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“ECONOMIC EFFECTS OF THE NEW ICMS VAT RATE – SENATE RESOLUTION
Nº 13/2012 – TAX WAR OF PORTS”

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Abstract: This paper objective is to analyze the economic effects resulted from the first years of enforcement of the Federal Senate Resolution nº 13/2012. This Resolution changed the ICMS – State value added tax – inter-state rate in order to reduce the effects of so-called “Tax War of Ports”.

Key points: Tax system - ICMS; “Tax War of Ports”; Federal Senate Resolution nº 13/2012; Tax Neutrality Principle; Economic effects.

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The opinions expressed in this paper reflect research efforts to understand the issue and do not express the opinions of the Secretaria da Fazenda do Estado de São Paulo.

1) INTRODUCTION

This study will examine the economic effects arising from the first years of the new interstate ICMS (Tax on the Circulation of Commodities and Service) rate, implemented by the Federal Senate Resolution No. 13/2012 – Res. 13/12¹.

The central objective of the study is to demonstrate whether this new system of the Value Added Tax (ICMS VAT) taxation for imported products actually contributed to reducing the problem caused by the "Tax War of Ports" and it can be adopted as a model for a broader tax reform.

The Term "Tax War of Ports" refers to the dispute between the Brazilian States by private investment through the irregular granting of tax benefits of ICMS on the import.

This system has brought great harm to the domestic industry, which as a rule has their products taxed at a VAT rate of 18% but the same imported goods in some cases may come to have a rate of 9%.

Proponents of this predatory tax policy for the domestic industry claim that the lack of public policies by the Federal Government to promote local development and the reduction of regional disparities justified this practice.

However, often the purpose of these states is simply to maximize tax revenue to the detriment of other states that end up having to bear the burden of these irregular tax benefits and the country that has suffered in recent decades the economic effects of strong deindustrialization.

¹Senate Federal Resolution nº 13, 05.25.2012

Due to this system of irregular tax benefits of ICMS, economic agents, at the time of making the investment, consider solely the tax factor instead of to analyzing what would be its great location, from the point of view of economic efficiency, such as production costs, conditions infrastructure, distance from markets, hand qualification work, among others.

As Alves's² highlights, Tax War is "every kind of dispute or conflict arising out of state intervention of federal entities in locational decision to productive activities and industry competition, and the tax instrument (ICMS especially) is the main subsidizing mechanism.”.

Such issues will be examined from the point of view of tax neutrality, to the extent that this policy for granting tax concessions by the States ends up causing major interference in the decisions of economic agents, also generating negative externalities on the national economy.

Besides the competition aspect, such practices cause other complications for the country's economic development, as the complexity of ancillary obligations and legal uncertainty.

In order to analyze how this system of tax benefits works, that in most times just causes traffic of goods for a particular State. And, after customs clearance, the goods are referred to another State, which in addition to not actually bringing economic development for a region, demands other transportation costs, logistics, and ancillary obligations etc.

In order to end or at least reduce the effects of "Tax War of Ports", the Federal Senate approved the Res. 13/12, in force from January 1th, 2013, which amended the interstate rate for products imported from 12% to 4%, and after almost 3 years of this measure, we will make an analysis of its economic effects, considering factors such as: i) displacement of economic activity (import volume between the States); and ii) negative effects of the Res. 13/12.

² Alves, Maria Abadia da Silva. "Guerra Fiscal e finanças federativas no Brasil: o caso do setor automotivo.". Dissertação de Mestrado apresentado ao Instituto de Economia da Universidade Estadual de Campinas. (2001, p. 30)

Considering that the Res. 13/12 is considered the first step towards a tax reform of the ICMS, the idea is to contribute to the analysis of the best alternative to the state taxation on consumption, so that tax policy contributes positively to economic development of the country.

In parallel, the American tax on consumption will also be analyzed in order to verify the positive lessons that we can learn and apply to the Brazilian tax reform.

This paper is divided into six topics: the first is introducing the first; the second will present the basic concept of ICMS VAT; the third will show how the "Tax War of Ports" works and its affects on the domestic industry; the fourth, the Res. 13/12; the fifth, the economic effects resulting there from; the sixth, the American interstate taxation; and the seventh, the conclusion.

2) NOTIONS ABOUT ICMS VAT

2.1) ASPECTS OF THE BRAZILIAN STATE TAX

The Federal Constitution of 1988³ – CF/88 establishes the structure of the Brazilian tax system, dividing tax jurisdiction between federal agencies (Federal, State and Federal District and Local Governments), giving each the power to legislate, raise (collect) and inspect.

Generally speaking the taxing power of the main Brazilian taxes in terms of revenue was divided as follows:

- i) Union shall have competence to institute the income tax, import tax, tax on manufactured products, tax on financial transactions and the rural property tax;
- ii) States and the Federal District have the power to institute the consumption tax, the tax on ownership of motor vehicles and the transitional tax causes deaths and donation;

³ Constituição da República Federativa do Brasil de 1988.

iii) Local Governments have jurisdiction to levy tax on services, the urban real estate property tax, and tax on real estate transfers.

The state consumption tax – ICMS VAT (in Portuguese, Imposto sobre Circulação de Mercadorias e Serviços) is a value added tax collected by Brazilian States on goods and selected services.

According to the Ministry of Finance⁴, this tax accounts for the largest volume collection among Brazilian taxes, around R\$388 billion in 2014, 20.32% of the total, and is also the main target of attention when discussing the reform of the Brazilian tax system due to operational complexity and serious problem because of the "Fiscal War".

The CF/88 establishes the tax event of ICMS which determines the tax levy on movement of goods and the rendering of interstate and intermunicipal transportation and communication services, even when such transactions and renderings begin abroad.

As movement of goods means any action that drives good or production supply goods to the end consumer, thus the ICMS can also be levied on transfer and donation, among other acts involving physical export of the goods.

The CF/88 delegated the establishment of the general rules of ICMS to complement law.

The Complement Law nº 87/96⁵ establishes the whole ICMS discipline, which also determine to be levied on imported goods.

Thus basically the ICMS is levied on any action (sale, donation, return, transfer, etc.) that implies movement of the goods or property held by corporate taxpayers and the imports carried out by individuals or legal entities, even unusual taxpayers.

