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PERSPECTIVES ON TAX REFORM IN BRAZIL[1]

Marc Morgan[2]

There is no question that the salience of tax reform in Brazil is high. It has become common to point out the country's low quality of public services and high level of taxes, at least from the view of the country's 'middle class' and poorer income groups. In this context it would be desirable to introduce new ways of thinking about matters related to government policy generally, and tax policy more specifically. By understanding the function and potential of taxes, as well as their links to inequality and economic development, the seed can be planted for deep change. Once we conceptualise the potential of certain policies, momentum can be garnered to fully realise them if they are desirable to a majority of the population.

Of the many economic issues, taxation is the one that is most often clouded by emotional thinking based on opaque reference points of judgement. Everyone is inclined to generalise from their personal situation without much regard for society as a whole. But regard for the whole is crucial if we are to achieve some sense of equity. How would we like to imagine a tax system if we did not know our economic position in society? And how could this system better advance the material development of the whole? This article attempts to examine the design of a tax system that would better serve the principles of equity and efficiency for Brazil and make the country a global leader in progressive tax policy. It is divided into four sections. First, the broad relationship between taxation and economic development will be explored, before delving into the link between taxation and inequality in Section 2. Section 3 presents the main proposals advanced in relation to two types of taxes, while Section 4 dwells on implications for other taxes currently debated in Brazil. Some final remarks will conclude the article.

1 TAXATION AND ECONOMIC DEVELOPMENT

Learning to tax effectively requires an understanding of the necessary conditions for its realisation. In an article in the early 1960s, British economist Nicholas Kaldor (1963) provided some clarity for underdeveloped countries regarding their tax-collecting potential. He timelessly outlined three factors that determine the abilities of countries to tax effectively, which, taken together, provide the necessary bedrock for successful tax reform.

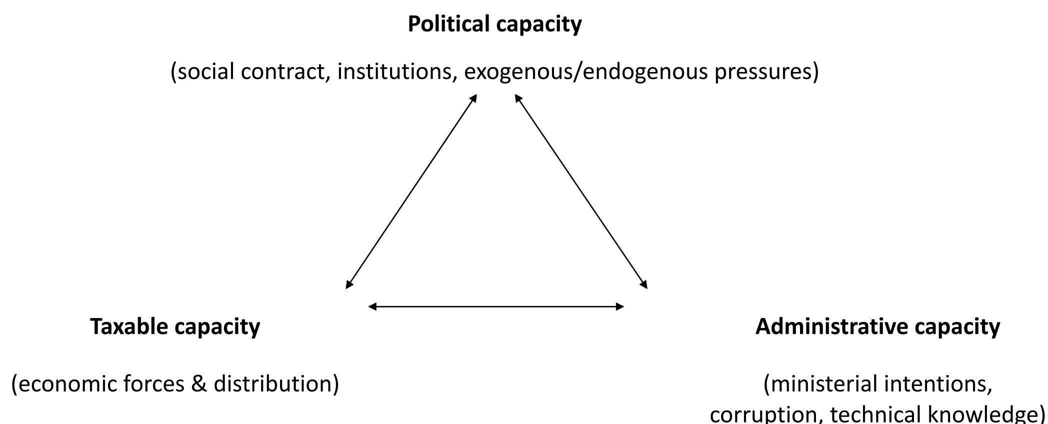
1. This is the English adaptation and revision of the article published in Fagnani (2018).

2. World Inequality Lab, Paris School of Economics and *L'Ecole des Hautes Etudes en Sciences Sociales.*

These interrelated elements are represented in Figure1. First and foremost, a country must have taxable capacity. This capacity is dependent on the existence of a tax base, from which to collect revenues. It is dependent on standard economic forces that lead to the generation of incomes that feed the tax base, and, importantly, on their distribution. For underdeveloped countries in particular, this latter force overrides considerations about average income values. Per capita incomes are, after all, an unsatisfactory indicator of whether substantial incomes exist for revenue-diverting purposes.

The second element to have in mind when thinking about the potential of taxes and their reform is administrative capacity. This has to do with the organisational proficiencies of the political class and the civil service. Everything from ministerial goodwill (including checks and balances on corruption) to the technical competencies of civil servants determines the efficiency with which tax collection or reform can be handled. However, taxable capacity and administrative capacity will only get a country so far in its quest for successful tax reform. For most middle- and high-income countries, the primordial factor setting change in motion, as Kaldor himself recognised, was political capacity (or "the balance of political power" in Kaldor's terms). This capacity is more institutionally and culturally rooted than administrative capacity, as it represents a social contract between the different constituent members of a society. This contract shapes the institutions that support it, without being immune to either exogenous pressures (foreign influences that can re-shape the contract) or endogenous pressures (in-built mechanisms of the contract that can lead to its (in-)stability over time).

