

Cooperative Compliance in Brazil: What Does the Future Hold?

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Institutions for
Development Sector

Fiscal Management
Division

TECHNICAL NOTE N°
IDB-TN-2793

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**Cataloging-in-Publication data provided by the
Inter-American Development Bank
Felipe Herrera Library**

Calijuri, Monica.

Cooperative compliance in Brazil: what does the future hold? / Monica Schpallir Calijuri, Phelippe Toledo Pires de Oliveira.

p. cm. — (IDB Technical Note ; 2793)

Includes bibliographical references.

1. Taxation-Brazil. 2. Taxpayer compliance-Brazil. 3. Tax administration and procedure-Brazil. I. Oliveira, Phelippe Toledo Pires de. II. Inter-American Development Bank. Fiscal Management Division. III. Title. IV. Series.
IDB-TN-2793

JEL Codes: H25, H26, H27, H32, H83, H87

Keywords: cooperative compliance, taxpayer compliance, risk, certainty, litigation

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COOPERATIVE COMPLIANCE IN BRAZIL

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Abstract

The concept of cooperative compliance has gained momentum in recent years as tax authorities seek to establish more collaborative relationships with taxpayers, especially in member countries of the Organisation for Economic Co-operation and Development (OECD). The subject had not arisen with the same interest in Latin America and the Caribbean (LAC). Brazil, in particular, has been cautious in its approach to cooperative compliance after a timid attempt some years ago. However, this has been changing since the launch of the Confia pilot program in 2021, where the Brazilian Federal Revenue (RFB) is collaborating with a group of large taxpayers participating in the pilot. Confia's main objective is to develop a relationship of trust between tax authorities and taxpayers by promoting a culture of compliance based on cooperation and transparency. This paper highlights the benefits of cooperative compliance including improved relationships between tax authorities and taxpayers, greater tax certainty, and reduced compliance and litigation costs. These benefits can help make Brazilian companies more competitive globally and improve risk assessments for tax administrations. Some initiatives taken by Brazilian tax authorities to enhance their relationship with taxpayers, including the experience of the RFB with Confia, could provide valuable lessons for other LAC countries.

Introduction

Countries around the world have struggled to establish a good relationship with their taxpayers. This issue has led tax administrations to develop trust-based relationships, initially referred to as “enhanced relationships” and later becoming known by the term “cooperative compliance.” Cooperative compliance is based on openness, collaboration, and mutual trust between taxpayers and tax authorities and it is characterized as “transparency in exchange for certainty” (OECD, 2013, 29).

Cooperative compliance gained particular attention after the Organisation for Economic Co-operation and Development (OECD) endorsed the idea that a relationship based on trust could benefit both taxpayers and the tax administration and published a series of reports based on countries’ experiences. Those reports highlighted some of the essential features and benefits of this type of relationship. Although not oblivious to cooperative compliance, Brazil’s tax administration had remained timid regarding such programs for some time.

More recently, based on successful experiences in other countries, tax administrations in Brazil have shown mounting interest in cooper-

ative compliance programs. Several states have already implemented programs in the spirit of cooperative compliance and, after a previous failed attempt to put in place a nationwide federal cooperative compliance program, the Brazilian Federal Revenue (RFB for its name in Portuguese) has recently demonstrated renewed interest in developing a pilot project alongside taxpayers.

In early 2021, during a virtual event to launch the committee expected to design and implement a nationwide federal cooperative compliance program called Confia, the RFB Secretary highlighted in his opening remarks that “tax administrations need to act in cooperation with [...] the civil society and taxpayers.” The Secretary also noted that one of the RFB’s objectives was “to amplify tax and customs compliance and, consequently, improve the relationship with taxpayers and the satisfaction with the Revenue Service” (RFB, 2021e).

Cooperation and open dialogue between tax authorities and taxpayers can certainly improve their relationship and increase the level of taxpayer satisfaction with the tax administration. However, they can do much more. An improved tax environment can also contribute to higher tax

certainty as well as reduce compliance and litigation costs, which can be an important factor in defining a country's attractiveness to investors and making Brazilian companies more competitive worldwide. Additionally, it benefits tax administrations themselves as they assist, for instance, in risk assessment.

In Brazil there is mutual distrust between the tax administration and taxpayers, which leads to an excess of litigation (Calijuri, Mac Dowell, and Cartaxo, 2022). The distrust is in part due to the Brazilian fiscal federalism model, which contributes to increased tax uncertainty due to the lack of uniformity of rules, the excess of norms, and changes in understandings regarding tax administration's and court's decisions. Jurisprudential harmonization, the introduction of alternative means of resolving tax disputes, and the analysis of preventive measures are valid alternatives to reduce the high number of tax conflicts.

Greater cooperation, trust, and transparency in relations between the tax authorities and the taxpayer is necessary, and citizen integration into the state structure would help improve these relations. Mechanisms can be adopted to help prevent conflicts, especially in areas that are ripe for diverging legal interpretations. Special emphasis should be placed on the use of transparency programs and tax compliance, in favor

of a less antagonistic relationship based on the paradigms of trust and collaboration. Despite the lack of a federal cooperative compliance program to ensure general guidelines, it is possible to identify common tendencies among legislation and programs encouraging tax compliance. All programs have similar classification risk assessment criteria, namely (i) performance of taxpayers' obligations and (ii) taxpayers' adherence to declarations and records and tax documents. Moreover, these programs are directed to all taxpayers, and the better classified taxpayers are, the more they will benefit from these programs (ABJ, 2022).

This document addresses cooperative compliance with an eye on Brazil. It explains how cooperative compliance programs normally work and the current stage of Brazilian programs. Section 2 analyzes how the concept of cooperative compliance has evolved over the years, with particular attention to the role the OECD has played in this respect. Section 3 explores the essential features, the importance of tax control frameworks, and the expected benefits of cooperative compliance programs. Section 4 examines the recent developments in cooperative compliance in Brazil. Section 5 recommends improving the country's state and federal cooperative compliance programs and Section 6 concludes.

The Development of Cooperative Compliance and Assurance Programs around the World

Cooperative compliance programs rely on a trust-based relationship between tax authorities and taxpayers. Improving trust and cooperation between these parties is intriguing for its apparent contradiction and the fact that they have competing objectives: taxpayers attempt to reduce their taxes, and the tax authorities endeavor to collect tax revenue (Ventry, 2008). However, even from opposing sides, it is possible to establish a more collaborative and less distrustful relationship.

Keeping that in mind, tax administrations from different countries started to discuss tax policies intended to enhance their relationship with taxpayers and foster tax compliance. The Netherlands was one of the first countries to put into place a program with that purpose in 2005. The Dutch “horizontal monitoring” program was based on transparency, mutual trust, and sound tax controls (Bronzewska and van der Enden, 2014).

Other tax administrations have followed suit. Australia, for instance, implemented a program in 2008 to manage taxpayers’ compliance in an open and transparent environment. The Annual Compliance Arrangement (ACA) program was available to large taxpayers willing to disclose

their major tax risks in real time. In return, taxpayers obtained certain benefits such as an ongoing dialogue with the tax administration and speedier resolution of their tax issues (OECD, 2013).

