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FEATURED Q&A

Is Brazil Making the Right Changes to its Tax System?



Brazilian lawmakers are eying a series of tax changes. The Chamber of Deputies is pictured before the Covid-19 pandemic. // File Photo: Agência Brasil.

Q Brazilian Economy Minister Paulo Guedes, Senate President Rodrigo Pacheco and Arthur Lira, the speaker of the lower chamber of Congress, on May 24 reached a deal to pass a series of piecemeal changes rather than a sweeping overhaul of the country's long-problematic fiscal regime. Why did the government of President Jair Bolsonaro step back from its initial proposal of an expansive reform of the tax system, and what are the major implications of the shift? What partial and gradual changes can be expected in the near term? Which sectors are likely to be the most affected by proposed modifications to the tax regime?

A Nestor Forster Jr., Brazil's ambassador to the United States: "The assertion that the government of President Jair Bolsonaro stepped back from its initial proposal of an expansive reform of the tax system is inaccurate. The Brazilian government has sent only one tax reform bill to the National Congress (PL 3887/2020). Based on the value-added taxes commonly seen in OECD countries, the new law—which does not apply to state and municipal taxes—would implement the Contribution on Goods and Services (CBS) in place of the PIS and Cofins social security contributions levied by the federal government and allow for the simplification of taxation at that level. Two other bills have been introduced as constitutional amendments by lawmakers, PEC 45/2019 in the Chamber of Deputies and PEC 110/2019 in the Senate, which would lead to changes in federal, state and municipal taxes. All the aforementioned proposals share the goals of broadening the tax base, eliminating tax exemptions and modernizing the tax collec-

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TODAY'S NEWS

POLITICAL

Wife of 'El Chapo' Pleads Guilty in U.S. Federal Court

Emma Coronel Aispuro, the wife of imprisoned Mexican drug kingpin Joaquín "El Chapo" Guzmán, admitted to helping her husband run his drug empire.

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ECONOMIC

Cuba Orders Halt to Acceptance of U.S. Cash Deposits

Cuba's government said it will temporarily stop allowing banks to accept U.S. dollars, blaming sanctions for the move.

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POLITICAL

Castillo Clings to Slim Lead as Vote Counting Ends in Peru

Socialist Pedro Castillo maintained a slim lead ahead of conservative Keiko Fujimori as vote counting ended in Peru's presidential election. Officials have not declared a winner, and an election jury is examining some 300,000 contested votes.

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Castillo // File Photo: Facebook Page of Pedro Castillo.

POLITICAL NEWS

Castillo Maintains Slim Lead in Peru as Vote Counting Ends

Socialist Pedro Castillo maintained a razor-thin lead Thursday ahead of his rival, conservative Keiko Fujimori, as vote counting ended from Sunday's presidential election runoff in Peru. However, election officials have not announced a winner, and an election jury is examining some 300,000 contested votes, a process that could take several days, Reuters reported. The country's ONPE election authority said on its website that 100 percent of the ballots had been counted and that Castillo had garnered 50.17 percent of the vote, while Fujimori had 49.83 percent, a margin of less than four-tenths of a percentage point, or just over 60,000 votes. More than 17 million votes were cast, according to ONPE. Fujimori has not conceded and has raised unsubstantiated allegations of fraud. On Wednesday night, Fujimori told journalists that she would seek the annulment of some 500,000 votes, which she said had raised suspicion, Reuters reported. She did not provide any substantial evidence to back up the claim, the wire service reported. Independent election observers have said the vote was handled cleanly. Following the polarized election and "an economy shattered by Covid-19," the country is "on the verge of social unrest," Mariana Zepeda, a Latin America research analyst at FrontierView, told the Advisor in a [Q&A](#) published Tuesday. [Editor's note: See the Advisor's [interview](#) on Peru's election with Cynthia McClintock of The George Washington University.]

Wife of 'El Chapo' Pleads Guilty in U.S. to Drug Charges

Emma Coronel Aispuro, the wife of Mexican drug lord Joaquín "El Chapo" Guzmán, pleaded guilty to U.S. drug charges, admitting that she