FIGURE 1
Kaldor's triangle of tax reform



Source: Authors' elaboration from Kaldor (1963).

When it comes to taxes, two broad purposes can be associated with them. The first is to redeem public spending already made by a currency-issuing government so that price stability is maintained. By taking money out of circulation, taxes can control inflation.[3] The second function of taxes, by modifying prices, is to encourage or discourage particular behaviours of individuals, whether they be through income or wealth taxes, or consumption taxes. In relation to the former, they can regulate the amount of income received or property controlled by individuals. Thus, taxes can define the bounds of a socially acceptable and economically desirable schedule of income or wealth, making socially excessive and economically unproductive incomes or portfolios costly to sustain.

2 INEQUALITY AND TAXATION

It is the second purpose of taxes that bears closest relation with inequality. This is due to the incentives that are generated from taxing different levels of income at different rates. For instance, if high-income recipients do not modify their remuneration behaviour when faced with higher tax rates, the State will not only collect more revenue but also limit post-tax inequality. If individuals do lower their remunerations, then the State will collect less in revenue, but pre-tax inequality will be reduced. Top income groups may even maintain their remunerations intact but choose to avoid taxes through legal loopholes or outright offshore evasion, which would have no effect on inequality or state revenues. Or they may simply opt to work less. The design of the tax system must balance these potential behaviours. Maintaining work incentives has to do with more than just the tax system, being related to economic activity more generally and to the personal aspirations of individuals. Tax avoidance and evasion, on the other hand, are much more connected to the design of the system through tax enforcement rules, the size of the tax base and the extent of tax neutrality ('horizontal equity') across income types. The same is true of bargaining for compensation in the context of an enterprise, since taxes can significantly alter the net reward for an executive's bargaining efforts.

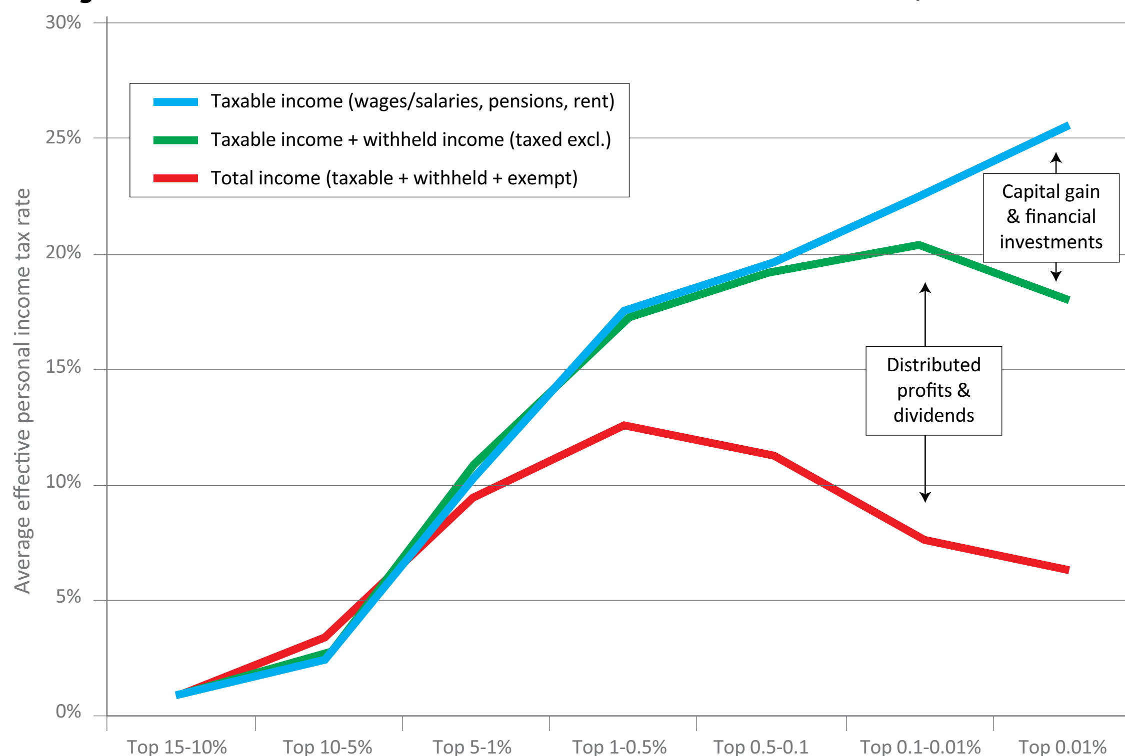
Brazil is a notable case of high income inequality coexisting with a weak regulatory personal income tax. These findings are a clear reflection of the separation of incomes in the country for fiscal purposes. As one moves up in the pre-tax fiscal income distribution, it is the sources of income received that matter most for individual tax rates (Morgan 2017). And such a fiscal separation of income can have a positive feedback on pre-tax income inequality. This is because high and horizontally uniform tax rates make it more difficult for individuals who have to bargain to increase their compensation, such as corporate executives, to receive a higher income (Piketty, Saez, and Stantcheva 2014).[4]

