.2.	Direct VAT effects	554
19.4.2.1.	General rules for input VAT deduction	556
19.4.2.2.	Input VAT deduction in FS practice	558
19.4.3.	Side effects of VAT exemptions	561
19.4.3.1.	Effects on business's decisions	561
19.4.3.2.	Effects on the corporate structure	562
19.4.3.3.	Effects on the administrative obligations	563
19.4.3.3.1.	Calculation of the portion of deductible VAT	563
19.4.3.3.2.	Accounting	563
19.4.3.4.	Legal uncertainty	565
19.4.3.5.	VAT avoidance	565
19.5.	Difficulties caused by FS VAT exemptions system	566
19.5.1.	Lack of level playing field	566
19.5.2.	Outsourcing and cooperation	567
19.5.3.	Compliance costs	568
19.6.	Current instruments to prevent certain difficulties	568

19.6.1.	VAT grouping	569
19.6.2.	Cost sharing exemption	570
19.6.2.1.	Independent group of persons	572
19.6.2.2.	The independent group supplies taxable services to its members	574
19.6.2.3.	The services are "directly necessary"	574
19.6.2.4.	Exact reimbursement of costs of each member's share of the joint expenses	576
19.6.2.5.	The exemption is "not likely to cause distortion of competition"	577
19.6.3.	Option to tax	577
19.7.	Designing a simple and fraud-proof tax system	579
19.7.1.	Improving the current regime for financial services	579
19.7.2.	Making more radical amendments to the current regime for financial services	581
19.7.2.1.	Should financial services be taxed under a consumption tax?	582
19.7.2.2.	Taxing financial services	584
19.7.2.3.	Zero rating financial services	585
19.7.2.4.	Financial services compensation fund	587
19.8.	Conclusion	588
Chapter 20:	**Anti-Avoidance Rules** *Pasquale Pistone*	591
20.1.	Introduction	591
20.2.	Defining abuse and fraud in VAT	591
20.3.	Preventing tax avoidance within the EU common VAT system	598
20.4.	General and specific anti-abuse measures	600
Chapter 21:	**Advance Rulings** *Madeleine M.W.D. Merkx*	603
21.1.	Introduction	603
21.2.	The influence of EU law on the national tax agreement practice	604
21.3.	Concluding agreements with the Tax Administration and the related consequences under Netherlands law	605
21.3.1.	The approval, the commitment and the tax compromise	605

21.3.2.	Consequences of an approval, commitment or tax compromise for the taxpayer	609
21.3.3.	The consequences of an approval, a commitment or a tax compromise for parties other than the taxpayer	611
21.4.	Horizontal monitoring	613
21.5.	Conclusion	615
Chapter 22:	**VAT Gap from an EU Perspective** *Ine Lejeune and Jeanine Daou*	617
22.1.	Introduction	617
22.2.	Defining the VAT gap	618
22.3.	Analysis of the VAT gap	619
22.4.	Measures to reduce the VAT gap	621
22.5.	Non-EU experience	625
22.6.	Alternative mechanisms to improve VAT collection	627
22.7.	Conclusion	631
Chapter 23:	**Compliance Costs and Costs of Collection** *Ine Lejeune, Wim De Clercq and Mathieu Van De Putte*	633
23.1.	Introduction	633
23.2.	Cost of compliance: What's in a name?	636
23.2.1.	Definition	636
23.3.	Cost of compliance: How big is the burden?	638
23.3.1.	PwC study on the feasibility and impact of a common EU standard VAT return	639
23.3.2.	Ex-ante and ex-post studies with respect to a reduced time frame and the options allowed for submitting summary statements	649
23.3.3.	Paying Taxes 2013 – The global picture	653
23.3.4.	A retrospective evaluation of elements of the EU VAT system	656
23.3.5.	Cost of invoicing	660
23.3.6.	PwC study on the feasibility of alternative methods for improving and simplifying the collection of VAT through modern technologies and/or financial intermediaries	663
23.3.7.	Overview of the size and most important factors influencing the cost of VAT compliance in the European Union	665

23.3.8.	Methodology and constraints	669
23.4.	Conclusion	674
Chapter 24:	**Conclusions: Designing a Simple and Fraud-Proof VAT System** *Ine Lejeune and Jeanine Daou*	677
24.1.	Defining the objectives and design principles	677
24.2.	OECD principles	678
24.3.	Global tax shift – Trends	681
24.4.	The European perspective	683
24.5.	Comparative analysis	686
24.5.1.	Neutrality	687
24.5.2.	VAT groups and head office – branch transactions	688
24.5.3.	VAT grouping	688
24.5.4.	Head office – branch transactions	691
24.5.5.	Treatment of financial services	692
24.5.6.	Anti-avoidance rules	694
24.5.7.	Advance rulings	696
24.5.8.	Cost of compliance and cost of collection	697
24.5.9.	VAT gap	698
24.6.	Conclusion	702
Contributors		703

Sample chapter

Brazil

Celso Grazioli and Elidie Bifano

3.1. Neutrality

The 1988 Federal Constitution establishes the principles of tax law, among them the equality from which tax neutrality derives, as follows:

> Art. 150:
>
> Notwithstanding other guarantees assured to the taxpayer, the Federal Government, the States, the Federal District and the Municipalities are forbidden to:
>
> II – institute different treatment among taxpayers that are in equivalent conditions,...;

Thus, the law must, when creating or increasing tax, seek tax neutrality with regard to the principles of equality and free competition (articles 150, II and 170, IV of the 1988 Federal Constitution).

Nevertheless, certain specific situations or practices adopted by taxpayers may put them in non-equivalent conditions, causing an imbalance in competition relations.

Therefore, in order to prevent these situations or practices from causing such an imbalance, the following provision was introduced in the Constitution:

> Art. 146*:*
>
> A. A complementary law may establish special taxation criteria, with the purpose of preventing imbalances in competition relations, not affecting the competence of the Federal Government, by law, to establish rules with the same purpose. (Included by Constitutional Amendment No. 42, of 19 December 2003)

The special taxation criteria must assure that the tax burden lies equally on all those who are in the same situation, and cannot be an addition to it.