Considering that the "Tax War of Ports" primarily affect the taxation of goods, the incidence of ICMS on services will not be analyzed in this article.

⁴ Ministério da Fazenda - <http://www1.fazenda.gov.br/confaz/boletim/Valores.asp> (Accessed in 10.24.2015)

⁵ Congresso Nacional – Law nº 87, 09.13.1996

2.2) ICMS RATES

The CF/88 thoroughly deals with the powers to fix the rates of ICMS VAT, which, due to the non-cumulative system of tax, has the power to divide the revenues between the states of origin and destination of the goods.

Thus different rules were established for fixing the two types of rates: internal rate (levied on the operation conducted within a state) and on imports; and the interstate rate - charged on a transaction between two states.

The CF/88 delegated to the Federal Senate (made up representatives of the states and Federal District) powers to set interstate rates, leaving the states and Federal District with the authority to fix the domestic rates.

The Federal Senate Resolution No. 22/89⁶ established the standard interstate ICMS VAT rate of 12%.

This resolution also created the special interstate rate of 7% for transactions from the Southern States and the Southeast (except for the Espírito Santo State) bound for the States of the North, Northeast and Central West (including the Espírito Santo State).

These rates applied for interstate transactions with imported goods once Res. 13/12 went into effect.

Importantly, this rate of 7% was established with the objective of providing a better distribution of income to the less developed regions (North, Northeast, Midwest and Espírito Santo State).

⁶Resolução do Senado Federal nº 22/89 – “Art 1º A alíquota do Imposto sobre Circulação de Mercadoria e Prestação de Serviços de Transporte Interestadual e Intermunicipal e de Comunicações, nas operações e prestações interestaduais, será de 12% (doze por cento).

Parágrafo único. Nas operações e prestações realizadas nas Regiões Sul e Sudeste, destinadas as Regiões Norte, Nordeste, Centro Oeste e ao Estado de Espírito Santo, as alíquotas serão:

I – em 1989, 8% (oito por cento);

II – a partir de 1990, 7% (sete por cento).(...).”.

For example, in a sale of goods from São Paulo State (Southeast) to Bahia State (Northeast Region), the interstate rate of 7% applies; in the opposite direction, the interstate rate of 12% applies.

The CF/88 delegated authority to the States and Federal District for the fixing of domestic rates, but they couldn't establish rates below 12%.

The CF/88 also delegates to complementary law how tax benefits will be approved.

Fulfilling this function, the Complementary Law nº 24/75⁷ provides for the need to conclude ICMS conventions between States for approving tax benefits.

These ICMS conventions shall be concluded under the authority of the National Council of Tax Policy – CONFAZ - conditional on the unanimous consent of the States and the Federal District⁸.

These ICMS conventions shall be approved by of the CONFAZ - conditional on the unanimous consent of the States and the Federal District .

The CONFAZ is an organ linked to the Ministry of Finance, and is composed of the Finance Secretaries of the States and Federal District, and its main function is to deliberate conventions about tax benefits.

Thus, as a general rule, until the publication of Res.13/12, ICMS was basically at the following rates:

- i) 17% or 18% for internal transactions within a state and for imports;
- ii) 12% or 7% for interstate transactions, depending on the state of origin and destination of the goods.

2.3) VALUE ADDED TAX

⁷ Congresso Nacional – Law nº 24, 01.07.1975 – “Art. 1º - As isenções do imposto sobre operações relativas à circulação de mercadorias serão concedidas ou revogadas nos termos de convênios celebrados e ratificados pelos Estados e pelo Distrito Federal, segundo esta Lei.(...)”.

⁸ Congresso Nacional – Law nº 24, 01.07.1975 – “Art. 2º (...) § 2º - A concessão de benefícios dependerá sempre de decisão unânime dos Estados representados; a sua revogação total ou parcial dependerá de aprovação de quatro quintos, pelo menos, dos representantes presentes.”.

Regarding the system of calculation, the CF/88 adopted the value added tax or so called non-cumulative system for the ICMS, predicting that "Art. 155 (...) the tax is not cumulative, offsetting up what is due in each operation concerning the circulation of goods or services with the amount charged in previous transactions by the same or another State or the Federal District. "

Such an added value system of taxation was based on the French model of taxation on consumption, and replaced the old Sales Tax and Consignment (IVC), which existed in Brazil until the early 60s.

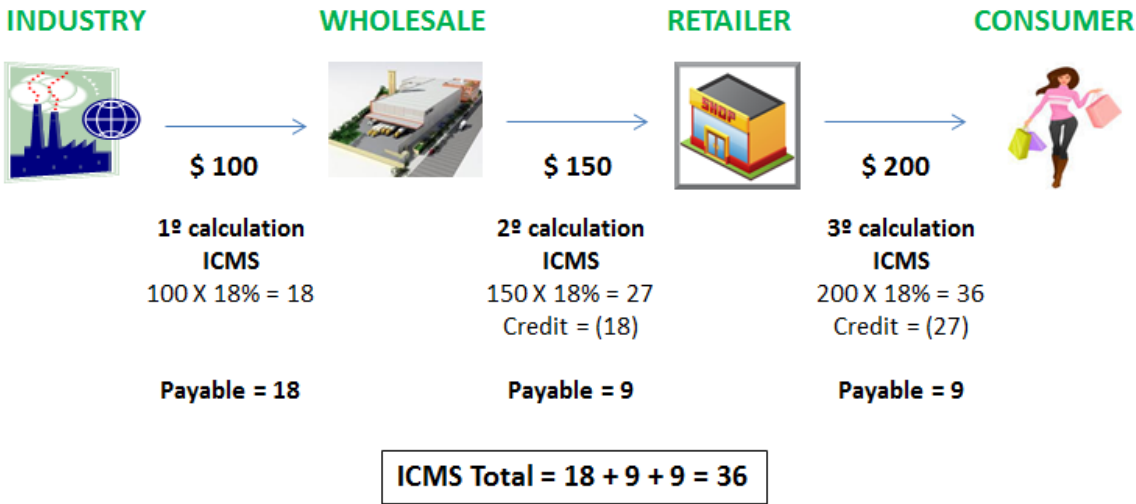
Due to the non-cumulative tax, all goods sales operation must be accompanied by tax document with the value of outstanding ICMS VAT indicated to the purchaser of the goods.