Figure 2 shows the different average effective tax rates applying on different categories of income in Brazil in 2015. The lack of tax neutrality between income forms is manifest, with income from capital gains and financial investments being subject to a separate, lower tax schedule, and in the case of dividends, no personal tax schedule at all. Moreover, with such a restricted tax schedule on taxable incomes (with rates ranging from 7.5 per cent to 27.5 per cent) and low average effective rates overall (due to the tax exemptions for certain important categories of income pertaining to the top), the constraint on 'compensation-bargaining' is not going to be very binding. This explains to a large degree the substantial income differences persisting in Brazil.

Crucially, the fiscal separation of income can influence the forms of remuneration chosen by asset-owning elites, linking the tax system to decisions that have important macroeconomic implications. This can be appreciated from decisions by corporate owners (i.e. shareholders) on whether to receive distributed profits (i.e. dividends) or to realise future capital gains by selling their shares later, or opting for share bonus schemes/buybacks, rather than accumulating wealth through retained earnings to re-invest in the company. In the Brazilian case, corporate owners pay less tax on distributed profits and share bonus schemes (being completely exempt) than if they were to accumulate profits in the company (either for induced capital gains—taxed at 15 per cent—or for fixed investments that increase labour incomes—taxed at the highest marginal rate of 27.5 per cent). The ploughing of profits into financial markets, whether through private equity or government securities, is a lucrative deal for upper income classes, given high interest rates and the favourable tax regime for these types of income. Therefore, under the prevailing incentives, the Brazilian income tax system opens the door to distinct forms of rent extraction among elites, the accumulation of financial paper assets and a short-term culture of 'maximising

shareholder value'. The challenge would be to design an income tax system that encourages real productive investment over profit withdrawals or financial asset purchases.

FIGURE 2
Average effective income tax rates for different income distributions in Brazil, 2015



Source: Morgan (2017).

The link between inequality and taxation can also be made from a more macro perspective. The concentration of income can have adverse demand effects for the economy, since it increases savings (higher-income households have higher saving rates) and increases the volatility of expenditures. The latter can be amplified by the lack of full employment across the business cycle, weak labour protection laws and weak income taxation. Therefore, a more progressive tax system could tap into the high saving propensities of richer households to divert private resources to much-needed public investment projects. By taxing more the individuals who consume a relatively small share of their income, and expanding the income of those who consume a higher fraction of their income (directly through transfers or indirectly through investment and more inclusive labour laws), the government could provide a dynamic stimulus to the economy. Otherwise, the excess savings will create a vicious cycle, going into financial markets, increasing the share of the financial sector and financial incomes, thereby increasing inequality further (as income is shifted from households with low saving rates to households with higher saving rates), which increases household saving further, and so on and so forth.

Furthermore, a large financial sector can have depressing effects on consumption and investment. This is because bull markets (markets with rising asset prices) provide lucrative alternatives to investment in production, as financial investments, being more liquid than real investments, provide returns more quickly. Investment in productive capital (plant, equipment, research and development in new products and technologies, worker retraining etc.) are

riskier, as they require greater financial commitment for a longer duration of time. This investment is, therefore, apt to be undertaken by the government, especially in periods of uncertainty or depressed market sentiment, since a currency-issuing government can more easily bear the risks involved (Mazzucato 2013). For private firms to be more encouraged to invest in such areas, a reduction in the cost of these investments would be desirable. A progressive and development-oriented tax system could be imagined to have multiple and complementary roles. It could regulate incomes more effectively to deconcentrate income, encourage private investments and divert resources for government infrastructure projects, whether the economy is operating below or at full capacity.

3 PROPOSALS FOR TAX REFORM

The discussion I present here can be seen as a rough blueprint for a more progressive tax system for Brazil that could aspire to the objectives outlined above. I shall mainly consider two types of direct taxes where the beginnings of a democratic 'fiscal revolution' could take place: the taxation of income and the taxation of inherited property. I will also briefly refer to implications for the taxation of other types of sources—namely, wealth, and goods and services—that are currently being debated.

3.1 INCOME TAXATION

A first point to note is that the Brazilian tax system is very complex and opaque. It is full of fiscal niches that benefit incomes unequally held in the distribution, such as different types of capital income. Overall, as Figure 2 shows, personal income tax becomes regressive within the richest 1 per cent of the population. This makes the system profoundly unjust and economically rather inefficient, as previously explained. In this case, reforms on the margin, such as taxing dividends exclusively at source at 15 per cent (as they were before 1995) or including them in the progressive individual income tax (*Imposto de Renda de Pessoa Física*—IRPF) schedule alongside labour incomes and property rent, would miss a big opportunity, despite both proposals being revenue-raising and inequality reducing (Gobetti and Orair 2016).