The value added taxes that burden consumption, (i) the tax on operations related to circulation of goods and provision of interstate and intermunicipal transportation and communication services (ICMS); (ii) the excise tax (IPI);

(iii) the contribution to social integration program (PIS); and (iv) the contribution for social security funding (COFINS), conceptually have features of neutrality very similar to those prescribed in the Guidelines from the Organisation for Economic Co-operation and Development (OECD), more specifically the following:

(i) the burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation;
(ii) (businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation;
(iii) VAT rules should be framed in such a way that they are not the primary influence on business decisions.

The other Guidelines:

(iv) with respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid;
(v) to ensure foreign businesses do not incur irrecoverable VAT, governments may choose from a number of approaches; and
(vi) where specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses,

do not apply since carrying out business activities subject to value added taxes requires domicile and residence in Brazil.

The ICMS is a state tax levied on operations related to the circulation of goods and services not taxed by the tax on services of any nature (transportation and communication), regulated by the Federal Constitution, article 155, II, and its uniformity for all states of the federation is assured by general rules provided for by the Federal Constitution, as well as by specific rules provided for by a federal complementary law, which binds all states.

The taxpayer is any legal entity that usually carries out operations related to the circulation of goods, whether their trading or import, or usually provides interstate and intermunicipal transportation and communication services. The Federal Constitution allows the taxpayer to be liable for a tax, the taxable event of which occurs at a subsequent moment: it is the person liable for tax or substitute, which is liable for certain products or segments, for the payment of the tax in the production chain or for their trading, thereby replacing another party in the tax operation.

The calculation basis is, as a general rule, the total amount of the operation, which is determined from the cost of the goods, plus taxes and added to the profit margin.

The internal rates of the tax currently range from 17% to 30% in the various states of the federation. The rates applicable to interstate operations are 7% in operations involving goods addressed to taxpayers located in the states of the north, northeast and centre-west of the country and Espírito Santo, and 12% in operations involving goods addressed to taxpayers located in the south and southeast of the country, except Espírito Santo.

The ICMS complies with the non-cumulative principle (article 155, paragraph 2, item I, of the Federal Constitution), which determines that the tax due in each operation is offset against the tax collected on prior operations, by the same or another state of the federation or, also, by the federal district. The non-cumulativeness applicable to the ICMS complies with the criteria of physical credits. In summary, the constitutional principle of non-cumulativeness, for the ICMS, is seen in the offset, made by the taxpayer itself, of tax debits and credits, recorded in the tax books and related to the purchase and sale of goods.

The credits from the entry of inputs to be used in the manufacture of goods intended for sale or from the purchase of goods intended for sale may be used within five years from the date of entry of the inputs/goods into the taxpayer's establishment. The same term is applicable to the refund of the tax overpaid or unduly paid.

The state legislation provides for the tax calculation period, usually monthly and separately by each branch of the legal entity, but it can be by goods or by goods in each operation. The obligations are considered due at the end of the calculation period and are settled through payment in cash in the month subsequent to the calculation.

If the tax calculation results in a credit balance (more credits from entries than debits from exits), the balance will be transferred to the following calculation period or, depending on its origin,[1] transferred to another establishment of the same legal entity or to third parties, in addition to other

1. The credit balances subject to transfer are those generated by tax-incentivized operations, as is the case of exports of goods abroad in which the exit of goods is not subject to the levy of tax, but the taxpayer is assured of the maintenance of credits from the entry of inputs used in exported goods, either due to the difference of rate in entry and exit of goods, or due to other possibilities provided for by state legislation.

possibilities provided for in state legislation. The transfer requires authorization from the finance department of each state and no term for granting of the authorization is provided for by the legislation.

The IPI is levied on industrialized goods, upon their exit from the establishment that produced them, as well as on goods made in foreign countries, upon their entry into Brazil. The IPI complies with the selectivity and essentiality criteria provided for in the Federal Constitution, and its rate ranges from 0% to 330%, depending on the classification of the goods in the IPI Rate Table (TIPI). The criterion used to determine the rate is guided by the principle of essentiality, with higher rates being applied to goods considered to be superfluous, as opposed to essential goods. Other essential goods may fit into a scenario of calculation basis reduction, deferral or suspension of the tax due.

The constitutional principle of non-cumulativeness (article 153, paragraph 3, item II, of the Federal Constitution), which determines that the tax due in each operation shall be offset against the amount collected on prior operations, is applied to the IPI. The non-cumulativeness applicable to the IPI complies with the criteria of physical credits only, and the crediting of costs and expenses on economic items is not permitted. In summary, the constitutional principle of non-cumulativeness, for the IPI, is seen in the offset, made by the taxpayer itself, of tax debits and credits.

The credits from the entry of inputs to be used in the manufacture of goods or from the entry of imported goods may be used within five years from the date of entry of the inputs/goods into the taxpayer's establishment. The same term is applicable to the refund or reimbursement of the tax in the cases provided for by law.

The tax calculation period is monthly and the payment, in the event of debit balance, is in the month subsequent to the calculation, on the 10th or on the 25th day, depending on the goods.

The IPI credits that, at the end of the calculation period, remain after the deduction of the tax debits, may be maintained in the establishment's tax books, for subsequent deduction of tax debts related to subsequent calculation periods or be transferred to another establishment of the same legal entity, only for deduction of IPI debits in the portion corresponding to tax-incentive credits.

If there are remaining IPI credits at the end of each calendar quarter, the head office may require from the federal revenue the reimbursement of such credits, or use them in the offset of its own debits related to taxes administered by the federal revenue.

The taxable event of the PIS and COFINS contributions is the monthly billing, thus understood as the total revenues earned by the legal entity, regardless of their denomination or accounting classification. The total revenues comprise the gross revenue from the sale of goods and services on own or third-party operations and all other revenues earned by the legal entity. The calculation basis is the billing and it does not include revenues from shipments exempt from contributions or subject to a zero-rate, as well as cancelled sales and unconditional discounts granted, non-operating revenues from the sale of fixed assets, among other exclusions permitted by the legislation.

The rates for PIS and COFINS contributions are 1.65% and 7.6%, respectively.

Effective in December 2002 and February 2004, respectively, with the enactment of Laws 10637/2002 and 10833/2003 and Constitutional Amendment 42/04, a non-cumulativeness regime was introduced for these contributions, in spite of the cumulativeness regime for revenues, segments and activities specified by law. The non-cumulativeness applicable to the PIS and COFINS complies with criteria determined by the legislator, consistent in the recognition of physical and economic credits. In summary, the non-cumulativeness principle, in the case of these contributions, is carried out through reduction of the amount of tax payable on the gross revenue, with the application of the rates of these contributions on credits calculated on costs and expenses incurred in the development of the business activity.