In this way the purchaser can be credited from the tax on the previous operation and can deduct it from the amount of tax due in the subsequent operation.

The taxis calculated as follows:

Practical situation: An industry sells a good for 100 to a wholesaler; that sells for 150 to a retailer; and this sells this product to the final consumer at 200 – all sales are made in the São Paulo State.

As seem below, the calculation of ICMS will take place in three distinct stages:



Thus the “not-cumulative” system of ICMS VAT works throughout the chain of production and marketing, always discounting the tax paid on the previous sales which will be due in the subsequent sales.

The CF/88 gave greater neutrality to tax to focus on the value added at each stage of industrialization or commercialization, thus eliminating the so-called "cascading effect" that occurs in other consumption tax systems.

The neutrality's objective of the tax is to preserve free competition, so that the tax affects the decisions of economic agents as little as possible.

Carvalho⁹ said: “neutrality should not be read as absolute absence of state interference in the market but as ensuring the equality of economic agents, which can occur with ICMS”. Schoueri¹⁰ agreed that tax neutrality is not synonymous with no interference tribute in the economy, but there should be neutrality of taxation with regard to free competition. Thus, products in similar conditions should be subject to the same tax burden.

However, despite these neutrality goals, it is precisely the “non-cumulative” which provides the perfect setting for the so-called "Tax War of Ports". Once an illegal tax benefit - without conventions CONFAZ - is granted by State A, the sales tax may be deducted from the tax payable to State B, which ultimately reduces the taxation of ICMS for particular product.

Because of this system of ICMS credit transfer between the states, the "Tax War of Ports" ends up producing a devastating effect on free competition, in so far as similar products - national and imported - have different tax burdens, as we shall see.

⁹ Carvalho, Osvaldo Santos de. Não cumulatividade do ICMS e Princípio da Neutralidade Tributária. São Paulo, 2013, PP. 67.

¹⁰ Schoueri, Luís Eduardo. Direito Tributário. 1ª Ed. São Paulo, 2011, PP. 38-39.

3) “TAX WAR OF PORTS”

The conduct of a Brazilian States granting a tax benefit of ICMS for importers to carry out the import of goods through ports or airports located in its territory is called “Tax War of Ports”.

In this situation, these states charge a fraction of the tax due but deliver the importer documents indicating that the tax has been fully charged.

Whoever acquires imported goods receives tax documents indicating that the tax has been integrally paid and in the subsequent sale can deduct the amount mentioned tax payable.

Despite the LC 24/75¹¹ establishes the discipline to the granting of ICMS tax benefits, it occurs in practice that the States seeking to attract business investment to their territory and increase its revenues, provide ICMS tax benefits without the approval of the conventions CONFAZ.

For this reason such benefits are illegal and, in most cases, are granted on the import of goods, resulting in a tax burden for the imported product much cheaper than the similar national product.

In most cases these illegal benefits of ICMS to function are as follows:

- i) A State shall suspend the ICMS VAT payable on the importation of goods;
- ii) This State grants a presumed credit 9% of the tax for the moment that this importer makes the transfer of the imported goods to another State.

How does this work?

First, let's examine how the taxation of ICMS works. An industry imports raw materials for its production which is carried out by the port located in that State of its location:

¹¹ Lei Complementar nº 24, de 7 de janeiro de 1975 – art. 1º.

Example 1: Importing supplies for industrialization by company located in State A, without tax benefit - before the "Tax War of Ports":

Industry in the State imports 100,000.00 of inputs through port A, located in the same state. Later, inputs are transform into goods that will sell for 150,000.00 within the state itself.

Whereas the internal rate and import is 18%, the state will have the total revenue of 27,000.00 from the ICMS gatherings occurred in two distinct phases: (i) 18,000.00 on the value of import (ii) 9,000.00 added to the value after its industrial process.

So would the calculation of ICMS:

i) Imports goods in State A:

Tax event - Import	
a) Import value with ICMS	100,000.00
b) ICMS payable of imports (18%)	18,000.00

ii) Sales goods to wholesale located in State A:

Tax event – Sale	
a) Sale value with ICMS	150,000.00
b) ICMS register on the sale (18%)	27,000.00
c) ICMS credit from import	(18,000.00)
d) ICMS payable of sale	9,000.00
Total amount of ICMS to be collected by State A (i.b + ii.d)	27,000.00

Example 2: This industry opens a subsidiary in State B to take advantage of the illegal tax benefit of ICMS on imports - "Tax War of Ports".

In order to attract the company to its territory, State B grants the suspension of ICMS payable on imports and an ICMS presumed credit of 9% on the subsequent sale.

In practice this State authorizes the company to make an accounting operation and suspension of ICMS payable on the importation becomes exempt so this tax will not be paid. Therefore it is an illegal tax benefit granted without approval of the Convênio CONFAZ.

Thus, this ICMS tax benefit causes the change in the normal flow of imports.

Considering the same values cited in Example 1, the calculation of ICMS will take place in three distinct stages, as follows:

i) Imports by subsidiary located in State B:

Tax event: Import	
a) Import value with ICMS	100,000.00
b) ICMS payable of imports (suspended*) 18%	18,000.00

* Suspended ICMS - in practice, this tax is not paid.

ii) Transfer to the company's headquarters located in State A:

Tax event: Interstate transfer	
a) Value transfer with ICMS	100,000.00*
b) ICMS register on the interstate transfer (12%)	12,000.00
c) ICMS presumed credit granted by State B (9%)	(9,000.00)**
d) ICMS payable to the State B	3,000.00
Total amount of ICMS to be collected by State B (ii.d)	3,000.00

* Since it is a transfer between subsidiaries of the same company, the value is the same import.

**Illegal credit granted by State B.

iii) Sales of goods in State A:

Tax event: Sales	
a) Sale value with ICMS	150,000.00
b) ICMS register on the sales (18%)	27,000.00
c) ICMS credit on interstate sales	(12,000.00)
d) ICMS payable to State A	15,000.00
Total amount of ICMS to be collected by State A (iii.d)	15,000.00

In this example, the full amount of ICMS paid to State B was 3,000.00 and State A was 15,000.00, amounting to the tax burden of ICMS 18,000.00, while in Example 1, without the tax benefit, the total amount of ICMS paid was 27,000.00.