Concerning personal income tax, therefore, a more complete reform could be imagined. The current IRPF could be replaced with a new income tax, replacing a large number of existing taxes, including social contributions, the current IRPF and other levies. As an illustration for the collective imagination, a simplified, comprehensive personal income tax schedule for Brazil is presented in Table 1.[5] This new tax would be levied at source on labour and capital incomes, following a progressive scale. Four important features should be noted.

First, the schedule applies to total income, defined in multiples of the minimum wage, rather than to a portion of income defined according to selected monetary thresholds (as in the current IRPF). By anchoring incomes in the schedule to the minimum wage directly, the income tax system can compress the distribution more easily while adjusting the value of the minimum over the course of the country's development. It should be noted that this would not be a 'new' proposal in the context of Brazilian fiscal history. Law No. 3.898 (19 May 1961) tethered the entire personal income tax schedule (threshold levels and deductions) to the highest monthly minimum wage in the country. For 1962, the exemption threshold was set at 24 times the country's highest minimum wage in the year preceding the year when the tax was

due. The top rate for the 1962 exercise—60 per cent—was levied on the portion of income exceeding 800 times the minimum wage (which was Cr$13,440 in 1962). This law lasted until 1964, when the military government returned to expressing the tax schedule in nominal currency, rather than being anchored to the minimum wage, whose value would be frozen in the following years (Nóbrega 2014).

Second, the schedule is expressed in effective tax rates, rather than marginal tax rates (as in the current IRPF). Thus, there are no 'threshold effects', whereby marginal rates produce significant jumps in tax payments and lead to bunching at certain income levels. The elimination of high marginal tax rates at the bottom would also remove the stimulus to informality. With a schedule expressed in effective rates, the amount of tax payable moves continuously and more smoothly with income. It also has the benefit of increasing clarity on who pays what—something that is made more complex with marginal rates. The top effective rate of 65 per cent is not unknown in Brazilian tax history, given that it was the top marginal rate above the final threshold for income tax in the early-to-mid-1960s and again in the mid-1980s.[6]

Third, the tax would completely replace the plethora of levies, contributions and local taxes existing in Brazil, making the system a whole lot simpler and transparent. There is no reason why payments to social funds should only be borne by labour incomes. In this case, a portion of the revenues could still be earmarked, through specific legislation, for social expenses (such as pensions and unemployment insurance) in the same way as current social contributions are. Similarly, the transfer of revenues between the federal, state and local governments could by legislated within this new system, according to clear rules decided democratically.

Fourth, by extending the schedule to cover incomes equal to and above one minimum wage, the income tax would reach a greater proportion of the population (approximately 70 per cent) and almost all personal income, compared to the current IRPF schedule, which covers about 20 per cent of the population and is restricted to 60 per cent of personal income considered taxable by the Receita Federal, and only 35 per cent of total personal income recorded in national accounts. By covering more people in a single, unified system, with tax neutrality across income types, the divisions between 'insiders' and 'outsiders' to the system—or between contributors and taxpayers—would be reduced. This would approach the principle, practised for decades in Scandinavian countries, of giving as many people as possible a stake in the system to lock in their interests towards its effective functioning.[7]

The tax would be levied at source every month by the employer or financial institution on behalf of the taxpayer, according to the income received from the paying institution. Since the effective tax to be paid depends on the annual income finally received by individuals (after certain deductions, such as a child allowance or intermediate business expenses of independent workers), corrections would be made at the beginning of the following year to each contributor's bank account. This procedure would be facilitated by the *Declaração de Informações sobre Movimentação Financeira* (DIMOF), a specific monitoring programme used by the Receita Federal which matches declared personal incomes from tax records with financial information provided by banks about all financial operations undertaken by their clients.

Such a comprehensive tax system would be preferable in my view to a dual tax system, in which, typically, labour and capital incomes are taxed through separate schedules. Current dual tax systems favour lower taxes on capital income than on labour incomes, whereas in the past it was common for countries such as the USA and the UK to apply higher rates on investment income (through a surcharge). Whatever the prevailing fashion, the distinction

between labour income and capital income is not easily made for the highest incomes. This favours equal treatment of distributed income to avoid tax optimisation behaviours that are not equally accessible to all.

TABLE 1
New comprehensive personal income tax schedule

Gross monthly income (multiples of monthly min. wage)	**Effective tax rate**	**Monthly tax bill** (example for 2018)
1	2%	BRL 19
2.5	10%	BRL 239
5	15%	BRL 716
20	25%	BRL 4,770
100	50%	BRL 47,700
250	65%	BRL 155,025

Source: Author's elaboration.