The calculation period of the contributions is monthly and the payment, in the event of debit balance, is in the month subsequent to the calculation.

The credits of the PIS and COFINS contributions calculated as provided for by the law, which cannot be used in the deduction of debits of the respective contributions, can be subject to reimbursement only after the end of the calendar quarter, if derived from costs, expenses and charges linked to revenues from operations related to the export of goods abroad, provision of services to individuals or legal entities residing or domiciled abroad, the payment of which represents inflow of currency, and sales to export trading company, with the specific purpose of export or sales made with suspension,

exemption, zero-rate or non-levy. Alternatively to the reimbursement, the legal entity may offset the credits of the PIS and COFINS contributions against any tax administered by the Brazilian federal revenue.

The credits on costs, expenses and charges linked to revenues may be used within five years from the date on which they could have been recorded. The same term is applicable to the refund or reimbursement of the tax in the cases provided for by the law.

3.2. VAT groups and head office – branch transactions

Brazilian VAT legislation does not apply for a VAT grouping regime. Furthermore, head office – branch transactions follow the basic rules of VAT, as laid down in this chapter.

3.3. Financial services

Financial services are not within the scope of VAT in Brazil. Instead they are subject to taxation by the tax on services of any nature (ISS) and collected by the municipalities on services related to the banking or financial industry, including those provided by financial institutions authorized to operate by the federal government or by an authorized party. The services taxed by the ISS are described in a specific list, attached to Complementary Law 116/03,[2] approved by the Brazilian congress, which introduces general ISS rules to be complied with by all municipalities. This tax, however, is cumulative and is not included in the category of value added taxes.

Moreover, the revenue earned by the financial institutions is taxed by PIS and COFINS social contributions, under a specific regime that permits that these entities may deduct from the calculation basis of these taxes all the financing cost of their operations (financial expenses). Currently, the concept of revenue, in financial institutions, is under examination by the Federal Supreme Court, which will decide, from the constitutional point of view, whether these contributions are to be levied on all revenue earned by these entities, thus understood as the revenue arising from the provision

2. In the Brazilian legal system, a complementary law has the function of supplementing the federal constitution and, especially in tax matters, provides for the general rules applicable to all federated entities (federal government, states, federal district and municipalities). It must be approved by the congress.

of services and from the perception of bank spread, or only on the revenue arising from the provision of services. The core issue is exactly the extent of the concept of financial services.

3.4. Anti-avoidance rules

An anti-avoidance rule is traditionally considered the legal provision that establishes the ineffectiveness of legal acts or businesses carried out with the purpose of reducing or eliminating taxes that would be due if acts or businesses with identical results were adopted. The expression "anti-avoidance rule" in Brazil has led to much debate because the avoidance, from the point of view of the Brazilian prevailing opinion and case law, is the reduction or elimination of the tax charge through the use of lawful instruments, provided for within the system, as opposed to evasion, which is the reduction or elimination of the tax charge through the use of instruments not permitted by law, therefore, by using illicit acts. Some people suggest, maybe in contrast to the internationally accepted anti-avoidance rule, using the expression "anti-abuse rule" or rule preventing abnormal or unusual practices. Besides being the question of terminology, much discussion has taken place about the possibility of introducing such a rule in the legal system, which prohibits the taxation by simple analogy or as a result of the economic interpretation of the legal and tax facts.

With the enactment of Complementary Law 104/01, approved by the Brazilian congress, a sole paragraph was introduced to Article 116 of the Brazilian Tax Code, which provides that:

> Art. 116
>
> Sole paragraph. The administrative authority may disregard legal acts or businesses practiced with the purpose of concealing the occurrence of the taxable event of the tax or the nature of the elements constituting the tax obligation, with due heed to the procedures to be established in a statutory law.

This provision immediately gained the incorrect designation of anti-avoidance rule, a feature that it does not have if we consider the concept of this type of rule from the point of view of the Brazilian prevailing opinion and case law and if we examine the purpose of the sole paragraph, which is not in line with the prevailing legal system. In fact, the legal provision means that the tax authority may disregard, in the calculation of the tax, acts or businesses carried out with a purpose different from that established by law for that business. To achieve a purpose different from that established by

law, in a business, one may act in a lawful or illicit way, the first category comprising avoidance and the second one comprising evasion. With regard to lawful actions, the legal system itself describes several procedures that permit achieving a purpose different from that established by law and that may be practiced by the taxpayer in the organization of its business, such as indirect business and fiduciary business[3]. Nevertheless, there are situations provided for by the system that, if practised, place the adopted procedure at the risk of challenge, such as the abuse of law, the abuse of corporate entity, fraus legis, and simulation.

Many doubts have arisen in relation to the above legal provision, given the wording adopted: is it an anti-sham rule, only for tax purposes, for talking about concealment or has the legislator introduced a general anti-abuse rule by allowing the disregard of legal acts or businesses. Therefore, in view of so many inquiries, what may the authority disregard and what are their drivers for this?

It seems that the actual objectives of the legislator are clear at the end of the sole paragraph, that is, in the expression "[…] with due heed to the procedures to be established in a statutory law". If this is the case, the discussion about the nature of the rule (anti-abuse, anti-sham or anti-avoidance) should be ruled out since the authority can only apply it if the procedures for this are defined in law. This provision, therefore, lacks a regulation describing in detail the procedures that the authorities should follow in order to consider that the legal business adopted by the taxpayer is a sham, abusive, abnormal or absolutely lawful, with the purpose of avoiding the levy of tax, which is permissible.

Some other aspects of this rule deserve separate comments: the disregard of an act or person, under the terms of the civil law, is a procedure that should be defined by the court. This is a reason why a tax agent alone should not carry it out, and the taxpayer, if this has occurred, has to have the right to object. Therefore, in the wording of the provision the objective criteria must be defined under which the tax agent may conclude that the taxpayer's action or business is susceptible of being disregarded, in tax terms. On the other hand, the introduction of the word "concealment" in

3. Both are Brazilian legal expressions. Indirect business means the use of another contract in order to get the same result. Fiduciary business means the *fideicomisso* or some transaction similar to the trust.

the provision adds an element not known in Brazilian law, which is not sufficient to characterize a rule as anti-sham, since the simulation is defined in the civil law.