In summary, through abstracting and other factors that affect the formation of the ICMS tax due on the importation, we saw how the system of granting illegal incentives of ICMS in the "Tax War of Ports" works.

Examples 1 and 2 compare the taxation of ICMS due on imported inputs - with and without tax benefit; we find that the tax burden was 1/3 lower because of these benefits.

The problem is even more serious if we consider that these tax benefits are granted for the import of end products and that these products compete with all this advantage over domestic goods.

Thus, this ICMS tax benefit causes the change in the normal flow of imports, causing other operating costs for transportation and tax ancillary obligations to the extent that the goods shall be imported by another State to receive the tax benefit and after customs clearance is transported to the state where they will be industrialization and consumption.

Silveira and Castilho¹² said the gain of the State granting the short-term benefit translates into enormous costs for society, as increased fuel consumption caused by the pointless shifting of goods by air pollution caused by diesel engines, use of roads and other indirect costs.

Historically, we can say that Espírito Santo State was the pioneer in adopting tax incentives already in the 1970s; it created the Development Fund of Port Activities (FUNDAP¹³). In the 1990s, this benefit attracted most of the vehicles imported to this State, which were later sent to other consumers states at the expense of the domestic industry that did not have such privileges.

Subsequently, Goiás State also granted the tax benefit of ICMS due on imported goods, through the program called “ComexProduzir¹⁴” created in 2002.

Recently, Santa Catarina State granted the program called “Pro-Emprego¹⁵” in 2007, which basically consists of the benefit similar to that of Example 2.

¹² Rodrigo F Silveira e Fábio R. C. Castilho. “A guerra fiscal que não interessa a ninguém”. Published in 03.2006 - <http://jus.com.br/artigos/8022/a-guerra-fiscal-que-nao-interessa-a-ninguem#ixzz3tHyvVkJLo> (Accessed in 12.11.2015).

¹³ Assembléia Legislativa do Estado do Espírito Santo - Law nº 2.508, 05.22.1970.

¹⁴ Assembléia Legislativa do Estado de Goiás – Law nº 14.186, 06.27.2002.

¹⁵ Assembléia Legislativa do Estado de Santa Catarina - Law nº 13.992, 02.15.2007.

These are just three examples of illegal tax benefits, but there are other states that also use such practices and in fact the big loser is Brazil which has suffered for years from the effects of deindustrialization.

The legislation provides for a series of penalties for States granting illegal benefits, and affected states have standing to file a lawsuit to declare such benefits unconstitutional. However, in practice, as these lawsuits take a long period of time to be judged, and these State repealing the law is on trial and edict another law with the same benefit, and the illegal benefit remains in effect.

According to the Federation of São Paulo State Industries (FIESP¹⁶), in studies conducted in 2011, due to the tax incentives of States over imports, Brazil ceased to grow 0.6% of GDP in 2000 to 2010, corresponding to a loss of 771 thousand jobs.

Also according to studies of FIESP, between 2004 and 2012, "industrial participation in economic activity amounted to a loss of 30.8%. Thus, the contribution share of the manufacturing sector to GDP fell from 19.2% in 2004 to 13.3% in 2014. The rate is already the lowest it has been since 1955, when the share reached 13.1%.¹⁷ "

It appears that the main effect of the "Tax War of Ports" was to remove the competitiveness of the domestic industry, transforming the industrial activity to merely import and distribution activity.

The graphs below show the effects of "Tax War of Ports" on the flow of imports in the country, we find that the Southeast region decreased by about 11% in the amount of imports between 2000 and 2012 – from 64.2% to 53.3%, while the South and Midwest regions increased respectively by 4.8% and 3.6%:

¹⁶ Federação das Indústrias do Estado de São Paulo (FIESP) - <http://www.fiesp.com.br/noticias/maior-preocupacao-da-industria-e-com-a-guerra-dos-portos-e-sua-ameaca-ao-setor-produtivo/> (Accessed in 27.10.2015 – “Custos Econômicos e Sociais da Guerra Fiscal do ICMS na importação” – DECONTEC/FIESP)

¹⁷ Federação das Indústrias do Estado de São Paulo (FIESP) - <http://www.fiesp.com.br/noticias/participacao-da-industria-no-pib-pode-cair-para-93-em-2029-aponta-estudo-da-fiesp/> (Accessed in 27.10.15).

