Brazil

Globalization Challenges from a Brazilian Perspective

Globalization has increased competition between companies and between tax systems. The dogma of tax sovereignty falls apart when one realizes that international investors seek more attractive systems. It is not only financial capital that is movable: as an outcome of the international crisis, whole companies are moving from one country to another. Since it is useless to forbid such movements, each country seeks to adjust its juridical – including tax – system according to the common practice, under the risk of isolation.

Several countries take advantage of this competitive environment by enhancing their companies' abilities. Unfortunately, besides the high tax burden, the current Brazilian tax system demands oppressive compliance costs and offers clear examples of mismatch with the international standards.

Brazilian multinational companies are subject to fiscal transparency on their taxation on a worldwide income basis. While several countries restrict transparency to CFC legislation (usually passive income in tax havens), Brazilian law applies the same regime for every investment, which ends up exporting the Brazilian tax burden.

As a result, if a subsidiary of a Brazilian company is in a country where it competes with locals and multinationals therein, all under the same taxation, only the Brazilian parent company will have the additional tax burden from undistributed profits. Accordingly, if the competitor is a European company, dividends shall most probably not be taxed in the country of the parent company due to the participation exemption. In the case of investors from the US, dividends shall be taxed only if and when they are distributed (tax deferral), not to mention the possibility of offsetting taxes paid in third countries. If one considers that subsidiaries usually do not distribute profits, but rather reinvest them, the effect on competition is enormous.

Present Brazilian transfer pricing rules also discourage investments in the country. Suffice it to say that the resale price method – one of the most usual and ordinary methods – requires, on the resale price of a company that purchases a good that is already finished and not submitted to any further production locally, a predetermined profit margin of 20%. If the same company decides to purchase raw material and industrialize it in Brazil, the margin will jump to 60%. In such a circumstance, for a cost of $ 40, a profit of $ 60 is required, which implies an absurd margin of 150%.

One should also take into account the insignificant number of Brazilian tax treaties: this issue becomes especially relevant insofar as Brazil is becoming the host country of multinational companies investing abroad.

When it comes to international trade, Brazilian compliance with WTO rules (namely the national treatment principle) was questioned worldwide when, in late 2011, the government raised by about 30% the excise tax charged on imported vehicles that do not meet requirements of national content (at least 65%). Despite the absence of a formal trade dispute regarding the issue to date, this is not the first time Brazil raises questions in the ambit of the WTO; one may remember the "Brazil Aircraft case", where the DSB allowed Canada to adopt compensatory measures regarding illegal subsidies granted by the country to its main airplane export company (Embraer). On the other hand, one must say that Brazil has successfully claimed before the WTO the illegality of the subsidies granted by other countries. This was the case of the US to its cotton producers.

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