The sole paragraph of article 116 of the Brazilian Tax Code is only a procedural rule to determine the undue use of a legal element in order to gain a tax advantage, thus not featuring as an anti-avoidance rule, as traditionally accepted. The requirement to regulate such a provision entails the impossibility of applying it, while this does not occur, in view of the Brazilian legal system.

Therefore, a general rule that consists in the regulation of the procedures to identify businesses that, due to their nature, are abnormal in the course of social activities, would be compatible with the Brazilian legal system. The requirements to characterize the use of an element as abnormal should be restrictive and, if not met, cumulatively, the act or business would be lawful, also for tax purposes. Any other hypotheses would automatically be considered illicit, being thereby characterized as evasion.

The vehicle used to introduce these rules was the complementary law[4] and the matter addressed in the sole paragraph is included in the category of general tax rule that should be applicable to all taxing entities (federal government, states, federal district and municipalities), since disregarding it may have effects in other collection spheres, which can only be resolved by a complementary law.[5] The regulation of the sole paragraph itself requires, therefore, a complementary law under penalty of the challenge of its constitutional validity, and the mention, in the sole paragraph, of the use of a statutory law to regulate the procedures for disregard is incompatible with the Brazilian legal system.

Some federal entities have introduced their own anti-avoidance rules, which show the difficulty in regulating the matter. Thus, the State of São Paulo[6] enacted State Law 11001/01, which through its article 2, added article 84-A to the State Law 6374/89, to determine that "the tax authority may disregard legal acts or businesses practiced with the purpose of concealing the occurrence of the taxable event of the tax or the nature of the elements constituting the tax obligation", assigning to the tax agent powers that are not

4. *Supra* n. 1.
5. Under Brazilian constitutional law, there are several issues that have to be regulated by complementary law. This kind of law needs a special national congress quorum.
6. São Paulo is the most populous and developed and the richest state of the Brazilian federation, accounting for 31% of the Brazilian GDP.

delimited by transparent processes. The Municipality of São Paulo[7], through Municipal Law 14133/2006, article 6, required the municipal tax auditor, with due heed to the Attachment II of the same law, to"[…] disregard legal acts or businesses practiced with the purpose of concealing the occurrence of the taxable event of the tax or the nature of the elements constituting the tax obligation", pursuant to paragraph 2, of article 19 of the same law. This contains references that the tax agent should observe, among them the lack of business purpose or the abuse of form, expressions not covered by the Brazilian legal system and which are rather subjective. Furthermore, the law authorizes the use of indications and presumptions, which is prohibited by the Brazilian tax system.

It may be concluded that the Brazilian legal system does not have a general anti-avoidance rule or a specific anti-avoidance rule, but has only general provisions that permit, in an unconstitutional way, that the tax agent may disregard legal acts or businesses that he presumes to be practised with the purpose of concealing the occurrence of the taxable event of the tax or of the elements constituting the tax obligation. In general, the laws that deal with the disregarding of legal business were not subject to regulation either, and there is no adequate description of the procedures that the authorities should follow to reach such a conclusion.

For many years the administrative courts have issued different decisions regarding avoidance, that is the lawful saving of taxes. In the past, the decisions were guided by the consideration of the compliance with legal formalities inherent to the intended business, while, more recently, the reason for and the economic substance of the transactions prevails. Even so, the concept of avoidance as lawful saving is maintained and the taxpayer must demonstrate it in each concrete case. With the introduction of sole paragraph of article 116 of the Brazilian Tax Code, some attempts have been made to link lawful avoidance to sham and fraud, which contaminates the business environment, creates insecurity in private relationships and places at risk all and any intended planning and, many times, the application of the law itself.

3.5. Advance rulings

The institute of advance rulings in Brazilian law was introduced in the mid 20th century, by act of the federal government, Federal Decree 70235/72,

7. São Paulo is the most populous and developed and the richest city of Brazil, accounting for the third largest GDP of Brazil.

which became a rule subsequently adopted by the federated states, by the federal district and by the municipalities. The legislation of each federated entity has variations, but the outlines of the advance ruling are the same, from the legal standpoint. This is why we will focus only on the provisions of the federal legislation on this matter.[8]

The advance ruling, with regard to tax matters, should not be confused with the right to information that all Brazilian citizens have (article 5, XXXIV, "a" of the Federal Constitution) due to its nature and effects. The advance ruling is a request for procedural guidance on the application of a rule involving taxes to a concrete case, submitted by the interested party, which once answered, binds the authority and the taxpayer, in administrative terms. The advance ruling is guided by the principle of legal certainty contained in the Federal Constitution, considering the complexity of the tax system, the multiple rules that exist and the effects that the undue application of the tax rule may have in the Brazilian economy as a whole.

The advance ruling, provided for by Federal Decree 70235/72[9], has not only inspired state and municipal legislation but it has also been adopted for all federal taxes, including those subject to the value-added regime, in the case of IPI, PIS and COFINS. At the state and municipal levels, the advance ruling process is identical for all taxes collected by the same taxing entity, there being no methodological or legal difference in its formulation in view of the type of tax. The coverage of the institute is wide, involving any rule of the tax legislation applicable to a certain fact, irrespective of whether the transaction to which it is bound corresponds to a future or present situation or a situation that occurred in the past, as long as it is not under audit by the tax auditors and it has not been subject to assessment notice. The matter covered by the advance ruling should correspond to a doubt on the application of the law in relation to a concrete case involving a principal obligation (payment of tax) or an accessory obligation (positive or negative action required from the taxpayer or responsible party in the interest of the collection of tax or of the tax audit).

The advance ruling, like all administrative acts, is subject to the principle of publicity, and should be published by the official press of the federal government, states, federal district and municipalities, to become valid. Nothing prevents the authorities from modifying their understanding after

8. Brazil has 26 states, the federal district and 5,565 municipalities, all with legal and tax autonomy within their competence.
9. Decree 70235/72 was changed, in several provisions, by Law 9430/96, without, however, losing the essential features being discussed here.

the publication of an advance ruling: this change is subject to publicity (new ruling) and will affect only the taxable events that have occurred after its communication to the interested parties or after its publication.