The reform of the personal income tax should not lose sight of changes to the corporate income tax, being itself part of the general income tax system. With National Institute for Social Security (*Instituto Nacional do Seguro Social*—INSS) and other social contributions being absorbed into the personal income tax, numerous contributions and payroll taxes could be abolished, such as social contributions of employees, the *Contribuição Social sobre o Lucro Líquido* (CSLL), the PIS/Cofins, *Salário-Educação*, *Sistema S* etc. Work-accident insurance and the *Fundo de Garantia do Tempo de Serviço* (FGTS) pension fund could remain or be reconfigured. The broad goal would be to simplify the corporate tax regime and invert the tendencies of independent workers towards *pejotização* (Gobetti and Orair 2018).[8] The closer complementarity of the taxation of personal incomes and corporate incomes would certainly help. The horizontally uniform and vertically equitable personal income tax presented above better calibrates the parameters of the tax system, by removing arbitrariness and tax erosion behaviours associated with *pejotização* and other phenomena that take advantage of current exemptions. With the expansion of the personal income tax, a reduction in the contribution made by employers (currently 20 per cent of total payroll) would be feasible, or at least for it to be only applicable to the portion of incomes that do not exceed the INSS ceiling, as proposed by Gobetti and Orair (2018). This could be a transitory phase over the short term, before eventually enlarging the base of contributions further and integrating them into the new personal income tax.

Regarding the tax rates applying on corporate profits, a similar progressive effective tax schedule could be imagined with rates ranging from 5 per cent to 30 per cent on gross income before depreciation, covering all companies in the currently separate regimes. Deductions could be used to incentivise the reinvestment of profits in fixed and human capital for replacement or expansion (plant, equipment, research and development in new products and technologies, worker retraining etc.), rather than investment in financial assets. A reinvestment income deduction could deduct the total value of this reinvestment from the taxable amount.[9] Alternatively, a surcharge on the investments made by firms in financial assets could be applied. Without the reinvestment income discount, the top corporate tax rate could be reduced—to, say, 25 per cent—with a surcharge—of, say, 15 per cent—imposed on profits invested in financial markets (increasing the top rate to 40 per cent in this case). The development of an inclusive productive structure where employment and income is more equally shared would be the broad objective.

3.2 TAXATION OF INHERITED PROPERTY

Given that much of private wealth is collectively determined (central bank setting interest rates, the effects of urbanisation on land prices, public investment in new products and technologies that become privatised, collective labour input into the capital value of firms etc.), it makes sense to tax wealth, especially when it is passed down through generations. Inheritance can be a powerful accelerator of unearned inequality and a destructor of meritocratic values. Rich liberal democracies, such as the UK and the USA, understood this, levying high taxes on estates passed down between generations (top marginal rates reached 70 per cent and 80 per cent, respectively, on the highest inheritances for much of the mid-20th century). The liberal British economist John Stuart Mill advanced the idea for a progressive inheritance tax already in the 19th century, stating that "a heavy graduated succession duty on all inheritances exceeding [a] minimum amount, which is sufficient to aid but not supersede personal exertion" should be created (Ekelund Jr. and Walker 1996, 578).

Some form of taxation of inheritance and *inter vivos* gifts/donations has existed in most countries. Brazil is no exception. The *Imposto sobre Transmissão Causa Mortis e Doação* (ITCMD) was created by the 1891 constitution and regulated in 1898 with tax rates between 0.5 per cent and 22 per cent, according to the relationship between the donor and the recipient (in the Federal District, for example, this range was increased to between 3 per cent and 38 per cent in 1940, and between 2 per cent and 65 per cent in 1962).[10] The ITCMD went through various changes over time, but the principal change came with the 18th Constitutional Amendment of 1965 (during the military dictatorship), which limited the tax base to immovable properties and reduced the tax rate to 2 per cent (Carvalho Jr. 2018). Its current form derives from the 1988 constitution, which expanded the tax's base. It continues to be a state-level tax, levied by each state government on any type of inheritance and donation, according to its own discretionary schedule. The only common feature across states is that the maximum marginal tax rate cannot exceed 8 per cent, which is very low by current and historical international standards.[11] There is no specific clause for the tax to be progressive (increasing by levels of inheritance/donations), but more states have been moving to a progressive schedule, with marginal rates ranging from 1 per cent to 8 per cent (currently, 15 out of 27 states operate a progressive system). On average, the ITCMD represents less than 1 per cent of state revenues.

In my view, the most appealing of the proposals to explore in this area would be to reform the current inheritance and donations tax into a universally progressive lifetime capital receipts tax, similar to the one envisaged by Atkinson (2015). Table 2 conveys an illustrative schedule of what this tax could look like in the Brazilian case. It would be a tax on the amount of inheritance transfers and donations received (capital receipts) each year, where the tax to be applied depends on lifetime receipts. This means that "every legacy or gift received by a person would be recorded from the date of initiation of the tax, and the tax payable determined by the sum received to date" (ibid., 194).