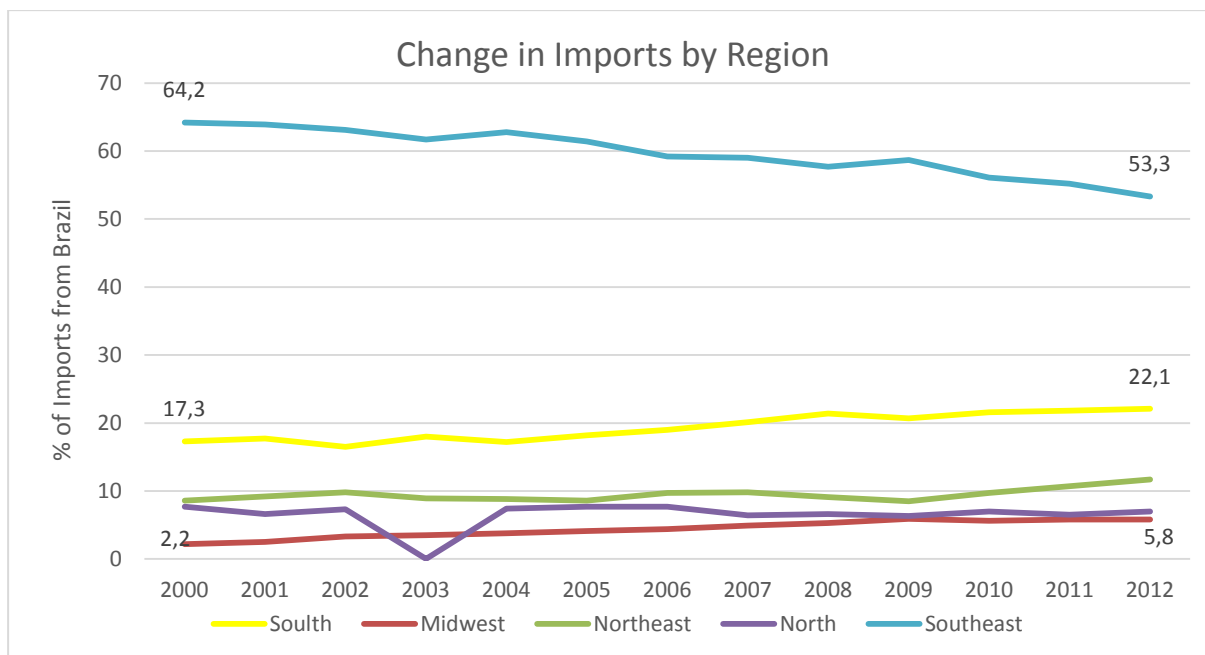


Table 1: Percent of the imports in Brazilian regions - from 2000 to 2012 - Source: Ministry of Development, Industry and Foreign Trade¹⁸.

Analyzing the volume of imports by Brazilian States, also between 2000 and 2012, we find that the loss of the Southeast is concentrated primarily in the São Paulo State, who suffered 11% reduction of imports – from 45.9% to 34.9%.

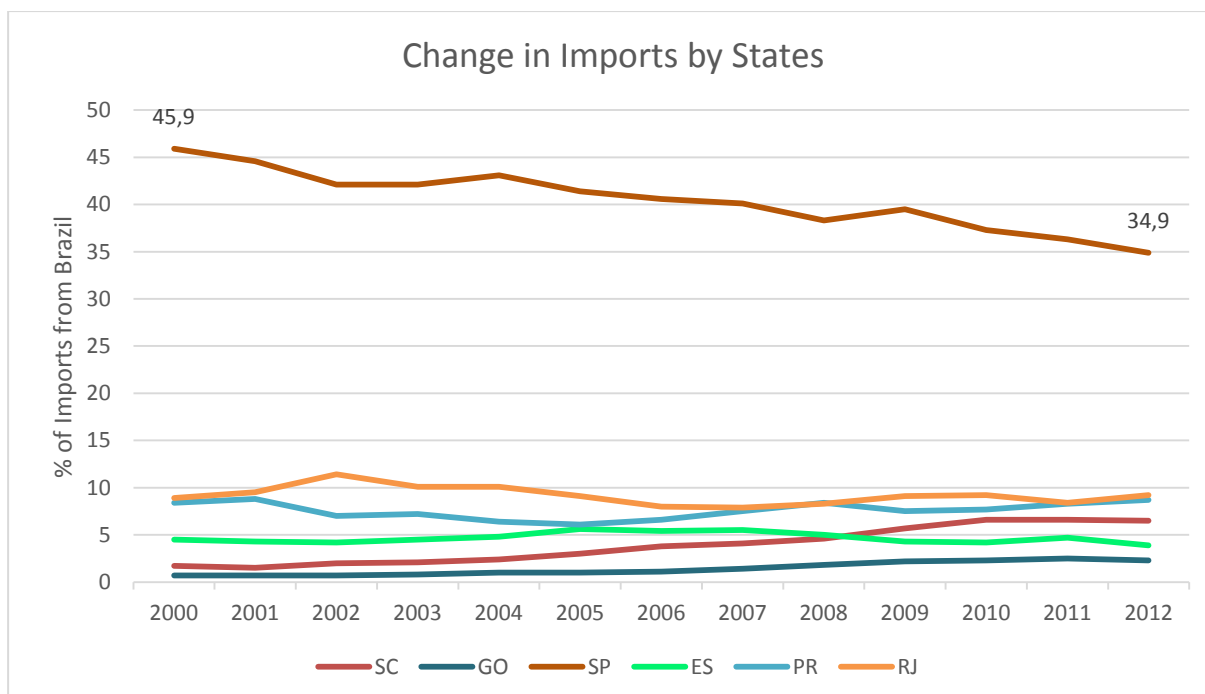


Table 2: Percent of the imports in Brazilian states - from 2000 to 2012 - Source: Ministry of Development, Industry and Foreign Trade.

¹⁸ Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC) - <http://aliceweb.desenvolvimento.gov.br/> (Accessed in 11.06.2015).

Most often, after customs clearance, these imported products are sent to the Southeast Region, which focuses on the large consumer market. This, in addition to competitive order factors, results in large operating costs of logistics, transport, ancillary tax obligations, among others.

At this point, we believe we have introduced the scheme of "Tax War of Ports" and the economic effects arising from it, making it possible to understand the changes made by Res. 13/12.

4) FEDERAL SENATE RESOLUTION n° 13/2012

In this context the Federal Senate approved the Res. 13/12, in force from January 1, 2013, that reduced the interstate rate for imported goods from 12% to 4%.

The specific objective was to reduce the percentage of ICMS credit that can be transferred from one state to another.

The Res. 13/12 determines this rate of 4% is applied to interstate sales with imported goods that have not undergone the process of industrialization; or if subject to industrialization in Brazil, resulting in goods with more than 40% of imported components.

So in the Example 2 above, after January 1, 2013, the importing subsidiary issued the tax document to apply the interstate transfer to its headquarters, only indicated the value of 4,000.00 by way of interstate ICMS. Following is the calculation of the tax after the Res. 13/12 (Exemple 2):

i) Transfer to the company's headquarters located in State A:

Tax event: Interstate transfer		
	Before Res. 13/12	After Res. 13/12
a) Value transfer with ICMS	100,000.00*	100,000.00*
b) ICMS register on the interstate transfer (12% or 4%)	12,000.00	4,000.00
c) ICMS presumed credit granted by State B (9%)	(9,000.00)**	(1,000.00)**
d) ICMS payable to the State B	3,000.00	3,000.00
Total amount of ICMS to be collected by State B (i.d)	3,000.00	3,000.00

* Since it is a transfer between subsidiaries of the same company, the value is the same import.