The OECD had a fundamental role in fostering such programs. For this document that role is divided into different stages, addressed in the following subsections: (i) asserting the need for an enhanced relationship, (ii) delineating the main features and benefits of cooperative compliance and the importance of tax control frameworks, and (iii) addressing the benefits of a multijurisdictional approach. But the OECD was not the only organization involved; Section 2.4 reviews the role of other international organizations in encouraging cooperative compliance.

2.1 Asserting the Need for an Enhanced Relationship with Taxpayers

Headway toward a cooperative relationship was made after the OECD published the 2008 report *Study into the Role of Tax Intermediaries* (OECD, 2008). The report had been commissioned a few years earlier when members of the Forum on Tax

Administration (FTA)¹ met in Seoul to share their concerns and exchange experiences to deal with the tax challenges of the 21st century.

The meeting's final declaration, called the Seoul Declaration (OECD, 2006), highlighted the need to address the role of tax intermediaries in conceiving and promoting aggressive tax strategies referred to at the time as “tax minimization strategies.” Though it acknowledged that taxpayers' behavior was influenced by different factors, among them the level of trust between taxpayers and their government, the Seoul Declaration did not specifically recommend mechanisms to establish an improved relationship with taxpayers.²

The discussions that resulted in the 2008 report included topics such as the relationship between tax authorities, taxpayers, and tax intermediaries. Eventually, it was concluded that intermediaries were only on the supply side of aggressive tax planning and that in order to influence the demand side, tax authorities also needed to understand taxpayers' appetite for tax risk. Therefore, the report encouraged tax authorities to build a trust-based relationship with taxpayers.

The report called this new rapport between tax administrations and taxpayers an “enhanced relationship” to distinguish it from the confrontational “basic relationship.” This enhanced relationship would be anchored in mutual trust rather than enforceable statutory obligations and would require tax administrations and taxpayers to work collaboratively (OECD, 2008). In order to achieve that, however, certain behaviors were needed from both taxpayers and tax administrations.³

Forming the FTA and releasing the OECD's 2008 report were the first initiatives to encourage this new relationship already embraced by a few countries. But it was important to show tax administrations and taxpayers that a trust-based relationship was not only possible but also beneficial for both parties. Other reports followed

suit, each one addressing different aspects of this relationship.

2.2 Delineating Cooperative Compliance and the Importance of Tax Control Frameworks

Years later, Co-operative Compliance: A Framework – From Enhanced Relationship to Co-operative Compliance (OECD, 2013) followed up on the OECD's previous work with a slightly different approach, describing the rapport based on mutual trust and collaboration between tax authorities and taxpayers as “cooperative compliance” rather than an “enhanced relationship.” The new term was promoted because of concerns that “enhanced relationship” could imply cozy agreements for certain taxpayers and that the remaining taxpayers would be in a “worsened relationship.” The report also addressed some concerns related to cooperative compliance at the time, giving particular attention to the issue of equal tax treatment between taxpayers in and outside those programs, in particular those without access to them (OECD, 2013).⁴

The 2008 and 2013 OECD reports prompted tax administrations to reconsider the terms of their relationship with taxpayers and encouraged

¹ The Forum on Tax Administration was created in 2002 within the OECD Committee of Fiscal Affairs and currently brings together officials from advanced and emerging tax administrations including all OECD and G20 members. Its purpose is to identify, discuss, and influence global trends and develop new ideas related to taxation. For more information, see Forum on Tax Administration (n.d.).

² According to the Seoul Declaration, “[w]e also recognized that taxpayers' attitudes towards paying tax is influenced by other factors such as taxpayers' perception of the quality of public goods and services and the level of trust between citizens and their governments in general” (OECD, 2006).

³ These behaviors were later identified as essential features in cooperative compliance programs. For more details on these features, see Section 3.

⁴ For a more in-depth analysis of cooperative compliance in light of equality, see Majdanska (2021, 265–292).

countries to improve tax compliance while restoring trust and confidence by means of cooperative compliance programs. Following the reports, more and more tax administrations started to implement programs that favored collaboration and mutual trust⁵ and the number kept growing in subsequent years.

The OECD continued to release reports building on previous works, including the 2016 Cooperative Tax Compliance: Building Better Tax Control Frameworks (OECD, 2016). The importance of tax control frameworks for a well-functioning cooperative compliance program had already been laid out in the 2013 report, but a more in-depth study on the topic was recommended, which was addressed in the 2016 report.

The 2016 report aimed to provide further guidance for businesses to design and operate their tax control framework by establishing the so-called general “building blocks”—that is, the essential features that should be present in tax control frameworks. Moreover, it addressed how revenue bodies should assess and test the scope and effectiveness of tax control frameworks, as well as evaluate and adjust their risk-management strategy accordingly.

In sum, those reports followed up on the previous work done by the OECD regarding trust-based relationships, now calling it “cooperative compliance” instead. The 2013 report addressed inter alia some particular concerns raised against cooperative compliance and the importance of well-functioning tax control frameworks, whereas the 2016 report focused its attention on tax control frameworks, further elaborating on their essential features and effective assessment.

2.3 Addressing the Benefits of a Multijurisdictional Approach

At the time of those 2013 and 2016 OECD reports, cooperative compliance programs were generally restricted to a particular jurisdiction. Local tax authorities assessed potential tax risks disclosed

by taxpayers unilaterally. Because there was no multilateral cooperative compliance, uncertainty remained for multinationals when tax authorities from a subsidiary jurisdiction applied different criteria to assess tax risks than authorities in the parent company jurisdiction. That prompted the FTA to encourage multilateral pilot projects.

The first pilot program was initiated in 2018 followed by a second one in 2019. The idea was to develop and test a multilateral framework capable of providing a more robust risk-assessment tool for tax administrations while preventing disputes through a certain degree of predictability for taxpayers, notably with respect to transfer pricing issues.

In 2021, the OECD launched the manual International Compliance Assurance Programme: Handbook for Tax Administrations and MNE Groups (OECD, 2021), known as ICAP. Based on the pilot projects, the manual complements previous OECD reports by focusing particularly on multinationals that operate in multiple jurisdictions and intends to promote tax compliance at a coordinated and international level (Martini and Russo, 2021). It includes a description of ICAP’s different stages, documents, and information that a participating multinational firm must provide.

ICAP can be described as multilateral voluntary risk-assessment and assurance tools that enable a multifaceted dialogue between taxpayers and tax authorities. These programs are designed “to facilitate open and co-operative multilateral engagements between [multinational] groups willing to engage actively and transparently and tax administrations in jurisdictions where they have activities” (OECD, 2021, 44).

Described as multilateral programs “in the spirit of cooperative compliance,” ICAP certainly presents characteristics that coincide with cooperative compliance. Both rely on cooperation and

⁵ Reportedly, as of 2014, more than 20 countries worldwide had implemented pilot programs that included cooperative compliance concepts. See Bronzewska and van der Enden (2014, 569).

require transparency. Moreover, the information provided by taxpayers is used by the tax administration for risk-assessment purposes and taxpayers' openness is rewarded by early assessments of their tax position by the tax administration.