Similar to the personal income tax reform proposal, the scale of capital values is anchored to multiples of the minimum wage, with the schedule being expressed in effective tax rates, again ensuring a smooth evolution of tax payments according to the accumulated value of transfers received (see Note 2 of Table 2 for an example). Exemptions could apply to the transfer of property between spouses or civil partners and donations received by charitable associations (up to a certain limit). For the case of land and housing, different competing arguments can be made regarding its taxable status. One could argue that residential property used as the recipient's sole residence should be exempt, on the grounds of its use

and sentimental value. In cases where residential property is sold, the value received would be subject to the tax. Similarly, for the transfer of land, a register of land values would have to determine the market value of the land, and transfers could be exempt or taxed according to its cultivated use by the recipients. On the other hand, one can make the case for this real estate to be subject to the schedule in full, on the basis that immovable property (residential real estate and land) is a scarce resource that comprises prime necessities for the population. Where the sums involved are substantial, a provision to pay in the form of an equity stake in the value of the property could be installed (ibid.). This arrangement could pave the way for a gradual transfer of such real estate into the public sector over time, making it collectively owned and augmenting the state's net worth. Property would then be leased from the state for short-term or long-term periods, with clear and strict laws applying to the government's (or parliament's) capacity to revoke the contracts.[12]

TABLE 2
New inheritance tax schedule (lifetime e capital receipts tax)

Accumulated capital receipts (multiples of annual min. wage)	**Effective tax rate**	**Annual tax bill** (example for 2018)
5	20%	BRL 11,448
25	30%	BRL 85,860
50	45%	BRL 257,580
200	65%	BRL 1,488,240
1,000	70%	BRL 8,013,600
2,500	75%	BRL 21,465,000

Source: Author's elaboration.

The tax would still be collected at the state level, with the schedule in Table 2 acting as a minimum schedule to be applied across the federal territory. The schedule chosen here parts from the principle that for the same amount received (expressed as multiples of the minimum wage), a higher tax should be applied to transfers from inheritance or donations than to amounts received from one's own labour or capital investment. Such a system would incentivise transferring movable property in small doses across more receivers, which would better regulate the transmission of inequalities from one generation to the next. Concerning the transfer of business capital (in family-owned firms or other companies in the form of shareholdings), the new lifetime capital receipts tax would directly encourage a dilution of ownership into smaller stock participations. Otherwise, the government could directly receive equity in the firms equal to the value of the tax payable and subsequently offer the shares to the workers in the firms at discounted prices. This would help broaden capital ownership across the population.[13]

4 IMPLICATIONS FOR OTHER TAXES

4.1 AN ANNUAL WEALTH TAX ON LARGE FORTUNES?

The discussion of taxing inheritance usually brings forth the question of an annual wealth tax. Many proponents of the latter believe that a recurrent tax on wealth owned would be more desirable than a 'one-off' tax on inheritance. While reasonable to think so, the above

proposal for inheritance tax does give it more of a recurrent character, as gifts and donations would be covered in full, and be tracked by the DIMOF. Nevertheless, some valid arguments exist for the introduction of a tax on net wealth (after deduction of debts), most notably the high levels of inequality persisting in the country and the significant levels of private wealth held domestically. An annual capital tax can also be thought of to finance interest on the national debt, in cases where an increase in the national debt, from deficit spending, does not expand national income sufficiently to cover the increasing amount of interest. Moreover, the implementation of a wealth tax would be a democratic and transparent way to directly track and assess the distribution of wealth among the population (even if revenues from the tax are usually very low). Thus, a proposal to be examined would be the introduction of an annual tax on net wealth above a certain threshold, with marginal rates inspired from international standards with minimal exemptions (for example, five rates, starting at 0.5 per cent and incrementing by steps of 0.25 per cent until reaching 1.5 per cent). With large fortunes under assessment, a provision for payment could take the form of an equity participation in the value of the assets (real estate, business capital etc.).[14]

The issue always arising in debates about property taxes, whether wealth or inheritance, is tax avoidance and evasion. On the positive side, the Receita Federal already avails of a registry of financial assets (which are most susceptible to evading taxes), knowing the owners and jurisdiction of the financial assets of individuals included in the IRPF. This monitoring programme could be expanded to cover all privately owned financial assets. However, for greater effectiveness, Brazil must cooperate with foreign tax authorities to put an end to cross-border evasion. It should certainly back the proposal for the automatic exchange of bank information to be encouraged through commercial sanctions by regional coalitions on non-cooperating countries and verified by a 'world financial registry' under the supervision of an international public organisation (World Inequality Lab 2018; Zucman 2015).[15]