** Illegal credit granted by State B.

ii) Sales of goods in State A:

Tax event: Sales		
	Before Res. 13/12	After Res. 13/12
a) Sale value with ICMS	150,000.00	150,000.00
b) ICMS register on the sales (18%)	27,000.00	27,000.00
c) ICMS credit on interstate sales (12% or 4%)	(12,000.00)	(4,000.00)
d) ICMS payable to State A	15,000.00	23,000.00
Total amount of ICMS to be collected by States (i.d + ii.d)	18,000.00	26,000.00

Thereby the ICMS credit transfer to the State A was reduced, which was 12,000.00 to 4,000.00. This resulted in 26,000.00 the total tax burden, so almost canceled out the tax advantage of the imported product from the domestic similar - which has the tax burden of 27,000.00 as explained in Example 1.

The reduction in interstate rate to 4% does not mean that the imported product will pay less tax, but only changes the distribution of income among states (origin and destination states).

The main objective of Res. 13/12 was to encourage domestic industry, by rebalancing the tax burden by attenuation of "Tax War of Ports" effects.

This change in the system of taxation of imported goods would tend, therefore, to redirect Brazilian imports to regions where mostly industrialization and consumption occur.

The next topic analyzes the effects of Res. 13/12 in the years 2013 and 2015, based on the São Paulo State, which is one of the state's most affected by the "Tax War of Ports".

5) EFFECTS OF FEDERAL SENATE RESOLUTION n° 13/2012

The State of São Paulo is the most populous Brazilian state, and in 2014, it had a population of about 44 million people¹⁹, or 21% of the population. From the economic point of view it had a share, in 2014, of 31.4% National GDP, corresponding to collection of ICMS VAT of approximately R\$ 123 billion, or 31.7% of total tax revenues.

However, the share of total collection of ICMS VAT and national GDP fell 7% and 2%, respectively, which in 2000 were 38.7% and 33.7%.

One reason for the drop in revenue in the State of São Paulo was certainly the worsening of the "Tax War of Ports" in the last two decades.

As we see in Table 2, one of the main purposes of the "Tax War of Ports" was to transfer the imports of São Paulo to the states granting illegal tax benefits.

To verify that the Res. 13/12 produced the expected effects, in order to reorient the imports, we will analyze the import flow considering the state of São Paulo in relation to other states.

¹⁹ Instituto Brasileiro de Geografia e Estatística (IBGE) - <http://www.ibge.gov.br/estadosat/perfil.php?sigla=sp> – (Accessed in 10.27.2015).

5.1) VARIATION IN THE FLOW OF IMPORTS

In 2013, at the beginning of the term of Res. 13/12, we observed an increase in total imports in Brazil, around \$ 16.6 billion or 7.4% compared to 2012, while in São Paulo this increase was even higher, 15.3% or \$ 11.9 billion.

In 2014, we found that there was a decrease of 4.6% or \$ 10.6 billion in total imports in Brazil, compared to the year 2013, while in São Paulo this decrease was 5.8% or \$ 4.9 billion.

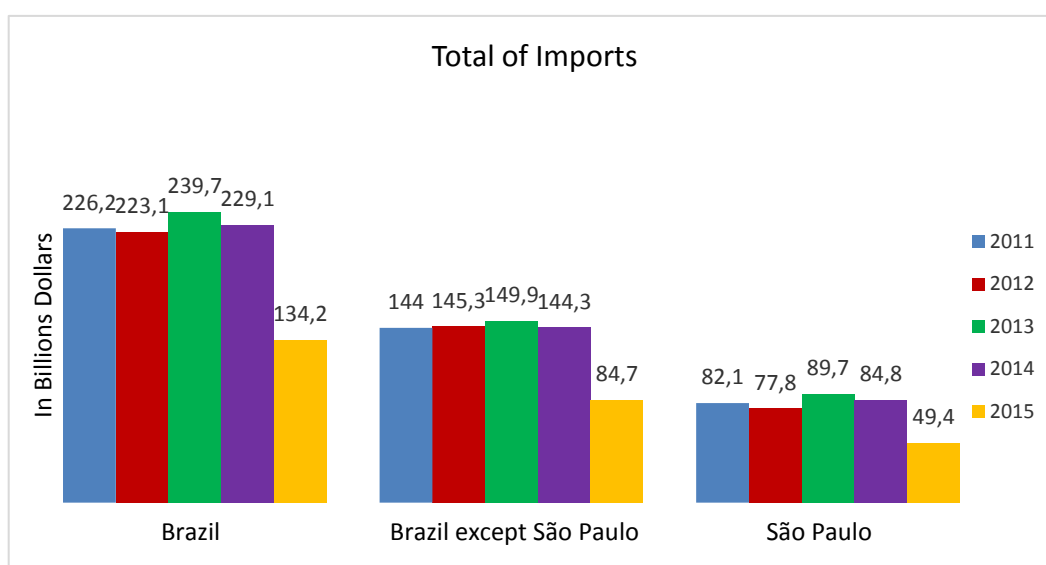


Table 3: Compares the values related to total imports in São Paulo State, Brazil, and Brazil without São Paulo, between the years 2011 to September 2015.

Source: Ministry of Development, Industry and Foreign Trade²⁰.

²⁰ Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC) - <http://aliceweb.desenvolvimento.gov.br/> (Accessed in 11.16.2015).