However, ICAP presents a few slight differences from cooperative compliance programs. For instance, the ICAP transcends national boundaries and focuses on cross-border risks, notably concerning transfer pricing issues. Additionally, unlike cooperative compliance, in exchange for the information provided by taxpayers the tax authorities do not provide upfront legal certainty but rather a certain level of comfort to taxpayers concerning their tax positions.

In brief, the OECD has played a fundamental role in developing cooperative compliance programs through the series of reports it published on the topic over the years. While assessing existent experiences, the reports supported countries to implement programs that encouraged voluntary disclosure from taxpayers in exchange for early assessment of their tax positions by the tax administration, providing at least a certain level of comfort if not legal certainty.

2.4 The Role of Other International Organizations in Encouraging Cooperative Compliance

Though the OECD was fundamental in developing and fostering cooperative compliance programs, it was not the only organization involved. Other international organizations also played a role in encouraging tax administrations to establish a trust-based relationship with taxpayers and businesses to adhere to them. Of particular importance are the International Monetary Fund (IMF), the International Chamber of Commerce (ICC), and the European Commission (EC).

In early 2017 the IMF released a joint report with the OECD on tax certainty (IMF and OECD, 2017). Though cooperative compliance was not

the focus of the report, the term is mentioned 18 times, highlighting the importance of those programs to assist tax administrations in assessing risk management, promoting trust, and reducing uncertainty for low-risk taxpayers. The report also emphasized the significance of multi-lateral programs for companies operating in multiple countries.

Following in the OECD's footsteps, in February 2019, the ICC released their Policy Paper on Co-operative Compliance (ICC, 2019). The policy paper suggests compliance could become more burdensome for taxpayers, especially after the OECD/G20 BEPS package recommended additional reporting obligations (for instance, the country-by-country [CbC] report containing aggregate data on the global allocation of income, profits, taxes, and economic activities under BEPS Action 13).⁶

As a consequence of those increased burdens, the ICC policy paper highlights that cooperative compliance is an important tool in the post-BEPS environment that can benefit both businesses and tax administrations. The paper stresses how cooperative compliance programs can foster trust and enhance certainty for business, thereby facilitating trade and investment. Moreover, it underscores their importance for tax administrations in order to promote risk assessment and avoid future unnecessary litigation (ICC, 2019).

At the European level, the EC published in July 2020 an action plan for fair and simple taxation in which it committed to developing a cooperative compliance framework known as the European Trust and Cooperation Approach (ETACA). Its purpose was to facilitate and promote taxpayer compliance based on greater

⁶ For further detail on the BEPS project and the information required on the CbC reporting obligations under BEPS Action 13 minimum standard, see OECD (2015). For corroboration of the idea that the BEPS actions increased taxpayers' compliance burdens, see Bronzewska (2016, 521-528).

cooperation, trust, and transparency between taxpayers and tax administrations as well as among tax administrations (EC, 2020).

Later in 2020, the ETACA guidelines were provided to interested taxpayers and participating tax administrations to assist in a pilot project. The guidelines intend to establish a framework within the EU for preventive dialogue between tax administrations and businesses to improve the tax certainty of cross-border transactions, avoiding double taxation and, therefore, disputes. The idea is to perform a high-level risk assessment of multinationals doing business in the EU for transfer pricing purposes.

Tax administrations from 14 countries committed to participate in the pilot project.⁷ The pilot started in March 2022 and was expected to last for approximately 32 weeks in total, divided in the following manner: 8 weeks for admission, 20 weeks for risk assessment, and 4 weeks for

the outcome. As with the ICAP, ETACA does not provide multinational taxpayers with legal certainty but rather a level of assurance of how tax authorities interpret the risk of their transactions.

In conclusion, in addition to the OECD, other international organizations also encouraged a trust-based relationship between tax authorities and taxpayers. The IMF highlighted the importance of cooperative compliance to achieve a level of certainty and the ICC encouraged cooperative compliance programs to mitigate a potential increase in compliance costs for taxpayers following the BEPS package. The EC, for its part, proposed an EU-wide framework for preventive dialogue to perform a high-level risk assessment of multinationals.

⁷ Participating tax administrations include Austria, Belgium, Denmark, Finland, Germany, Hungary, Ireland, Italy, Luxemburg, the Netherlands, Poland, Portugal, the Slovak Republic, and Spain.

Essential Features, Tax Control Frameworks, and Expected Benefits of Cooperative Compliance Programs

Cooperative compliance is built on a reciprocal relationship of cooperation and trust between taxpayers and tax authorities (ICC, 2019). To move from the more typical contentious relationship to one based on trust, cooperative compliance programs generally rely on two pillars: transparency and certainty.

Transparency means taxpayers will be required to provide timely and adequate information to the tax administration, including information beyond the scope of taxpayers' mandatory reporting obligations. Certainty, in turn, means the information voluntarily disclosed would be used by the tax administration to provide an early assessment of potential tax issues and give predictability to taxpayers regarding their tax consequences.

There is no uniform approach to cooperative compliance. In different countries it has been implemented under varying names (cooperative compliance regimes, compliance assurance programs, compliance arrangements, horizontal monitoring, etc.) and with different scopes and characteristics. As will be discussed below, for a cooperative compliance program to be successful it is expected that it (i) presents certain essential

features, (ii) has an effective tax control framework, and (iii) brings benefits for both parties.

3.1 Essential Features of Cooperative Compliance Programs

Cooperative compliance programs must have certain features to be successful. Tax administrations' dealings with taxpayers should be based on commercial awareness, impartiality, proportionality, openness and transparency, and responsiveness. Taxpayers, in turn, are expected to provide disclosure and transparency for the tax administration.

Most of these features—impartiality, proportionality, tax administration openness and transparency, responsiveness, and taxpayer disclosure and transparency—are explained in more detail in this section; commercial awareness (understanding of the taxpayers' industry) is discussed later in the analysis of the potential benefits of cooperative compliance programs.

- **Impartiality:** Actions undertaken by the tax administration should be consistent and

objective, notably when it comes to resolving potential disputes with taxpayers. Tax administrations should seek to collect taxes that are due under the law, raising arguments with a reasonable legal basis and addressing potential disputes on their merits. By contrast, tax administrations should not decide on potential disputes with an eye to reaching a certain target for revenue collection (OECD, 2008).