This initiative would be facilitated by the creation of a global tax on capital, withheld at source by, for instance, the International Monetary Fund on behalf of the individual countries. The rate of this tax should be at least equal to the highest national rate observed—for example, 3 per cent. It would act as a sufficient constraint against financial opacity, since the tax would only be reimbursed to the proprietaries of the assets once they declare these assets on their tax form in their home countries, thus allowing states to preserve their fiscal sovereignty.[16] For countries that already have a wealth tax, their taxpayers would be reimbursed the difference between what is withheld at source by the International Monetary Fund (or another global institution) and what is due to the fiscal authorities in their home countries. The citizens not subject to any rate under the tax would be reimbursed the entirety of the 3 per cent (Zucman 2015). A global tax on capital could also motivate countries that currently do not have a progressive wealth tax, such as Brazil, to create one, without fearing capital flight.

4.2 REDUCING THE DEPENDENCE ON CONSUMPTION TAXES

The principle concern of this article was with direct taxation, as evidenced by the proposals made. However, with an expanded role of direct taxes, the reliance on indirect consumption taxes in Brazil could be eased, especially for the most modest households. These taxes are known to be fragmented, highly complex and regressive (Silveira, Rezende, Afonso, and Ferreira 2013). Proposals to move towards a modern federal value-added tax system, implemented gradually in conjunction with state-level value-added taxes (*Impostos sobre Valor Agregado*—IVAs) are definitely worth pursuing.[17] In this scenario it would be desirable

to simplify the indirect tax system, merging or substituting current levies for the creation of a more unified and transparent value-added tax covering all products, without exemptions or preferential treatments, and with a limited number of rates.

FINAL REMARKS

The perspectives on tax reform presented in this article are, first and foremost, intended to open up space for ideas and debate in a country where the topic is becoming ever more salient. Brazil should not have to draw inspiration from other developing countries, or even from current trends in OECD countries. It should seek to become a leader of its own in matters of tax policy, by looking at its global history and the country's own potential and creativity. The proposals sketched out in this paper are only blueprints for a more socially just and economically efficient tax system. It is important to envisage the reforms as one part of a broader project—namely, fiscal policy. A more complete fiscal revolution would integrate the spending side of fiscal policy into the equation. While the latter is beyond the scope of this article, it is crucial not to lose sight of it. As was highlighted above, taxes are a tool to stabilise prices, regulate incomes and wealth and redirect resources towards investing in the future.

The framing of the reforms—how their objectives are transmitted—needs to be thought out. It is down to the sphere of philosophy to offer a vision of how a society can function. If citizens agree with the vision advanced and channel their behaviours accordingly, there is no reason why far-reaching reforms cannot be successful. Of course, making the transition in a country that is still underdeveloped and carrying very high levels of inequality is a tall order. It was these types of considerations that made Nicholas Kaldor ponder whether progressive taxation is only applicable when a country has reached an advanced stage of development. The answer can be found in his triangle of fiscal reform, presented in Figure 1. Even at a low stage of development, countries with a high concentration of resources will always have taxable capacity—something the average income of a country does not reveal. Therefore, the choices facing the country are located in the other two corners of the triangle—creating the administrative capacity for enforcement and collection and fostering the political capacity to make change happen.

This is why inequality is in the end a political choice; it depends on factors that are 'chosen'. But this is not to say that the solution is easy. The good news is that Brazil already has a relatively high degree of administrative capacity (a well-paid and knowledgeable civil service, counting on the latest tax assessment techniques). The issue going forward is to improve tax enforcement, by tackling tax avoidance and evasion, which have been a prevalent feature of economies such as Brazil's. A further factor inhibiting development on this front has been informality. Characteristic of the region, close to one third of the country's workforce is in the informal sector and, therefore, excluded from much of the tax and benefit system. However, the proposal made for the new personal income tax could entice more workers to enter formal jobs (with their demand being driven by government investment), given the removal of threshold effects and high marginal tax rates at the bottom of the distribution in the new system.

However, as Kaldor (1963, 419) recognised, the central element to put things in motion in a democracy is political power: "The problem which has yet to be solved is how to bring about that change in the balance of power which is needed to avert revolutions with *having* a revolution?" This would depend, it seems, on the aversion of the ruling classes to instability, and to their grip on policymaking circles and the economy more generally.

Ties to policymaking circles are channelled through 'instrumental power', which is the power wielded through institutional outlets that influence opinions, such as the media, partisan links to political parties, campaign finance etc. Economic influence operates through 'structural power', which is the indirect influence that individuals, groups or sectors have over the policymaking process through their control of investment and employment. Structural power thus derives from the economic position that agents have in particular societies. In market-based capitalist societies, private-sector agents will tend to have strong structural power, particularly if they are attached to a sector that contributes a significant share of gross domestic product (GDP), generates significant employment or maintains many linkages to other sectors that can magnify the impact of its investment decisions (Fairfield 2015).