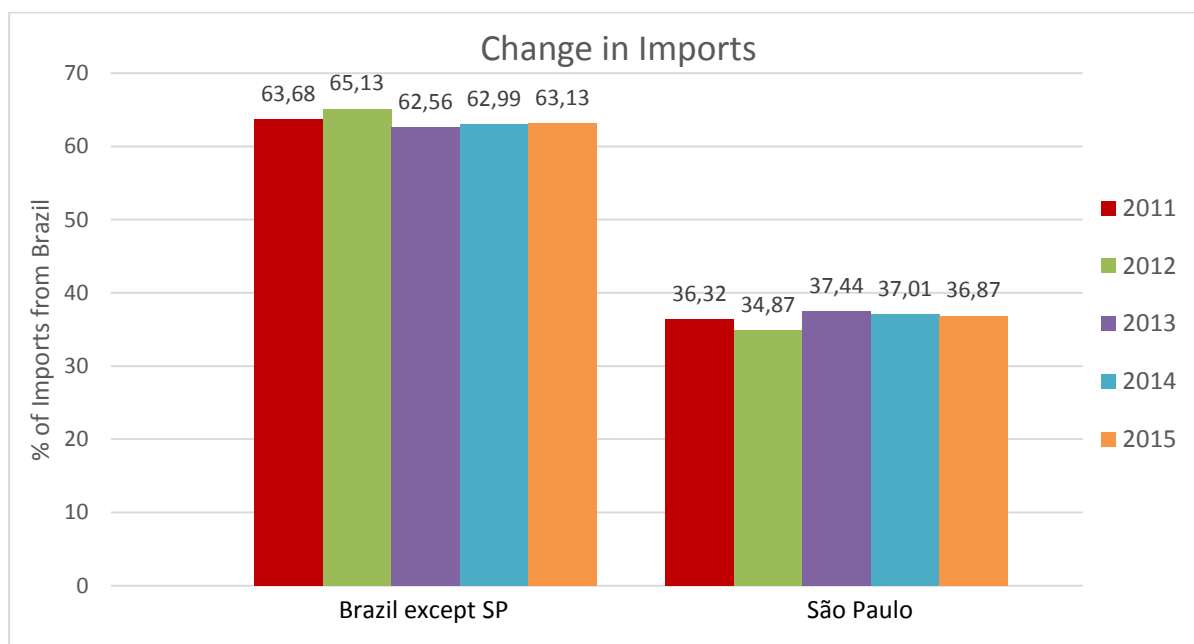


Table 4: Shows percentage of shares of total imports in Brazil and São Paulo in the years 2011 until September 2015.

Source: Ministry of Development, Industry and Foreign Trade²¹.

We found that percentage of São Paulo in total imports increased from 34.87% in 2012 to 37.44% in 2013.

Therefore, we find that in the first years of operation there are indications that Res. 13/12 changed the pattern of imports from Brazil, reversing the downward trend of São Paulo that had been occurring since 2000, as we see in table 2.

5.2) NEGATIVE EFFECTS

5.2.1) “ICMS CREDIT BALANCE”

As we saw above the Res. 13/12 reduced the ICMS interstate rate for imported goods from 12% for 4%, thus shifting taxation to consumer states.

²¹ Ministério do Desenvolvimento, Indústria e Comércio Exterior (MDIC) - <http://aliceweb.desenvolvimento.gov.br/> (Accessed in 11.16.2015).

Due to the reduction of the ICMS interstate rate, the "ICMS credit balance" problem has increased.

This problem occurs when a company imports a raw material or finished good and resells it to another state. In this situation, the ICMS collected on importation (18% rate) is higher than the amount of ICMS that is payable on the interstate sale (4% rate) generating "ICMS credit balance".

This credit represents the taxpayer right to receive money from state and the refunds depend on a bureaucratic process. In practice, the "ICMS credit balance compromises the working capital because states are generally slow to make refunds.

In order to correct the problem, some states grant the partial suspension of the ICMS due on imports, such as São Paulo State which published the Portaria CAT nº 108/13²².

However, this is a problem to be corrected in any tax reform that reduces the interstate ICMS rate, not only to imported goods but also to domestic goods.

5.2.2) IMPORTED CONTENTS CERTIFICATION

The Res. 13/12 changed the ICMS rate to imported goods that have not undergone the process of industrialization in Brazil, and, if imported raw materials are subjected to a manufacturing process, they result in goods with imported content greater than 40%²³.

The main problem is the need to prove the 40% import content, which must be calculated based on the company's costs.

The Convênio ICMS 38/2013²⁴ regulated Res. 13/12 and specified operational aspects including complex ancillary obligations to prove of imported content.

²² Secretaria da Fazenda do Estado de São Paulo - Portaria CAT nº 108, 10.24.2013 – "*Disciplina a concessão de regime especial para a suspensão do lançamento do ICMS devido no desembaraço aduaneiro de mercadorias importadas que serão objeto de saídas interestaduais sujeitas à alíquota de 4%, conforme Resolução do Senado Federal 13, de 25-04-2012*".

²³ Senado Federal do Brasil - Resolution nº 13, 05.25.12 – Artigo 1º, § 1º, inciso II.

Although this Convênio has simplified ancillary obligations in relation to the previously existing rule - Adjust SINIEF 19/2012²⁵, there are still complex ancillary obligations such as the fulfillment of the Import Content Sheet – FCI.

In summary, this FCI requires all taxpayers to undertake industrialization process with imported inputs related to production costs in order to assess the existence of the imported contents above 40%. Filling out the FCI is a burden to the taxpayer. Every industrial process with imported inputs is required to fill out the FCI and send it to the Secretary of Finance. This complex ancillary obligation is further compounded by products with a long manufacturing chain. Every industrial process with imported inputs is required to fill out the FCI and send it to the Secretary of Finance.

Takano²⁶ said that simplicity should be the vector to reduce the complexity of ancillary obligations of Res. 13/12. The ideal goal is that the costs of these additional obligations would be less than the costs of deleterious "Tax War of Ports" which affects domestic industry and the tax revenues of states.

On the other hand, we understand that an ICMS reform model adopting the same rates for domestic and imported products would dispense with proof of import content and greatly simplify such accessory obligations.

²⁴ Conselho Nacional de Política Fazendária - Convênio ICMS 38, 05.22.2013 – *“Dispõe sobre procedimentos a serem observados na aplicação da tributação pelo ICMS prevista na Resolução do Senado Federal nº 13, de 25 de abril de 2012, e autoriza a remissão de crédito tributário na hipótese em que especifica”*.

²⁵ Conselho Nacional de Política Fazendária - Ajuste SINIEF 19, 11.07.2012 (revogado pelo Convênio ICMS 38/13).

²⁶ Takano, Caio Augusto. *“A Guerra dos Portos e a estabilidade da Federação brasileira”*. Ob. Cit., p. 133.

6) ASPECTS OF NORTH AMERICAN TAXATION

The main American consumption tax is the Sales and Use Tax (US SUT), the State competence which contributed in 2014 with 31.3%²⁷ of the states' total revenue.