helped her husband to run his drug trafficking empire, the Associated Press reported. Wearing a green jail uniform, Coronel Aispuro appeared in federal court in Washington and entered guilty pleas to charges including knowingly and willfully conspiring to distribute heroin, cocaine and marijuana—as part of a plea agreement with prosecutors. She also pleaded guilty to a charge of conspiracy to engage in money laundering and to participating in transactions with a foreign narcotics trafficker, the AP reported. Coronel Aispuro has been jailed since her arrest in February at Dulles International Airport in Virginia. U.S. federal prosecutors have accused Coronel Aispuro of working "closely with the command-and-control structure" of Mexico's Sinaloa drug cartel and conspiring to distribute large amounts of drugs, with the knowledge that they would be smuggled into the United States. Prosecutor Anthony Nardozi said Coronel Aispuro "aided and abetted" the objectives of the Sinaloa cartel and helped it to import to the United States more than 450,000 kilograms of cocaine, 90,000 kilograms of heroin, 45,000 kilograms of methamphetamine and approximately 90,000 kilograms of marijuana, the wire service reported. During Guzmán's trial in 2019, prosecutors accused Coronel Aispuro of helping to orchestrate her husband's two escapes from prisons in Mexico. In her plea agreement, Coronel Aispuro admitted to aiding Guzmán's escape in 2015 by facilitating the purchase of a property near the prison where he was being held that would be used to dig a tunnel to the drug lord's cell, The Washington Post reported. She also arranged for the delivery to Guzmán of a GPS watch disguised as a food item, which helped the people digging the tunnel to find his cell and build an entrance under his shower. Mexican authorities recaptured Guzmán in January 2016, and he was extradited to the United States a year later. He was convicted in February 2019, sentenced to life in prison plus 30 years and is incarcerated at the ADX Florence "supermax" penitentiary in Colorado. Coronel Aispuro is scheduled for sentencing on Sept. 15, and U.S. District Judge Rudolph Contreras ordered that she remain held until then. The judge told her that prosecutors agreed to recommend leniency if she cooperates, though he added that he was not bound by that

NEWS BRIEFS

U.S. Ambassador to Brazil Steps Down After Just Over a Year

U.S. Ambassador to Brazil Todd Chapman, who was appointed by former President Donald Trump, said on Wednesday that he had resigned from his position, the Associated Press reported. Chapman, who held the post for a little more than a year, was seen as friendly to Brazilian President Jair Bolsonaro. Chapman said he was leaving diplomatic service altogether to be near his family and pursue other professional opportunities, the AP reported.

Colombian Government to Propose 'Consensus' Tax Reform: Finance Minister

Colombia's government will submit a "consensus" tax reform plan to Congress in the coming weeks, new Finance Minister José Manuel Restrepo said Thursday, Reuters reported. President Iván Duque's administration in April had presented a proposal that sparked massive and sometimes deadly demonstrations, pushing it to withdraw its initial reform plan. However, there are less than two weeks until the current legislative session is set to end. Senator Carlos Abraham, who accompanied Restrepo during the announcement, said the proposal is unlikely to be debated this session.

Mexican Fintech Clip Receives \$250 Million in Capital Investments

Clip, a payments financial technology start-up, has received \$250 million in capital investment from SoftBank's Latin American Fund and Viking Global Investors, Bloomberg News reported Thursday, citing the company's founder and chief executive officer, Adolfo Babatz. The investments give the start-up a valuation of \$2 billion, the news service reported. "We are planning to grow aggressively and hire about 320 people in the next 18 months," said Babatz.

request. Under federal advisory guidelines, the plea agreement that Coronel Aispuro entered estimates a sentence of between nine and 11 years in prison, The Washington Post reported.

ECONOMIC NEWS

Cuba to Temporarily Stop Allowing U.S. Cash Bank Deposits

The Cuban government said Thursday that it would temporarily stop allowing cash bank deposits in U.S. dollars while still accepting transfers, Reuters reported. It was unclear how long the suspension will last, the Miami Herald reported. The announcement came just before Cuba's government was due to present its annual resolution to end the longtime U.S. embargo on the Caribbean nation at the United Nations General Assembly. In announcing the move, the Cuban central bank shifted the blame to U.S. sanctions, saying they restricted the country's ability to use dollars abroad. "It is ever more difficult for Cuba to find international banking or financing institutions willing to receive, convert or process U.S. currency in cash," the bank said in a statement disseminated by state-run news media. Some Cuban analysts saw the move as an attempt to control the black-market price of the dollar, which has spiraled to more than twice the official exchange rate since the Communist-run country began opening stores selling hard currency and stopped selling dollars due to a lack of cash available, Reuters reported. More than 20 banks have stopped processing transactions involving Cuba since former U.S. President Donald Trump tightened sanctions on the country, said central bank Vice President Yamile Berra Cires. Cuban and foreign bank account holders on the island will have until June 21 to deposit dollars in their accounts, the Miami Herald reported. [Editor's note: See [Q&A](#) on U.S. remittances to Cuba in the May 20-June 2 issue of the Dialogue's biweekly Financial Services Advisor.]

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tion process. The Ministry of the Economy believes the implementation of CBS could be simpler and faster than proposals requiring amendments to the constitution and long transition periods. Looking forward, the benefits of a simpler, neutral and homogeneous tax system to productivity and economic growth could establish incentives and a model for future reforms that may also cover the ICMS and the ISS, levied by states and municipalities, respectively. Specifically on sectoral consequences, it should be noted that the tax reform would not uniformly affect taxpayers in the same sector of economic activity or of similar corporate size."