Following the historical lessons from developed economies, in which elites relinquished many of their privileges for future social stability, could the Brazilian ruling class not learn to acquire "an instinctive appreciation of its long-run interests"? (Kaldor 1963, 419). Is there something distinct about Brazilian capitalists (and Latin American capitalists more generally)? Do Brazilian capitalists not need the development of the rest of society for their long-run economic interests? Of all the mechanisms imaginable to change a society's vertical structure, progressive taxation would seem one of the most peaceful and democratic. Over the 20th century it became one of the central pillars of social democratic movements and parties around the western hemisphere. This is because many social thinkers of that century identified that inherent instability is the result of political democracies that do not democratise their economic systems and forge plutocracies along the course of their development. This state of affairs only increases social tension and can breed the rise of violent transitions or regimes. In many ways, the Second World War served as the turning point for social democracy, as it sought to prevent the renewal of fascism in the future. Building an inclusive, democratic vision of the economy would thus be the first step on the long road towards sustainable development for countries such as Brazil.

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NOTES

3. For governments not issuing their own currency, such as Eurozone or dollarised countries, taxes are required to fund spending, since they cannot provide currency through their own central bank to spend before they collect revenues. For currency-issuing governments, such as Brazil, revenues are only needed to be collected for public spending when the economy is functioning at full capacity and the government, for example, wants to build needed infrastructure. In this case, taxes would be used to divert some of the fully utilised resources from the private sector to the public sector. When operating below full capacity, the excess space always gives the government room to spend directly without needing 'revenues' to do so (Mitchell, Wray, and Watts 2016).

4. The authors refer to the elasticity of the change in income to the change in tax rates that is not due labour supply or tax avoidance as the "compensation-bargaining elasticity"—a response that leads to changes in remuneration as a result of the different incentives created by the new tax rates in the negotiation process.

5. For an application of this type of tax to the French context, see Landais, Piketty, and Saez (2011).

6. The schedule presented in Table 1 is meant to be an illustrative guide. Different rates and income scales could be imagined. Ideally, using comprehensive data on incomes from income tax files and social contributions, one could simulate the effects of such reforms on the budget and on inequality, as done by Landais, Piketty, and Saez (2011). See: <http://www.revolution-fiscale.fr/>.

7. Of course, this strategy requires that support be also attached to the spending and services side of fiscal policy, by ensuring that universal spending and high-quality public services are attained. These matters are beyond the scope of this article.

8. A practice whereby a private individual establishes a company and becomes a shareholder for tax avoidance purposes.

9. If the value of the reinvestment exceeds the taxable amount, the excess can be carried over for deduction in subsequent years (Kalecki 1946).

10. Article 5 of Federal Decree-Law 2,224 of 1940 and Article 76 of Federal Law 4,191 of 1962. In the latter law, the exemption limit was defined up to five times the minimum wage of the Federal District.

11. However, the state tax thresholds are also very low for international standards, and there is no tax differentiation by type of relationship. Since 2015, the ratio of Brazil's inheritance tax to GDP is the highest amongst developing countries. However, its effects on inequality are very limited (ibid.).

12. The revenues from this reformed tax could effectively finance a minimum inheritance for all Brazilians upon reaching adulthood (as proposed by Atkinson (2015) for the UK) of the value of the minimum threshold chosen for the schedule—for example, five annual minimum wages.

13. As with the personal income tax proposal, different schedules can be imagined for the taxation of inheritance. A valid argument exists for the abolishment of all inheritances and donations received by individuals above a minimum amount, on the basis that personal exertion should not be displaced by being born into wealth (after all, receiving 25 per cent of the value of transfers at or above 2,500 annual minimum wages without working for it is a very handsome amount). This would imply the application of a 100 per cent effective tax rate on transfers received above the minimum threshold, which could be set at five annual minimum wages, for example, while maintaining the exemptions outlined in the text. The state would thus take a 100 per cent equity stake in the assets, whose value exceeds the minimum threshold.

14. If the goal is to devise a capital tax to service national debt, it would make sense to take into account the net capital of firms and persons (excluding shares to avoid the double taxation of business capital). As Michal Kalecki (1946) highlighted, since such a capital tax would be paid from all forms of wealth, capitalist consumption and the profitability of investment would not be affected. Thus, the tax would not affect output and employment when the national debt is increased to finance the full employment of resources.

15. A world financial registry would in effect identify the owners and jurisdiction of all global financial assets in circulation, allowing national fiscal administrations to verify that their contributors have honestly declared all their financial assets inscribed in the registry.

16. This reimbursement clause would also be a constraint against the use of trusts and foundations by individuals to conceal their identity.

17. For more information on this harmonised system, see Gobetti and Orair (2018).

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