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Brazil grapples with tangle of tax laws

Growth in Latin America's largest economy is strangled by labyrinthine rules

The headquarters of Sao Paulo's Bovespa stock exchange: Brazil's over-complex tax system has long been seen as a drag on investment © AFP via Getty Images

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João Carlos Brega does not conceal his exasperation as he reels off a list of numbers to explain the complexity of Brazil's tax system.

“There are more than 40 different taxes and for each one there are sub-items, totalling 394,000 . . . many of which contradict each other. A company here spends around 2,600 hours a year attending to tax requirements,” said the president of Whirlpool Latin America.

“And it is almost impossible for anyone to be 100 per cent compliant as every day they are publishing new rules.”

Mr Brega’s angst is echoed in boardrooms across Latin America’s biggest nation, where businesses have for decades strained under a Kafkaesque tax regime of constantly shifting rules and opaque regulations.

But now, buoyed by the passage of a long-awaited pension reform earlier this year, officials in Brasília have turned their sights on simplifying one of the world’s most complex tax systems.

It is an ambitious goal. Consecutive administrations have pitched tax reform, only for proposals to flounder under pressure from political lobbying and deeply entrenched interests, typically at the state and municipal levels. Historical legacies and a lack of trust have for years fuelled resistance from the nation’s 27 governors and thousands of mayors to any attempt to centralise tax collection.

Optimism, however, is growing that between the government’s reformist bent, a sympathetic Congress and the clamorous corporate sector, the stars are aligned to pass legislation that could attract investment and boost Brazil’s stuttering economy.

A recent poll showed that 52 per cent of the nation’s parliamentarians believe some form of tax reform will pass in the first quarter of next year.

“Doing taxes here is a predatory, time-consuming black hole of misery. A reform would change the lives of every CFO,” said Kevin Gibson, chief executive for Latin America at Robert Walters, the recruitment group.

A midsized Brazilian company takes about 2,000 hours to prepare and pay taxes, according to World Bank data — by far the most in the world. By contrast, a US company takes 175 hours and a UK group takes 105 hours.

During the past 30 years, an average of 35 tax rules were changed every day, or 1.45 every hour, according to the Brazilian Institute for Planning and Taxation. The global Tax Complexity Index, run by LMU Munich and Paderborn University, places Brazil last.

“I have never seen anything like this in my life. Brazil is just a different beast,” said Laurent Kabbabe, the chief financial officer for Louis Vuitton in South America. “Reform is 100 per cent necessary.”

There are three proposals on the table — one from the government and one from each of the two houses of parliament. To varying degrees, all share a common objective to simplify Brazil’s plethora of taxes by unifying them in manageable bundles.

“We have three levels of taxation in the country: federal, state and municipal [and] there is no connection between them. So we have one federal government, but we have 27 different states. And more than 5,000 cities. That is why the tax system is so complex,” said Douglas Mota, a tax partner at Demarest, the law firm.

“And more, we have vast obligations and a lot of penalties if you are not in compliance. It is not a problem of the tax burden, it is problem of complexity and legal uncertainty,” said Mr Mota, adding that the proposals are likely to be revenue-neutral for the government.

Of the three potential models, a proposal by lawmaker Baleia Rossi in the lower house is the most advanced. It seeks to create a general tax on goods and services by uniting five different taxes across the federal, state and municipal levels.

The proposal, however, is controversial and likely to be hard fought because it "changes the way states receive income", said Lucas Galvão, a partner at law firm Barros Carvalho Advogados, pointing to deep opposition to any plans for federalised tax collection.

The plan, which would be subject to a 10-year transition period, is also likely to raise the hackles of the nation's service sector, which would experience "dizzying increases" in payment obligations, Mr Galvão added. Industry, on the other, is poised to benefit.

The government's proposal, meanwhile, attempts to steer clear of a confrontation with the states and municipalities by focusing on the creation of a federal-level value added tax. The government is also believed to be considering a tax on dividends at a later phase.

"Nobody is asking for a reduction [in taxes]. We recognise that it is necessary for the government to pay its expenses. But reducing complexity is mandatory and needed as soon as possible," said Mr Brega.

The complexity of the paperwork means companies are forced to pad their finance teams with junior staff that executives say do not add value to the company.

"Tax reform is one of the keys to unlock Brazil's potential. Simplifying the tax system will liberate resources for companies and the government," said Tiago Azevedo, chief financial officer for Brazil at ecommerce group Mercado Livre, who receives daily tax updates in order to stay on top of the changing rules.

Despite the enthusiasm from corporate Brazil, however, analysts have cautioned that the process could take time. Lawmakers say discussions will not begin in earnest until February when Congress resumes after its summer recess.

The proposals then run the risk of falling victim to political horse-trading ahead of important municipal elections in October.

"This will be very difficult," said Tasso Jereissati, a prominent senator.