No matter to which federal entity the advance ruling is addressed, the following requirements, provided for by law, must be observed, both by the taxpayer and by the tax authorities:

(i) parties to the advance ruling or consultants: *exclusively* the taxpayer of the principal or accessory tax obligation, the tax substitute, the party liable for the tax, the bodies of the public administration or the entities representing economic or professional categories, in the name of their associates, all of them requesting taxpayers, identified and characterized by their location and activity;
(ii) object of the advance ruling: provision of the tax legislation, duly indicated, applicable to a certain fact, clearly described, identifying in detail the doubt raised. An advance ruling on a theoretical matter is forbidden;
(iii) presentation of the advance ruling: in writing, there being no verbal or previous discussion of its content with the authorities;
(iv) place of presentation of the advance ruling: jurisdiction of the tax domicile of the requesting taxpayer, addressed to the local body of the entity responsible for administering the tax covered in the advance ruling;
(v) elements of proof of the claim: besides the petition describing the issue that is the subject of the advance ruling, there is the possibility of attaching proofs of the binding of the situation under examination to the mentioned legal provision, in order to assure the intended understanding.

An advance ruling on past-due debt, assuming an unfavourable ruling to the requesting taxpayer, is considered to be spontaneous denunciation, i.e. voluntary confession, up to the date of its filing, as long as the corresponding payment is made within the term provided for by law.

There is no special legal provision regarding the submission of an advance ruling by a non-domiciled or non-resident taxpayer. This would not even be necessary for two different reasons: (i) non-domiciled or non-resident taxpayers, for tax purposes, are taxed at source, since they are not required to file a tax return or prepare financial statements and are, therefore, payers of the tax obligation in Brazil and, as such, fulfil the first formal requirement for submission of the advance ruling, that is, a legal interest; (ii) as taxpayers, although taxed at source, non-domiciled or non-resident taxpayers cannot be distinguished from the taxpayers domiciled or resident

in Brazil by force of the principle of equality that assures the latter access to the pronouncement of the public authorities, in the case of advance ruling. Regarding the accessory obligations, in certain circumstances, non-domiciled and non-resident taxpayers are even required to register as taxpayers in Brazil.

Non-domiciled taxpayers that hold investments and interests in Brazil must comply with the tax legislation, directly or through a legal representative (solicitor, nominee), residing in Brazil, duly qualified, Brazilian or not, constituted in the country of origin or locally. The advance ruling may be submitted directly by the non-domiciled or non-resident taxpayer or by its representative. The comments already made in relation to the institute of the advance ruling, in general, are applicable in the event that the requesting taxpayer is non-domiciled or non-resident.

In contrast to the full efficacy of the advance ruling submitted in strict compliance with the law, there are situations in which it is considered by the authority to be ineffective and without any effect, and especially failing to protect the requesting taxpayer. Included in this situation are:

(i) advance rulings submitted in contravention of the legal provisions regarding the requesting taxpayer, its object, form, presentation and the jurisdictional authority to which it is addressed;
(ii) advance rulings submitted by the taxpayer that has been notified to comply with the obligation related to the facts that are the subject of the private letter;
(iii) advance rulings submitted by the taxpayer under tax proceedings started to examine facts related to the matter addressed;
(iv) advance rulings submitted regarding a fact that has already been the subject of a prior decision, not yet modified, expressed in an advance ruling or litigation in which the requesting taxpayer was a party;
(v) advance rulings submitted regarding a fact established in a normative ruling, published before its submission;
(vi) advance rulings submitted regarding a fact defined or declared in a literal provision of the law;
(vii) advance rulings submitted regarding a fact defined as a crime or misdemeanour;
(viii) advance rulings submitted without describing, completely or exactly, the issue to which it refers;
(ix) advance rulings submitted without containing the elements necessary for its ruling, except if the inaccuracy or omission is excusable, at the discretion of the authority deciding on the request.

Under the law, the authority deciding on the request is responsible for declaring the inadmissibility of the advance ruling, in the cases described above. The administrative authority cannot express an opinion on an advance ruling that deals with constitutionality of the tax legislation, which is the exclusive competence of the Federal Supreme Court.

At the federal level, and as a condition for the validity of the advance ruling, it should be submitted in the jurisdiction of the tax domicile of the requesting taxpayer, addressed to the local body of the entity responsible for administering the tax dealt with in the advance ruling. The tax domicile is not to be confused with residence and is the place where people, individuals or legal entities fulfil their obligations and claim their rights, in tax matters. Federal taxes are audited, charged and collected by the Brazilian Federal Revenue Service, a body of the Ministry of Finance which comprises several departments, among them the Coordination of the Taxation System, responsible for examining the claims on the taxes in general, including the value added taxes. In the several states and municipalities, the local laws determine the form in which the advance ruling is submitted, including the competent body to receive it, and these bodies are subject to the state finance secretaries and municipal finance secretaries. The responsible official assigned to this task does not receive any special qualifications, always being included in the general category of tax auditors of the national, state or municipal treasury allocated to the function of responding to the advance ruling.

The ruling is published in the official press. At the federal level, if there are different conclusions among published rulings related to the same matter based on an identical legal rule, a special appeal can be filed, within 30 days from the notification of the ruling, without supersedeas,[10] to the competent authority. The responsible official who is aware of the divergence can also submit a petition, at any time, to clarify the issue. The taxpayer that is aware of a ruling diverging from that which is being given, as a result of an advance ruling it has previously submitted, can file a special appeal within 30 days from the publication of the new ruling. The authorities must publish a formal act on the ruling regarding this divergence, thereby standardizing the ruling for all taxpayers.

A condition for the validity of the advance ruling, as already mentioned, is that it must be submitted in writing. No oral discussions or previous formal

10. In procedural matters, eliminating the supersedeas entails that the appealed decision must be immediately applied.

hearings of the authority regarding the advanced ruling that is intended to be submitted or to hearings subsequent to the formal rulings, assuming that it is negative to the requesting taxpayer, are permitted.

No term is established by law for the authorities to express their opinion on the matter. This is a relevant issue in the Brazilian context, since if the advance ruling is an element that permits the taxpayer to avoid risks, in the name of legal certainty, and even though it cannot be charged for a tax or penalty while a ruling is still pending on this issue at hand, such a delay always has damaging effects. The delay in obtaining a ruling may also discourage the taxpayer in applying for it.

In the states and municipalities, the local laws determine the form by which the advance ruling is submitted. In the State of São Paulo, for example, the taxpayer that submits an advance ruling on an identical matter, already previously decided, will receive a copy of the prior response, and the new process is filed. Also in the State of São Paulo, if a divergence among rulings given for the same matter is identified, grounded on an identical legal rule, the requesting taxpayer may file a request for reconsideration, within 15 days from the notification of the ruling.