- **Proportionality:** Tax administrations' actions should be proportionate and balanced. This means their choices of where to allocate their resources and which taxpayers, tax returns, and tax issues to focus on must consider the overall outcome potential. Tax administrations should have regard for the revenue consequences when initializing an audit and discontinue it when an audit or inquiry is unlikely to result in good use of their resources (OECD, 2008).
- **Openness and transparency of the tax administration:** Tax administrations should be open and transparent in how they assess taxpayers' tax risks on at least three different levels: (i) approach to risk management: behaviors and transactions that offer risks, (ii) selection for audit, and (iii) risk assessment of particular taxpayers (OECD, 2008). It could also consider including taxpayers in tax policy formulation (Majdanska, 2021); this could be achieved, for instance, through consultations.
- **Responsiveness:** Tax administrations' responsiveness to taxpayers has two facets. Taxpayers should receive prompt information from tax authorities when they submit a tax issue. Moreover, the decisions provided by tax authorities should bring tax certainty; for that to occur, low-level decisions must be consistent with high-level guidance so they are not subsequently overruled (OECD, 2008).
- **Disclosure and transparency by taxpayers:** Taxpayers participating in a cooperative compliance program should voluntarily

disclose information that goes beyond their legal requirements, including all the information necessary for tax authorities to understand their tax issues and undertake an informed risk assessment. Transparency, in its turn, refers to the openness expected from the taxpayer in the ongoing dialogue with the tax administration (Majdanska, 2021).

These features create the foundations for a trust-based relationship. An environment in which they are present encourages trust and cooperation to emerge between taxpayers and tax administrations (Martini, 2022). However, the features highlighted above are just examples of the conduct expected from each party. To move toward a fruitful cooperative compliance program, other attributes may be needed.

3.2 An Effective Tax Control Framework: The Heart of Cooperative Compliance Programs

In addition to the essential features described above, cooperative compliance programs rely heavily on tax control frameworks. A tax control framework is a business's internal validation system for verifying its own tax information. Because an effective tax control framework reduces the need for additional reviews and audits by tax administrations, tax control frameworks are central to a well-functioning cooperative compliance program.

The tax control framework is an integral part of a business's overall system of internal control (OECD, 2013). It deals specifically with the business's tax information and should describe how tax information is obtained and handled by the business and how responsibility for governance of the framework is assigned. Additionally, it should show how the system is monitored, tested, and adjusted whenever needed (Majdanska, 2021). The specific features of a tax control

framework should reflect the circumstances of the particular business.

The OECD identified six features of tax control frameworks, referred to as “building blocks”: (i) tax strategy is established by high-level management, (ii) tax strategy covers all relevant transactions, (iii) clear responsibilities are assigned within the enterprise, (iv) governance process is documented, (v) policies and processes are monitored and tested regularly, and (vi) assurance is provided to stakeholders (including the tax administration) that disclosures are reliable and internal control is adequate (OECD, 2016).

Taxpayers are expected to develop and maintain the tax control framework at their expense; the tax administration auditors can then build on the work already performed by the taxpayers’ internal and external auditing instead of duplicating their work (Bronzewska, 2016). This is a change from the functions traditionally performed by tax administration auditors. In cooperative compliance, tax auditors test the soundness and reliability of tax control frameworks instead of analyzing taxpayers’ transactions.

Tax administrations need to understand the controls in place to assess and test tax control frameworks’ accuracy and trustworthiness. That knowledge can be obtained through a dialogue with a business’s management team. Any potential reservations arising after assessing and testing the tax control framework should be communicated to the business. The tax administration’s feedback regarding their level of comfort with the tax control frameworks provided by taxpayers helps taxpayers improve their frameworks (OECD, 2016).

A well-functioning tax control framework is key to a successful cooperative compliance program and plays a crucial role in enabling the delivery of benefits that make cooperative compliance programs appealing to both tax administrations and taxpayers. These are explained in more detail below.

3.3 Expected Benefits of Cooperative Compliance Programs

Cooperative compliance programs are often described as a “win-win situation” because they can generate mutual gains for both tax administrations and taxpayers. They rely on carrots rather than sticks by encouraging compliance instead of penalizing non-compliance. For tax administrations, these programs can assist in improving taxpayer compliance while building a trust-based relationship. Taxpayers, in turn, benefit in different ways, particularly from early assessment of their tax risks.

One of the main goals of tax administrations is to maximize compliance, and they normally do so through monitoring and enforcement. Cooperative compliance programs assist tax administrations to improve taxpayer compliance in different ways including: (i) providing a better understanding of the taxpayer’s industry, business, and tax strategies; (ii) assisting tax authorities in risk-management systems; and (iii) minimizing administrative costs related to enforcement. The three are, to a certain extent, intertwined.

- **Better understanding of taxpayers’ industry, business, and tax strategy:** Comprehensive information provided by taxpayers enables the tax administration to have a complete understanding of the unique characteristics of the industry sector in which the taxpayer does business (OECD, 2008). The information assists tax authorities in comprehending how taxpayers operate their business, the context in which they undertake their activities, and their tax strategies.
- **Risk management:** Given that material and human resources are limited, revenue bodies must prioritize taxpayers with high-risk tax positions. Risk management is an important tool for tax administrations to assess the risk presented by taxpayers and efficiently

allocate resources accordingly.⁸ Focusing on taxpayers with high revenue potential and targeting audits on high-risk taxpayers and tax cases are efficient ways to better allocate resources. Risk management also assists in identifying gaps in the tax system so that tax authorities can propose legislative changes to address them.

- **Minimizing administrative costs:** Information provided voluntarily by taxpayers in the context of cooperative compliance programs can reduce the time tax authorities spend assessing taxpayers' tax returns, thereby decreasing administrative costs for the tax administration. Moreover, information obtained in advance reduces not only unnecessary tax audits but also the number of unsuccessful audit inquiries by the tax administration (Majdanska, 2021).

Cooperative compliance programs can benefit tax administrations by helping them better understand taxpayers' industry, business, and tax strategy and develop more efficient risk-management tools that enable them to prioritize high-risk taxpayers and minimize administrative costs. But tax administrations are not the only ones who can benefit from these programs. Taxpayers who participate in cooperative compliance programs also enjoy advantages, including: (i) early assessment and certainty regarding their transactions, (ii) reduced compliance costs, and (iii) reputational benefits.

- **Certainty:** Tax law is often criticized for wording that is ambiguous and subject to interpretation. The possibility of different interpretations of tax law gives rise to tax uncertainty.⁹ Cooperative compliance can provide predictability for taxpayers regarding the tax consequences of their business transactions. This can be achieved through an informal dialogue or a system of binding rulings. When tax authorities are ready

to discuss the tax treatment of transactions before taxpayers enter into them or file a tax return, it enhances certainty for the business.

- **Reduced compliance costs:** The additional information provided by taxpayers assists the tax administration's risk assessment. As a consequence, low-risk taxpayers are expected to have their compliance burdens reduced when participating in cooperative compliance regimes. Taxpayers will probably face increased costs in the short term, as they will have to prepare and provide additional information to tax authorities and implement an effective tax control framework, but in the long term taxpayers—especially large ones—are expected to compensate for those initial added costs with less frequent and lengthy tax audits, as well as reduced exposure to penalties.
- **Reputational benefits:** Companies are very sensitive to adverse publicity, including on tax matters, especially when a company is publicly held and traded on stock markets (OECD, 2008). Because some of those companies have been in the limelight for their aggressive tax arrangements, there have been increasing calls for further transparency and corporations are searching for ways to restore their reputation.¹⁰ Against this backdrop, disclosure can help to rebuild trust with wider society.