A Gabriela Rosa Lopes, tax and legal consultant at BMJ Consultores Associados in Brazil: "The choice of the size of the tax reforms is closely related to Brazil's political situation. Although there was a rapprochement between the government and the lower chamber with the election of the new speaker, that wasn't enough to obtain the necessary consensus with party leaders or to neutralize unaligned political forces who had a set opinion on what the final bill should be. A misaligned player in this dispute was the rapporteur himself, Representative Aguinaldo Ribeiro, with whom the house speaker was unable to hold dialogue. As a result, the speaker changed his narrative to one approving a 'possible' rather than an ideal reform. Delays in the agenda discussion were also significant, to the point that it is unlikely that Congress will vote on a text that changes the constitution. The Chamber of Deputies should try to approve a lean version of the tax reform in the second half of the year by merging only social security contributions. Also, adjustments to the income tax levied on individuals are considered popular measures. On the Senate side, the Parliamentary Inquiry Committee (CPI) on Covid-19 has captured senators' attention, and there is no rush to return to the tax reform. A more superficial reform

usually is seen as insufficient to solve the main problem of the tax system: the tax on goods (ICMS). However, service sectors that feared an increase in the tax burden should be less afraid, as their major concern was the state and municipal taxes."

A Joel Korn, president of WKI Brasil and senior international partner at UPITE Consulting Services: "The piecemeal approach to the tax reform is largely driven by political factors. The proposed initial focus on federal taxes in different stages reflects a pragmatic assessment of the limited support that may be forthcoming from Congress, 14 months away from presidential, gubernatorial and legislative elections. The most desirable path of a comprehensive overhaul of the fiscal regime, including state and municipal taxes, is highly unlikely at this juncture given the diverse base of interests of state and municipality governments. In fact, even a limited-scope reform is questionable. President Bolsonaro's eagerness for re-election and the ongoing mobilization of potential opposition candidates suggest a cautious posture by both sides to avoid a loss of popular support. Budget constraints may hinder the administration's capacity to compromise in the negotiations with Congress, even within the context of a limited reform. Initially, the limited reform contemplates the merger of two sources of federal revenues, PIS and Cofins, into a new 'Contribution Over Goods and Services,' and in subsequent phases, among other measures, further consolidation involving IPI (tax on industrialized products), IOF (tax on financial operations) and possible reduction of corporate income tax in exchange for taxation on dividend distribution. In sum, the absence of a thorough reform hinders the overdue resolution of a series of structural bottlenecks such as: a myriad of tax regulations and fiscal subsidies along with inadequate allocation of tax revenues at federal, state and municipality levels, reduction of regional

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and social inequalities and lowering costs imposed on economic activity by the current cumbersome system, thereby resulting in productivity gains, enhanced competitiveness and renewed impetus for investments, all key ingredients for sustainable economic growth. Let's hope that meaningful and far-reaching structural reforms may finally materialize following the 2022 elections."

Alone Amorim, economist at the Brazilian Institute for Consumer Defense (IDEC): "The lack of leadership in the tax reform debate and the slicing of proposals to change the tax system are possibly among the main reasons why the Bolsonaro administration has backed off from the tax reform. The proposals currently being discussed in Congress should have as an immediate purpose the simplification of collection and maintenance of the current tax burden. One of the highlights of the reform is the simplification through the unification of five taxes, with the creation of a new single tax on consumption, the Tax on Goods and Services (IBS). The proposal is that the transition to the new model would take place over 10 years. This measure will contribute to increasing competition in the sectors and ending the fiscal war with tax waivers by states and between municipalities to attract companies. Tax reform will affect around 10 percent of companies, benefiting the industrial sector and affecting the service sector. Thus, today, the biggest critics of the proposal are medium and large service companies, with emphasis on service and education. It is possible that there is a risk of increased informality and precariousness of labor relations, for companies to obtain tax benefits to be paid at the IBS. For Idec, equity in taxation involves redistribution of the tax burden, changing the regressive nature of the Brazilian system

and supporting the reduction of consumption taxes and shifting taxation toward large fortunes and profits and dividends."

Aerich Decat, political analyst at DKPG: "In Brazil, the debate over tax reform seems to be like the myth of the Tower of Babel. Members of the government, senators, deputies and businesspeople do not share the same language regarding the potential reform. Legislators have voted for an overhaul bill after a year of discussion in a nonofficial committee composed of senators and deputies. In sum, the draft bill affects only consumption taxes. However, the proposal was shelved. Why? Because the Ministry of Economy team turned a blind eye, as it had not participated in the talks, nor had it supported this bill. In parallel, the government had sent to Congress another bill that merges two taxes and affects the gross revenue of companies. Service sector businesspeople have criticized this proposal and accused the government of overtaxing them during the pandemic. Due to the deadlock, lower house Speaker Arthur Lira and Senate President Rodrigo Pacheco have decided to pass a series of gradual changes. However, this idea might not work for several reasons. First, because the legislators' and senators' priorities do not match. Second, most lawmakers do not favor a split tax reform, arguing that this could unbalance the tax system. But there is a further challenge: time. Lawmakers have until October to vote on a potential reform. After that, they will switch to 2022 election mode and will be reluctant to debate any controversial issue. Legislators will continue to debate until this deadline, but in the end, they will not vote on any deep-rooted changes during the Bolsonaro administration."

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