The right to request an advance ruling from the administration due to doubts that the taxpayer has may be exercised at any level (federal, state or municipal), without the payment of any fees, in line with the provisions in article 5, XXXIV, of the Federal Constitution, which assures all persons the right to petition, to the public authorities, in defence of rights or against illegalities, without any payment. The use of advance rulings to dispel doubts is usual, as may be concluded from the number of rulings published only in the Official Gazette of the federal government, in some jurisdictions.[11]

The advance ruling, submitted with due heed to the formal requirements of validity, has the following main effects:

11. Brazil is divided into ten superintendencies of the federal revenue, each of them divided into offices, located in the big cities, which are divided into several specialized bodies (more than 15). Of these bodies, only the Superintendence's Collection Division of the 9th Region, DISIT 09, issued, between January and November 2011, 233 rulings on several taxes, including non-cumulativeness of PIS and COFINS; DISIT 08 issued 317 rulings and DISIT 04, 108, all in the same terms described herein; the Customs Administration Division, DIANA 09, issued 112 rulings on tax classification, in the same period. Such data, a small portion of the total in Brazil, refers only to the federal government, which is a reason why it is very difficult to determine accurately the number of advance rulings submitted and the rulings issued.

(i) mandatory binding of the tax authorities and optional binding of the requesting taxpayer regarding the content of its decision; the latter may resort to the judiciary power if it does not agree with the ruling;
(ii) prohibition of starting a tax proceeding on the matter covered in the advance ruling and of imposing penalty in the event tax is due;
(iii) suspension of the requirement of paying the tax, related to the object of the advance ruling, from its submission to the 30th day subsequent to the date of notification of the decision and, if this is the case, the payment of the tax due up to this date must be made;
(iv) validity of its effects only for the interested requesting taxpayers, in spite of the publication of the ruling;
(v) subsidiary use in the administrative defence of third parties, non-requesting taxpayers, in a similar matter;
(vi) lack of suspension of the term for payment of the tax, withheld at source or self assessed, before or after its submission, or the term for filing the tax return;
(vii) applicability, in its effects, in the event it is submitted by an entity representing an economic or professional category, to associates or affiliates, after notifying the requesting taxpayer about the decision.

The ruling binds the tax authorities until: (i) a new ruling is given on the same matter in an advance ruling submitted by another taxpayer and the matter submitted to a new examination is given, in a ruling on divergence, a different treatment; or (ii) there is a change in the legislation, followed by new guidance. The ruling is valid while it is compatible with the system, not having a term for application determined by law or by the authority.

Under no circumstance may the authority fail to express its opinion on the advance ruling request submitted by the taxpayer. The administrative advance ruling processes, at the federal level, are decided in a single court and no request for reconsideration of the ruling or of the order declaring its ineffectiveness may be filed. In these two situations the taxpayer can use the judiciary power to avoid any damage; if it does not agree with the content of the ruling, the taxpayer may resort to the courts, which is the sole option that remains to claim the loss that may derive from the administrative decision, since the ruling is not subject to appeal. In the states and municipalities, the local laws determine whether the rulings are subject to appeal or not.

There are no courts specialized in tax matters in Brazil, so if the matter involves a federal tax the federal courts should be approached: at the lower court, by appeal to the regional federal court of appeals (Brazil is divided into regions for this purpose) and ultimately to the Superior Court of

Justice, except if the matter involves constitutionality, in which case it will be examined by the Federal Supreme Court. If the matter involves a state or municipal tax, the state court is competent to take cognizance of the matter, the State Court of Justice to take cognizance of the appeal and the Superior Court of Justice to render a definitive decision, except if there is a matter involving constitutionality to be examined, when the competence will rest at the Federal Supreme Court.

The Federal Supreme Court is not unaware of the effects of the rulings, having already decided that an indemnity is applicable as a result of damages caused to the taxpayer due to the adoption of a ruling given by the state tax authorities. Likewise, the Regional Federal Court of the Third Region granted a preliminary injunction to assure to the taxpayer the use of a ruling given before the change of the law. Legal proceedings in Brazil are permitted a large number of appeals, for both parties, tax authorities and taxpayer, which is associated with the high volume of lawsuits filed at all levels of the judiciary and which leads to lengthy waiting periods in order to obtain final decisions on any matter.[12]

3.6. VAT gap

The Brazilian legal system establishes various penalties in the event the taxpayer does not pay the tax due or fails to comply with a related obligation. In the event of simple non-compliance with these obligations, the law determines the automatic application of a fine that must be paid by the taxpayer, irrespective of any action by the public authorities: this is known as the fine for default on the obligation, sometimes designated as default fine, along with the collection of interest. The default fine is considered to be a tax penalty of a civil nature and its constitutionality has often been discussed since the Brazilian legal system provides for the possibility of the taxpayer making a spontaneous denunciation, i.e. voluntary confession, paying the tax with interest, without any fine.

In other circumstances, however, the lack of payment or the non-compliance with the accessory obligation entails violation of the general rules, a violation that must be investigated by the tax auditors in a proper procedure that results in the issue of a tax assessment notice. The fines imposed as a result

12. There is recent data of the ministry of the federal government's attorney general that estimates eight years as the average term for obtaining a final and unappealable decision for simpler cases, and 16 years for more complex cases, which before the judiciary.

of a tax audit process are called punitive fines and the nature of the violation, intended or not, is a factor in establishing its amount. The fines imposed by the tax authorities, at the federal level, range from 75% to 150%, the latter being imposed when there is evident intention of fraud. This fine can also be imposed when tax evasion and collusion are proven.

Fraud, in accordance with the law, is any malicious act or omission intended to prevent or delay, fully or partially, the occurrence of the taxable event of the principal tax obligation, or to exclude or modify its essential features, in order to reduce the amount of the tax due and avoid or defer its payment. Evasion is any malicious act or omission intended to prevent or delay, fully or partially, the knowledge by the tax authorities: (i) of the occurrence of the taxable event of the principal tax obligation, its nature or material circumstances; (ii) of the personal conditions of the taxpayer, susceptible to affecting the principal tax obligation or the corresponding tax credit. On the other hand, collusion is the malicious arrangement between two or more natural or legal persons, aimed at any of the afore-mentioned effects. The fine arising from the fraud has a tax penal nature and is, not rarely, accompanied by an indictment by the Public Prosecutor's Office to be classified as crime against the tax order. The payment of the tax, together with a fine, extinguishes the punishment as a penal matter, even if the payment is made after the sentence, in a final and unappealable decision, as decided by the Federal Supreme Court.