The US SUT comprises two types of taxes which are mutually exclusive: (i) Sales Tax is the retail sales tax, which is calculated as a percentage of the sale price and is payable by the seller at the time of sale; and (ii) Use Tax is levied on the use, storage, or consumption of tangible property and is paid by the buyer to the state of its location in situations where the Sales Tax has not been paid.

US SUT laws are quite varied according to the jurisdiction of each state, their rates are around 5-9%²⁸, and five states - Alaska, Delaware, Montana, New Hampshire, and Oregon - do not charge.

The main difference from the ICMS VAT is that the US SUT does not adopt the system of value added taxes (VAT), and it is calculated by applying a percentage of the value of the sale without compensation of credits from previous sales.

Thus, the problem arising from the transfer of credits that occurs in the Brazilian "Tax War" does not occur in the United States. However, the disadvantage in terms of economic efficiency is that the tax may be charged several times - cumulatively - on the same product in the middle of a chain of production or marketing.

According to Burman and Slemrod²⁹, the United States did not adopt the VAT because it would be unpopular to create a new tax that could raise hundreds of billions of dollars a year; furthermore, the storage cater to increased expansion of administration. Others

²⁷ United States CENSUS Bureau - <http://www2.census.gov/govs/statetax/G14-STC-Final.pdf> (Accessed in 11.07.2015).

²⁸ Tax Foundation - www.taxfoundation.org – (Accessed in 05.11.2015)

²⁹ Leonardo E. Burman and Joel Slemrod – "Taxes on America" pag. 101

also believe that the VAT would interfere with states' ability to administer their own sales tax - the largest source of revenue for state and local governments.

In practice, the American States grant tax exemptions and deductions for certain products used as inputs or as capital assets in order to avoid distortions arising from the cumulative. In general, the sales of raw materials, agricultural inputs, some fuel and machinery industries are exempt. However, these exemptions will certainly not generate the same effects in terms of neutrality and equality of VAT, as there should be situations in which sales are made between retailers and industry and the tax is collected cumulatively.

Another situation where the US SUT is not as efficient in terms of equality and neutrality is the taxation of interstate trade mainly in online sales, that in some situations is not taxed and causes great competition with traditional stores. In this situation, the Use Tax is levied instead of Sales Tax and it must be paid by the buyer in the state of its location.

The purpose of the Use Tax is precisely to protect local businesses from competition from dealers located in another state. However, as this obligation is with the buyer, the compliance rate is very low, as Burman and Slemrod highlight: “(...) in California has estimated that \$ 1,1 billion in use tax owed annually is never paid – a 1 percent compliance rate. Nationwide, uncollected sales tax is estimated at \$ 23 billion in 2012. Owners of “brick-and-mortar” retail stores complain that this gives online retailers an unfair (and, from a social perspective, inefficient) advantage.”.

For this reason, the states prefer to charge Sales Tax of the seller located in another state, but such charge may be challenged in court by the lack of nexus³⁰ between the seller and the state of consumption.

This is what happened with North Dakota which levied Sales Tax of a company localized in Delaware to hold a sale through catalog on its territory. In this situation, as in 1992, the US Supreme Court declared the unconstitutionality of the collection due to the encumbrance of interstate commerce, claiming that states cannot impose tax obligations on remote suppliers without having a legal determination in this regard.

In recent years, states have published laws to regulate this tax collection, called "Amazons Laws", however, the constitutionality of these rules is still questioned to the extent that the courts understand that there must be a nexus between the seller and the rule of destination of the product.

In fact, this connection to the target state beyond the physical and territorial aspect aims to protect remote taxpayer from the complexity of the Sales Tax by the various consumption states would require.

In 2005, The "Streamlined Sales and Use Tax Agreement - SSUTA" was created, which is basically the standardization of rates and ancillary obligations between States in order to facilitate the tax collection of remote sellers.

Therefore, one of the challenges of the American Sales Taxes is to develop a system of taxation of interstate commerce that reconciles the collection of Sales Tax with the simplification³¹ of taxation between the various jurisdictions.

³⁰ The Supreme Court found that the nexus must respect two constitutional provisions: i) The state has provided some benefit for which you can ask for something in return; ii) and the seller has a fair warning that their activities may be subject to jurisdiction of the State

7) CONCLUSION

We found that the complex structure of the ICMS VAT tax allows the existence of "Tax War of Ports" between the Brazilian States. Some states illegally granted ICMS tax benefits on imports which have majorly impacted on industrial activity in the country.

Our research also found that this systematic illegal ICMS tax benefits compromises the neutrality of taxation, causing the displacement of imports into states that host these types of benefits.

Despite the short time of operation, we note that there is evidence that Res. 13/12 produced the expected effects and altered the import flows of 2013, the first year of operation. More specifically, from São Paulo State, we found that the downward trend in their share of total imports, which had been occurring since 2000, was reversed.

We understand that the tax reform model adopted by Res. 13/12 is operating properly in that it rescued the competitiveness of domestic industry, making the most efficient taxation in terms of neutrality and free competition.

We believe that also reducing the interstate rate for domestic products and the reduction of taxation in the middle of the production chain, as occurs in the United States, is the most appropriate measure to reform the ICMS. Such measures, in addition to nullifying the effects of the Tax War on national products, would bring great simplification in the ICMS tax system, eliminating distortions arising from Res. 13/12 such as the need for proof of import content and the ICMS credit balance.

On the other hand, it is important to emphasize that the actual impact on the revenues of States due to the reduction of interstate ICMS rates was not analyzed in this study.

³¹ Congress after many years of discussion approved in 2013, the draft law called The Marketplace Fairness Act, which imposes a series of conditions and regulates this type of sale.

Certainly, this reduction will cause great loss to the producing states in the short term (the sale of products to other states will be taxed at 4% instead of 12%). However, in the long run, we believe that the benefits of these measures for economic development across the country offset these immediate losses, combining a more efficient tax system with the simplification of ancillary obligations and greater legal certainty.

Finally, as with the American tax system, we found that the Brazilian system has some distortions that need to be corrected. These adjustments should be made with caution and in partnership with the appropriate economic sectors so that the tax system causes the least possible interference and makes possible the development of economic activity.

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