Small and mid-size enterprises (SMEs) may not be attracted to cooperative compliance

⁸ For the importance of risk management strategies for tax administrations, see Bird (2015).

⁹ For a more detailed analysis of the main sources of tax uncertainty, see IMF and OECD (2017).

¹⁰ Not surprisingly, corporate social responsibility and strategic tax behavior became a constant topic of discussion at the high ranks of corporations and multinationals started to adopt more proactive information disclosure policies. Several firms implemented voluntary disclosure of their tax information, including tax strategies, tax positions, and even CbC reports. See Owens and Pemberton (2021).

programs because the additional related costs may sometimes outweigh the program benefits. That is particularly true for SMEs with uncomplicated tax affairs or a high degree of tax compliance (Owens and Pemberton, 2021). Therefore, although cooperative compliance programs are not restricted to large taxpayers, they are the ones normally attracted to these programs.

In addition to the benefits described above, taxpayers and tax administrations can take advantage of a common benefit: the reduction in tax disputes and litigation. Tax disputes and litigation are generally associated with tax uncertainty. Accordingly, the early certainty obtained by taxpayers regarding the tax authority's understanding of their transactions in the context of a cooperative compliance program may reduce the scope for tax disputes and litigation.

However, as important as cooperative compliance regimes are for reducing disputes and litigation, such programs are not to be considered a silver bullet for those problems. Both sides should avoid unrealistic expectations that participating in such programs will prevent any conflicts.

A trust-based cooperative compliance program could bring taxpayers and tax authorities together—if not to a common understanding regarding the tax consequences of a given transaction, at least to make clear the legal grounds for their disagreement so they can agree to disagree. The simple act of opening a dialogue to determine what they agree with and to what extent they disagree is a step toward a less adversarial relationship.

Until recently, tax audits have been the traditional method for the tax administration to identify tax offenders. In addition to being intrinsically confrontational, audits imply committing a lot of human resources to assess taxpayers' tax compliance. Cooperative compliance programs do not intend to replace audits but to complement them. These programs create positive incentives for compliant taxpayers rather than only punishing those not complying with the tax legislation. In other words, it relies also on carrots and not only on sticks.

Finally, one could argue that tax administrations benefit more from cooperative compliance because it serves their revenue collection interests. In that sense, taxpayers would voluntarily disclose more information only to have the tax administration say they must pay more taxes. But even if that is true, taxpayers—in particular large firms—can also benefit from having the tax administration's understanding of their transactions in advance, which provides certainty.

On the other hand, if taxpayers wait for a tax inspection to confirm the tax administration's position, they may incur extra costs. Penalties normally accompany deficiency notices and, in some cases, very high penalties, such as in Brazil, where penalties can reach up to 225 percent of the debt due. Additionally, challenging a deficiency notice in administrative or judicial court implies additional costs as well as having to register a provision in the balance sheet during the litigation procedure, which decreases dividend distribution.

Recent Developments in Cooperative Compliance in Brazil

A cooperative relationship presumes mutual trust and collaboration between tax authorities and taxpayers. Cooperative compliance programs are generally based on a dual approach: voluntary information and tax certainty.¹¹ Taxpayers voluntarily disclose all facts and circumstances regarding issues that may represent possible tax risks. In return, the tax administration opportunistically provides advice on the tax consequences of those issues (Owens, 2012) to mitigate taxpayers' uncertainty.

Tax uncertainty is at the heart of tax disputes and litigation in Brazil. Brazil's complex and intricate tax system is one of the reasons taxpayers complain of tax uncertainty. For instance, a survey-based study to measure corporation tax uncertainty puts Brazil among the top-ranking countries with respect to uncertainty in corporation tax, second only to India (Devereux, 2016). However, it is consumption taxes, not corporation tax, that cause the most uncertainty and litigation among taxpayers.

Historically, Brazilian tax authorities have had an adversarial relationship with taxpayers. High tax litigation is a testament to how this relationship has deteriorated and how confrontational it has become over the years. Litigation in tax

matters includes not only tax foreclosure cases brought by the tax administration to recover tax debts from taxpayers, but also substantial administrative and judicial procedures brought by taxpayers to challenge them.

A recent report shows that approximately 40 percent of all ongoing judicial cases concern tax foreclosure cases (CNJ, 2020).¹² Moreover, a survey-based report suggests that the number of disputes between tax authorities and taxpayers in Brazil is much higher than in most countries. For instance, the amounts under dispute in tax cases in Brazilian courts reportedly correspond on average to more than 50 percent of companies' annual sales, as opposed to 3 percent in other countries' courts (Insper and CNJ, 2022).

Because of its federal structure, Brazilian federative entities have their economic independence ensured. Therefore, the division of taxing powers occupies a central position in the Brazilian

¹¹ For a more in-depth analysis of the many facets of cooperative compliance programs, see Owens and Pemberton (2021). For the importance of tax risk management in cooperative compliance programs, see van der Hel van Dijk and Siglé (2016).

¹² See also OECD (2020).

legal system. That means, however, that the delimitation of taxing powers occurs in the conceptual scope, opening the way for interpretative divergences and conflicts (e.g., is a software a good subject to state-level VAT or a service subject to municipal-level service tax?). This results in numerous “fiscal wars” waged both between entities at the same federative level and between entities of different spheres.

Furthermore, tax litigation is also stimulated by other factors, such as: (i) the delay in resolving tax conflicts in administrative and judicial courts; (ii) the possibility of reforming and/or rejecting the original tax assessment in the administrative and judicial spheres; (iii) the low cost of litigating in administrative courts; (iv) the antagonism and lack of transparency and collaboration in relations between the tax authorities and taxpayers; (v) the expectation of the emergence of an administrative or judicial decision of a binding nature contrary to understanding held in the tax assessment, especially with respect to major controversial issues; and (vi) legal uncertainty arising from different interpretations of tax legislation.

The aforementioned factors lead to high litigation numbers. Statistics show that, in 2018, tax litigation at the federal level already exceeded 3.4 trillion reais, corresponding to 50.4 percent of the national GDP. In addition to demonstrating the ineffectiveness of the current conflict resolution system, these values show that the high level of tax litigation in Brazil was faced with difficulties in reaching theoretical and factual resolution (ABJ, 2022).

Despite this context, which would be the perfect breeding ground for a cooperative compliance program in the country, and the fact that cooperative compliance programs have been gradually implemented by tax administrations around the world over the last two decades, until recently, Brazil had no formal cooperative compliance program. This did not mean, however, that Brazilian tax authorities were oblivious to the existence of those programs.

The idea of cooperative compliance and a trust-based relationship has recently grown among state and federal tax authorities in Brazil. Brazilian involvement in cooperative compliance initiatives includes: (i) early experience with the Authorized Economic Operator, (ii) state-level cooperative compliance programs, (iii) previous federal initiatives toward an open relationship with taxpayers, and (iv) the federal cooperative compliance initiative currently underway.