In the case of accessory obligations, especially the withholding at source without subsequent payment, the illicit act is characterized as the omission of payment, and the source is characterized as a bad faith depositary, subject to civil penalties rather than to criminal penalties.

The law may assign the liability for the tax payment to a third person, linked to the taxable event of the tax obligation, excluding the taxpayer's liability or assigning it on a replacement basis. Under these conditions, the following are liable for the payment of the tax: (i) successors of assets, in general (properties and establishments); (ii) parents, for the taxes due by their children; (iii) guardians and conservators, for the taxes due by the wards; (iv) administrators of third parties' assets, for the taxes due by them: (v) administrators, for the taxes due by the estate; (vi) trustee, for the taxes due by the bankrupt estate; (vii) notaries public, for the taxes due on the acts they conduct; (viii) partners, for the taxes due on the company's liquidation; (ix) partners, directors, managers, representatives of private companies and their nominees, as a result of management in disagreement with the bylaws/

articles of incorporation. In matters of penalty, only the fines called default fines can be charged from third parties, since the punitive fines are the exclusive responsibility of the party that acted contrary to the law.

In the past years the tax legislation has been improved to meet local control requirements, and to avoid international tax competition. With regard to the collection control, at the three taxation levels, measures were adopted that assured and increased the collection: (i) increase of levy at source, reducing the tax audit only to the paying source; (ii) transfer of the duty of paying the tax, in the production chain, to the industrial producer that carries out the first exit of the goods (tax substitution regime) in the case of taxes levied on consumption; (iii) introduction of transfer pricing rules on the import and export of goods, services and rights; (iv) transfer of the payment of the tax, in the case of operations related to the purchase of inputs, with individuals and cooperatives of producers, especially in agribusiness, to the end of the chain, before the delivery to the final consumer; (v) introduction of a special tax audit system for the major taxpayers, with the authority remaining in the taxpayer's establishment, for long periods, and following the daily activities; (vi) special service for major taxpayers, in specialized offices; (vii) centralization of the payment of certain taxes in a single establishment; (viii) authorizations to transfer tax credits among the taxpayer's establishments and to third parties; (ix) investments in education and preparation of tax auditors; (x) introduction of information crossing among documents and among taxpayers.

Recently, a public digital bookkeeping system (SPED) was introduced, through which all corporate accounting and tax documents are transmitted by digital means to the authorities, so that the tax audit may be carried out on time and on a comprehensive basis. This instrument is intended to reduce tax bureaucracy, increase the level of compliance with tax obligations in general and reduce the costs of collection. The SPED is adopted at the federal and state levels; the big municipalities already have their digital bookkeeping systems, which, however, are not yet integrated with the federal government and the states.

There is no official data available on the: (i) eventual savings or reduction of the cost of complying with the bureaucracy generated in the tax system, as a result of the implementation of some or all of the measures discussed here; (ii) the nature of the taxpayers, type of activity or location linked to taxes not collected; (iii) the amounts of taxes not collected.

In Brazilian tax law, the principle that the burden of proof is on the party that alleges the fact is widely accepted. The authority, therefore, when accusing a taxpayer of an illicit act must identify it fully, demonstrate the amount of the tax not collected or the accessory obligation not complied with and typify them, indicating the violated rule and its consequence. There is no presumption of fault or innocence and, based on the Federal Constitution, article 5, LV, the accused parties will be assured, in general, of a judicial or administrative proceeding, the adversary system principle and a full defence, with all means and resources inherent to it. The business of the taxpayer will continue normally during any audit by public authorities, even if there is a presumed illicit act. This occurs irrespective of the entrepreneur being considered guilty, since the entity is not to be confused with its administrator or responsible officer. The only case in which there would be a cessation of activity would be the business practice itself be considered illicit.

During the investigation of an illicit act, the taxpayer has the obligation to respond to the tax auditors, answering all questions regarding the tax matter under investigation and providing the requested documents (information, documents, files, balance sheets, etc.). There are specific penalties for those who do not provide information or hamper the investigation by any means. Corporate accounting documents kept in good order constitute a proof in favour of the taxpayer, in tax matters. At the federal level, the investigation takes place at two levels: the tax authorities, and police authorities and representatives of the Public Prosecutor's Office whenever there is a suspicion of a crime against the tax order. When the investigation by the tax authorities is finished, the tax assessment notice is issued and a fine is imposed, with the detailed description of the illicit act, its legal classification and the amounts of the tax due. With regard to the investigation by the police or Public Prosecutor's Office, a police investigation and a criminal process against the taxpayer is opened if there are reasons to do so. It should be pointed out that while there is no administrative decision it will not be possible to proceed with the criminal case, since the latter depends on the former.

The tax authorities have five years from the taxable event to assess the tax, thus constituting the tax credit. In the event of proven fraud, the authority has, with regard to income tax, another six months to make the assessment. This term has a preclusive nature and is not interrupted. Once the tax is assessed and the credit constituted, the tax authorities have five years to charge them, and this term has a preclusive nature since it may be suspended for the reasons described in the law.

3.7. Compliance costs and costs of collection

The accessory obligations involving value added taxes in Brazil today represent a very high cost for taxpayers for the following reasons: (i) there are many such obligations, because of the number of taxes and for the number of taxing entities; (ii) they are complex, repeating the same informational content in different obligations; (iii) they are not neutral, since they affect the economic activity as a whole; (iv) they are not efficient since they do not serve as a facilitating instrument of collection either for the public authorities or for the taxpayer; (v) they do not admit of any flexibility or offset among them; (vi) they require a high number of employees for compliance with them; (vii) non-compliance is punished with very burdensome fines, sometimes in an amount equivalent to the amount of the tax itself.

There is no official data from the Brazilian government on the costs associated with the compliance with accessory obligations. Some independent and reliable institutes in the business environment have made surveys about the matter in respect to taxpayers; however, with regard to public authorities the exact number of persons, budget, assessment notices and penalties imposed in relation to the value added taxes are not known. What is known is the amount of value added tax that was collected in several years, as disclosed by the Brazilian Federal Revenue Service.