4.1 Early Experience with the Authorized Economic Operator

The Brazilian Federal Revenue (Receita Federal do Brasil or RFB) is responsible for federal taxes, customs, and duties. In that capacity, it was familiar with the underlying idea of a cooperative compliance program as it has gradually implemented a customs regime called the Authorized Economic Operator (AEO; *Operador Econômico Autorizado* or OEA in Portuguese) over the last decade. The AEO regime is based on the World Customs Organisation’s SAFE Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework) and can arguably be considered a cooperative compliance program.

The AEO consists of an accreditation granted by customs authorities to businesses operating in foreign trade (i.e., importers, exporters, carriers, terminal operators, etc.) that meet certain requirements with respect to supply chain security standards and customs duties compliance.¹³ The accreditation is voluntary¹⁴ and information collected by the customs authorities is used for risk

¹³ Requirements to obtain the accreditation depend on the type of accreditation and include businesses’ previous compliance with customs legislation, adopting customs risk-management standards according to ISO31.000, and having no tax debt with the federal government (businesses must present a tax clearance certificate in order to be eligible for the AEO). For further detail, see RFB (2020a).

¹⁴ For more information on the AEO program in Brazil, see Quadros da Paixão et al. (2015).

assessment, thus enabling target inspections on high-risk cargo handled by non-accredited operators. Businesses that satisfy high-quality internal process requirements are granted benefits.

There are two types of accreditations, each with its own benefits. Benefits granted to businesses accredited for AEO Security include priority in pre-departure document inspection and less exposure to inspections. In contrast, benefits for businesses accredited for AEO Compliance include waivers of guarantees for special regimes and a 40-day time limit for tax authorities to issue rulings regarding the classification of goods. Businesses can apply for one or both types of accreditations.¹⁵

The AEO relies on the two pillars of cooperative compliance programs: transparency in exchange for certainty. The program requires transparency because accreditation as a low-risk operator is contingent on voluntary information provided by the operator. Certainty is present because the tax authorities are expected to issue a ruling regarding their understanding of a tax issue: classification of goods for customs purposes. Therefore, the AEO undeniably includes some features similar to cooperative compliance programs.

4.2 State-Level Cooperative Compliance Programs

Brazil has a federal structure with three levels of government—federal, state, and municipal—each with its own taxes. State taxes include state-level VAT, gift and inheritance tax, and vehicle tax. State-level VAT is certainly the most important among state taxes in terms of tax revenues.¹⁶

Brazilian tax authorities began to participate in cooperative compliance at the state level when the state of São Paulo passed legislation in 2018 creating the program *Nos Conformes* (Legislative Assembly of the State of São Paulo, 2018). Taxpayers met the initiative with enthusiasm, as it was one of Brazil's first efforts to encour-

age voluntary tax compliance. The country was finally following in the footsteps of other tax administrations.

Nos Conformes is based on a compliance grading system for taxpayers according to previous compliance with state-level VAT. Taxpayers are classified from A+ to E (and N/C, meaning not classified) based on two main factors: whether taxpayers paid taxes when they were due and whether taxpayers' books and tax returns correspond to their commercial invoices. Taxpayers awarded a high grade are entitled to simplified procedures for different tax processes including tax refunds, renewal of special tax regimes for tax compliance, and the use of accumulated input state VAT credits.¹⁷

Taxpayers can access their grades through a restricted-access platform. If taxpayers do not agree with their grade, they can challenge it. If taxpayers accept their grades, the information is made available to the public through the state Secretary of Finance and Planning website. Hence, in addition to the simplified procedures made available for highly graded taxpayers, the program provides a reputational benefit for compliant taxpayers.

However, the program is not without its critics. Detractors contend that, because the grading system is based on taxpayers' previous tax compliance, simple mistakes in interpreting the tax law may adversely affect taxpayers' grades and prevent them from benefiting from the program's incentives. Moreover, some of the incentives can be viewed as taxpayers' rights, so by making them contingent on voluntarily complying with

¹⁵ For an overview of the AEO and a detailed analysis in the context of the European Union, see Polak (2020). For the particular benefits given to each type of AEO accreditation in Brazil, see Ministry of Finance (n.d., "Benefícios do Programa OEA").

¹⁶ State-level VAT represents more than 80 percent of state tax revenues and approximately 7 percent of the country's GDP. For further detail, see Ministry of Economy (2021a).

¹⁷ For more details on the *Nos Conformes* program, see São Paulo Secretary of Finance and Planning (n.d.).

the law the tax administration is actually limiting taxpayers' rights.¹⁸

Additionally, the program can be characterized more as a risk-assessment tool than a cooperative compliance initiative. Cooperative compliance programs are certainly used for risk-management purposes, but their focus is on the voluntary disclosure of information by taxpayers in exchange for tax certainty by tax authorities via early assessment of taxpayers' positions. The Nos Conformes program does not provide certainty but instead offers incentives for low-risk taxpayers.

The program is still in its early stages, which makes it difficult to conclusively assess its success. However, preliminary results made available indicate that the program resulted in a number of taxpayers advised on compliance issues and many tax returns filed after the tax administration had notified taxpayers of inconsistencies in their tax returns. As of December 2021, it is estimated that Nos Conformes has brought in BRL 3.7 billion (USD 750 million) in cash since 2018.¹⁹

Following in the state of São Paulo's footsteps, many other states in Brazil have implemented—and others are in the process of implementing—similar programs.²⁰ The names and details vary from state to state, but the programs' core guidelines all encourage taxpayers' voluntary compliance and enhance their relationship with the tax administration. Other initiatives to build trust and improve relationships were also considered.

For instance, in the state of Rio Grande do Sul, in addition to a program based on a grading system according to taxpayers' previous tax compliance (also called Nos Conformes), legislation includes a code of good tax practices and a forum for discussion with representatives from different business sectors (State of Rio Grande do Sul, 2020). The program in Minas Gerais (Contribuinte Bom Pagador) offers modest tax relief from vehicle property tax for taxpayers with a history of compliance in the previous two years.²¹

In general, state-level initiatives rely on risk-management tools that offer incentives for compliant taxpayers. Reduced compliance costs for low-risk taxpayers can certainly improve their relationship with the tax administration, but only to a limited extent. For those programs to be more effective in establishing a collaborative rapport with taxpayers, they could include a mechanism by which taxpayers could obtain early certainty. This is addressed in detail in Section 5.

4.3 Federal Initiatives toward an Open Relationship with Taxpayers

The federal government in Brazil has not been indifferent to building a trust-based relationship with taxpayers. Three initiatives at the federal level demonstrate a change of attitude toward a more open and less confrontational relationship with taxpayers: (i) a draft regulation to implement a program to encourage voluntary compliance, (ii) an initiative to support taxpayer compliance, and (iii) a more open dialogue with large taxpayers in the context of monitoring. See below for more details regarding each one of these initiatives.

A tentative regulation to implement a program called Pró-Conformidade at the federal level is one example of an initiative toward an open relationship. In 2018, Brazilian Federal Revenue proposed a regulation to encourage vol-

¹⁸ For a more critical view of the Nos Conformes program, see Silva (2019).

¹⁹ For an updated summary of the program's results, see São Paulo Secretary of Finance and Planning (2022).

²⁰ States offering programs to encourage tax compliance include: Alagoas (Contribuinte Arretado), Ceará (Contribuinte Pai d'Égua), Mato Grosso (Programa de Autoregularização), Minas Gerais (Contribuinte Bom Pagador), Piauí (Contribuinte Legal), Rio de Janeiro (Projeto de Lei de Conformidade Tributária), Rio Grande do Norte (Contribuinte Exemplar), Rio Grande do Sul (Nos Conformes), and Rondônia (Fisconforme).

²¹ The tax relief amounts to 3 percent of the vehicle property tax. For more detail, see Minas Gerais Secretary of State Finance (n.d.).

untary compliance based on a grading system according to factors such as accuracy of reporting obligations and timely filing and payment of taxes, including any breach of previous tax amnesty agreements.²² Highly graded taxpayers would have priority in tax refunds and could regularize inconsistencies before audits were initiated and penalties imposed. Conversely, low-graded taxpayers would be subject to comprehensive auditing.²³

After an initial framework for a nationwide federal program was drafted, the proposed regulation was subject to consultation and taxpayers and other stakeholders were invited to provide input. However, it is uncertain to what extent stakeholders did actually give feedback on that occasion.²⁴ In the end, the program did not reach fruition and the idea of creating a nationwide program for federal taxes was somehow left behind, yet that did not prevent the development of other nation- and statewide initiatives with the purpose of enhancing the relationship with taxpayers.

Another example is the program to support taxpayer compliance. If inconsistencies are found in taxpayers' reporting (e.g., after cross-checking taxpayers' and third parties' information), tax authorities warn taxpayers of inconsistencies so that they can rectify their information without penalties. The idea is to allow taxpayers to correct them before an auditing procedure begins. Initially implemented for individual taxpayers, this program was later extended to corporate taxpayers under the name Programa de Apoio à Conformidade Tributária (PAC/PJ).²⁵

A third example can be drawn from monitoring initiatives for large taxpayers. For a taxpayer to be considered a large taxpayer, tax authorities look at a series of elements. For corporate taxpayers these include their revenues, taxes, and payroll; for individual taxpayers, their income, assets, and shareholding are considered. While large taxpayers are subject to close monitoring so that tax authorities can better understand

their activities and behavior, tax authorities are expected to establish an open dialogue with them.

This includes prioritizing initiatives that induce taxpayer compliance, such as holding in-person or online compliance meetings with taxpayers or strategic industry sectors. During compliance meetings, tax authorities are expected to advise taxpayers about tax compliance issues before imposing any penalties for noncompliance.²⁶ A compliance meeting to warn representatives of the banking industry about inconsistencies in their reporting obligations and to call their attention to the need for more consistent reporting of taxpayer activities made headlines in 2021 (Graner, 2021).

Failure to implement a nationwide program encouraging voluntary compliance did not prevent regional offices of the RFB from implementing their own programs. For instance, in 2021 the 7th Fiscal Regional Office of the RFB, which includes the states of Rio de Janeiro and Espírito Santo, introduced a tax and customs compliance program designed to encourage taxpayers' voluntary compliance (RFB, 2021d).²⁷

This regional initiative is expected to be renewed on an annual basis and only applies to taxpayers established in the area covered by the 7th Fiscal Regional Office. The program essentially relies on two pillars: (i) educational and awareness programs and (ii) voluntary self-compliance: the possibility for taxpayers to rectify

²² A draft ordinance to encourage voluntary compliance was submitted for public consultation and made available through the Brazilian federal tax administration website in late 2018. For more details on the draft, see RFB (2018).

²³ For more details and a brief critical analysis of the proposed rules, see EY (2018).

²⁴ A request for information (request number 03005.240110/2021-93, December 10, 2021) regarding the stakeholders' feedback after consultation based on the Freedom of Information Act (Lei de Acesso à Informação or LAI) remained unanswered on the grounds that it required extra work to extract and consolidate the information.

²⁵ For more information, see RFB (2022c).

²⁶ For tax administration regulation on the monitoring of large taxpayers, see RFB (2020b).

²⁷ Also see Ministry of Economy (2021c).

their tax returns after an inconsistency is found but before the tax administration begins a tax assessment and imposes fines.

The problem with regional cooperative compliance programs is that taxpayers could be treated differently depending on whether they are established in an area covered by such a program. Additionally, the program covering the 7th Fiscal Regional Office in particular does not seem to provide enough incentives to persuade taxpayers to comply with their tax obligations and disclose additional information voluntarily. But no matter how limited they are, regional programs seem to be positive progress toward an improved relationship between taxpayers and the tax administration.

All the initiatives the RFB has taken in the past were very welcome and helped build trust with taxpayers. But, as important as they may be, they focus on grading systems for risk-assessment purposes, education, and self-compliance. Much like the state programs, thus far, the federal tentative and current initiatives—except for the AEO—seem to lack one of the cornerstones of cooperative compliance: transparency in exchange for certainty.

4.4 Is Brazil Finally Heading toward a Nationwide Federal Cooperative Compliance Program?

A nationwide federal program to encourage voluntary compliance may gain impetus in the foreseeable future. In early 2021, the RFB created a committee that would be responsible for determining the guidelines for a federal cooperative compliance program under the name Confia, which means “trust” in Portuguese (RFB, 2021b).

The committee comprises high-level officials from different areas of the RFB including customs officials and heads of regional offices. The committee was expected to open a discussion forum with entities representing taxpayers in order to

draft a cooperative compliance program. Unlike the tentative federal Pró-Conformidade program from 2018, this time the tax administration has engaged with stakeholders before drafting the regulation.

A group of companies was invited to participate in the preliminary discussions with the tax administration and in early October 2021 the RFB created a discussion forum with taxpayers’ representatives (RFB, 2021c). Later that month, the discussion forum kicked off by setting an action plan and a timetable for the next steps (Ministry of Finance, 2022) and the committee responsible for establishing Confia’s guidelines approved the discussion forum’s bylaws²⁸ and a series of meetings followed.

The idea is that the discussion forum assists in designing Confia. The resulting program is expected to merge the tax administration’s and taxpayers’ interests. Furthermore, the discussion forum is also expected to assist in drafting a code of good tax practices and a tax control framework. The fact that taxpayers’ representatives are engaged from the very beginning of development of the program is already an important step toward a less adversarial relationship.

However, the discussion forum is only the first of many steps necessary to keep the program running. Once the program is designed, it will be tested as a pilot project to validate it and then, if necessary, improvements will be made. The pilot is expected to be launched in 2023 with a small group of taxpayers that already have a high level of tax governance and a tax control framework in place. Finally, the program is expected to be gradually implemented for a more comprehensive number of taxpayers.²⁹

While designing the nationwide cooperative compliance program together with the discussion forum, the RFB has created a national center to manage the activities under the Confia program

²⁸ For the discussion forum bylaws, see RFB (2021a).

²⁹ For further detail, see Ministry of Finance (n.d., “Programa Confia”).