The value added taxes in Brazil are not administered by specialized bodies, as they are the responsibility of the following authorities: (i) PIS and COFINS, federal taxes, owed by the legal entity (company) with head office in Brazil, including the branches of foreign companies authorized to operate locally that are assimilated, for tax purposes, to Brazilian domiciled companies, are checked and collected by the Brazilian Federal Revenue Service, a body subordinated to the Ministry of Finance; (ii) ICMS, a state tax, owed by the establishments located in the States and not by the legal entities, is checked and collected by the finance departments of the states and of the federal district. The taxes that are levied on foreign trade (import and export) are federal taxes owed by the legal entity (company) also checked and collected by the Brazilian Federal Revenue Service. The taxpayer-legal entity or establishment is required to register with the collecting agency, keep the books and documents required by law and meet the legal notice and requirements of the public authorities relating to the respective taxes.

The accessory obligations of federal and state value added taxes are presented in digital form (SPED), through the Internet, but they are not made available to third parties, except other bodies of the Government and, even

then, as provided for by law. All documents in Brazil are prepared in the Portuguese language. Non-domiciled taxpayers are not rightful taxpayers of these taxes, which is the reason why they do not have any accessory obligation in relation to them.

The federal and state value added taxes have a monthly calculation period, and should be paid in the immediately following month. The amount of the tax to be collected is the amount calculated on the operations subject to its levy less the amount of the credit corresponding to the inputs and expenses authorized by law. The credit not used in a month can be used in the following month, without adjustment for inflation. The tax should be paid by the taxpayer through the use of a specific payment document, in an institution of the financial system authorized for this. The tax paid after the established term is subject to interest.

The taxpayers should fill in specific documents on the federal and state taxes paid, as well as books and documents with the monthly movement of entry and exit of goods and merchandise. Currently all these books and documents are electronic, transmitted online by the authorities.

3.7.1. Penalties

In Brazil administrative penalties for non-payment of tax are calculated on the unpaid amount, in percentages that vary, depending on the taxing entity (federal government, states, federal district and municipalities). For federal taxes, the fines can be default fines or punitive ones. The default fine is 20% and must be paid by the taxpayer, regardless of any actions by the public authorities. Because in Brazil there is the element of voluntary disclosure that permits the payment of the tax only subject to interest, this fine is considered to be unconstitutional. The punitive fines are: (i) 75%, “ex officio” fine, imposed by the authority, which can be reduced to half if paid within 30 days, if the taxpayer gives up his right to object and decides to pay the tax liability; (ii) 150%, aggravated fine, imposed by the authority when there is evident intent of fraud by the taxpayer. The default and punitive fines must be paid together with the tax, plus interest calculated on the basis of the SELIC rate, a financial reference rate used by the Brazilian government and calculated by the Special System for Settlement and Custody of Public Securities (SELIC).

Other consequences may derive from the lack of payment of tax or non-compliance with accessory obligations, such as: (i) refusal by the

public authorities to grant a debt clearance certificate (CND) while the tax is not paid, with all applicable charges. The CND is a document essential to participate in bids conducted by the government, to operate in foreign trade and to record corporate acts, among other things; (ii) a statement of the company's invalid enrolment, due to non-compliance with certain accessory obligations, entailing a statement of lack of credibility of the documents issued by it, including to third parties.

In the event of an aggravated fine (150%), the taxpayer has been convicted in a criminal proceeding, with the application of sanctions depending on the nature of the infraction, which may vary from the provision of community services to the penalty of imprisonment. There are no penalties that entail the cessation of activity by the company or establishment, except if the activity is considered to be illicit.

3.8. Conclusions

There is no available data from the public authorities to examine the effectiveness or ineffectiveness of the tax model adopted in Brazil. Some work has been done by important Brazilian and foreign entities, not linked to the public authorities.[13]

The costs of calculating and pay taxing in Brazil, not the tax itself, have therefore been traditionally recognized as very high, in companies, either regarding persons who meet the legal requirements or concerning the contracting of internal or external specialists in order to interpret and follow up on the law. Thus, the high number of taxes required by different taxing entities and their corresponding rates require from companies the maintenance of persons able to meet such requirements, to avoid further damage. The companies' tax departments are organized with specialists in the various taxes and, furthermore, they act as a liaison with lawyers and external consultants and deal with tax auditors. All this requires time to comply with the bureaucracy and does not apply to production activities. There is data showing that a substantial portion of the GDP is used for this type of task.

13. *See* in this regard: PwC and World Bank, *Paying Tax 2011* (November 2010), available at http://www.pwc.de/de_DE/de/steuerberatung/assets/Studie_Paying-Taxes-2011.pdf (accessed 30 January 2014); CND Costs, 2006 and 2009, developed by PWC; several studies developed by the Brazilian Institute of Tax Planning; studies developed by the Brazilian-American Chamber of Commerce, in partnership with the International Finance Corporation, São Paulo Trade Association, among other organizations.

The Brazilian tax model, with the ICMS collected by the states and not by the federal government, affects the application of and compliance with tax, since in Brazil there are 26 states and the federal district that legislate on the matter and it is the taxpayer's task to interpret this set of very complex laws. Moreover, the substitution regime (payment of the tax levied on the consumption chain, in advance, by the producer) removes from the taxes their characteristic of being levied on the sales revenue, so that they are levied on a presumed basis, in disregard of the business conducted and market rules. The discussion regarding the full use of the expenses incurred on the operation subject to taxation also causes insecurity in economic relations.

In the past years, successive proposals for changes of the consumption taxation have led to debate in the legislative branch, but given the difficulties caused by the federal model adopted by Brazil there is no strong indication of change in the short term.

In Brazil there is a general understanding among taxpayers and among many representatives of the tax authorities that the cost of compliance with accessory obligations represents a material burden for the development of business in Brazil.[14] In the last years the use of the expression "Brazil cost" has increased; this cost represents, for many reasons, the high cost of doing businesses locally as compared with the cost of doing business in other countries. Although it may be affirmed that the value-added tax is almost always passed on to the final consumer, the cost of complying with the corresponding obligations and the cost of interpreting the tax law, given the legal complexities involved, is a discouragement for the entrepreneur and increases the final price of the goods, making them less competitive.

For this reason, review of the costs of compliance with tax obligations is constantly subject to public debate, in trade associations, in the Brazilian congress and in the academic environment.

14. *See* PwC, *Doing Business and Investing in Brazil* (São Paulo: 2010), available at http://www.pwc.com.br/pt/publicacoes/assets/doing-business-10.pdf (accessed 30 January 2013).

Notes

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