(RFB, 2022a). It also provided guidance regarding a procedure test intended to assess taxpayers' work processes (RFB, 2022b). Additionally, representatives from the Brazilian tax administration have participated in roundtables to discuss the program's progress and challenges. The program is gradually starting to take shape.

In early 2023, Brazil enacted Provisional Measure No. 1160/2023 specifying that the RFB can use cooperative compliance programs to prevent disputes and assure an open dialogue between the tax administration and taxpayers (RFB, 2023). This probably derives from the understanding that taxpayers and the tax administration would be better off if there were a law allowing cooperative compliance programs. The provisional measure, however, lost its validity because it did not obtain congressional approval within 120 days as required by the Brazilian constitution.

In its place, a new bill was presented for debate in Congress (PL No. 2,384/2023). This bill provides that the RFB can use preventive measures to encourage taxpayers' self-compliance

and cooperative compliance programs to prevent disputes and assure an open dialogue with taxpayers. The bill allows the RFB to create a grading system for taxpayers and specifies the benefits taxpayers can enjoy. It also gives the tax administration more flexibility not to apply tax penalties where the taxpayer voluntarily presents information to the tax authorities for early assessment of the tax consequences. Though the bill was swiftly approved by the House of Representatives, at the time of this writing Senate approval was still pending.

In sum, the development of a nationwide federal cooperative compliance program is underway. The RFB has engaged with stakeholders through a discussion forum to assist in designing not only the program itself but also a code of conduct and a tax control framework. After the project is designed, it will have to be tested as a pilot in a small group and only then will it be gradually implemented in a larger group. The program continually evolves but there is still a long way ahead. A legal framework to support the program is also under discussion.

Recommendations for Brazil's Cooperative Compliance Programs

The previous sections have examined how cooperative compliance programs based on collaboration and mutual trust can assist in developing an improved relationship between tax administrations and taxpayers. However, experience shows there is no unique approach to designing and implementing these programs and that countries need to adapt them according to their particular circumstances and needs (Owens and Pemberton, 2021).

Looking into the current state-level programs and the federal cooperative compliance under discussion, one can only wonder how to make those programs more effective in light of Brazil's needs. This section focuses on three important topics considering the country's particular circumstances: (i) a subnational cooperative compliance program, (ii) the inclusion of different taxes in the federal program's scope, and (iii) integrating tax rulings with cooperative compliance programs.

5.1 A Subnational Cooperative Compliance Program

Currently, state-level VAT is complicated because state VAT legislation is fragmented within 27 state

legislations.³⁰ The lack of a harmonized state VAT coupled with a system largely based on the origin principle has led to VAT competition among states; states use state VAT as an industrial policy instrument granting tax benefits to attract industries. Moreover, states often grant tax benefits in violation of the constitution and the national law that requires state VAT benefits to be approved by states' unanimous decision.³¹

In the absence of successful remedies to curb illegal state VAT competition, destination states have taken the matter into their own hands and unilaterally disallowed input tax credit for the tax

³⁰ Brazil is composed of 26 federal states plus the federal district where the capital, Brasília, is located. The federal district accumulates taxing powers attributed to local governments (municipalities) and states.

³¹ In this respect, it is noteworthy that the Brazilian constitution (Art. 155, Para. 2o, XII, g) determines that supplementary law regulates the conditions for states to grant VAT incentives. A supplementary law (LC No. 24/1975, Article 2o, Para. 2o) requires that tax incentives be approved by the National Public Finance Council (Confaz), a tax policy discussion forum composed of state finance secretaries. However, states often bypass Confaz's approval and unilaterally grant tax incentives and, in the absence of legal mechanisms for Confaz to enforce compliance, disputes arising from illegal tax incentives most likely end up in litigation.

paid in the origin state when it suspects that the origin state granted a tax benefit in discordance with the law. That practice has led to an adversarial relationship with taxpayers situated in one state and buying goods from a supplier located in another state, which often ends in litigation.

A subnational cooperative compliance program could be proposed to improve this situation, which is disadvantageous to both taxpayers and tax administrations insofar as it leads to distrust and a litigious relationship. For that purpose, state tax administrations could consider implementing a program in the spirit of the existent ICAP (see Section 2.3) that instead of focusing on transfer pricing issues and countries' tax administrations would target state-level VAT and state tax administrations.

A multilateral dialogue between taxpayers and different state tax authorities can be an important instrument to prevent conflicts and reduce litigation between taxpayers and state tax administrations. Additionally, a subnational cooperative compliance program with standardized rules could significantly reduce compliance costs for taxpayers. Finally, shared information among states can be a valuable tool in providing a uniform risk assessment for taxpayers.

5.2 The Inclusion of Different Taxes in Programs' Scope

In addition to the state-level cooperative compliance regimes, the RFB is in the process of developing the Confia nationwide federal program. At this point, there has been no indication of a new blueprint for a nationwide federal cooperative compliance program as the committee and discussion forum are yet to define its design.

One of the questions when designing a cooperative compliance program is which taxes should be included in the program. Ideally, these programs should include all taxes (Owens and Pemberton, 2021). However, in most federal structures it is not legally possible to include taxes other than

those collected by the level of government implementing the cooperative compliance program.

Because Brazil has a federal structure with three levels of government—federal, state, and municipal, each with its own taxes—it would be most appropriate for the program to center on federal taxes, which include custom duties, personal and corporate income taxes, tax on manufactured goods, rural land tax, payroll taxes, and social contributions such as PIS and COFINS.³²

The wide scope of federal taxes can render it too burdensome for the RFB to address all federal taxes right from the outset of starting a federal cooperative compliance program, notably because of the high cost the tax administration may have to incur to develop a pilot project that includes such a wide range of taxes.

By contrast, restricting the federal cooperative compliance to income taxes may not be sufficient because many taxpayers may not pay as much in income tax or not pay income tax at all, for instance because they incurred losses (Owens and Pemberton, 2021). Additionally, limiting the program to certain taxes may also frustrate participant taxpayers because their tax issues related to other types of taxes will remain unanswered.

In any case, as many federal taxes as possible should be included in the program. Particular attention should be given to PIS and COFINS social contributions, which are VAT types of taxes. The multiple PIS and COFINS regimes, each with their own rules and tax rates, make those taxes very complex and give rise to great uncertainty (de Oliveira, 2022). Not surprisingly, they are a major source of litigation.³³

For that reason, including PIS and COFINS in the scope of a federal cooperative compliance

³² In addition to the general taxes (“impostos”) laid out in Article 153 of the Brazilian constitution, the federal government can also levy social contributions, fees, and other particular taxes.

³³ PIS/COFINS make up approximately 40 percent of the cases filed by taxpayers against the federal tax administration. See Ministry of Economy (2021b).

program would benefit taxpayers and the tax administration. Transparency and early assessment can provide the desired legal certainty that cooperative compliance programs are expected to offer, thereby avoiding unnecessary and long-lasting disputes regarding those taxes.

In sum, a federal cooperative compliance program should ideally include all federal taxes or at least those federal taxes that cause the most tax uncertainty. In this regard, the complex and contentious PIS and COFINS social contributions should be included in the program's scope right from the start or in a later stage of the project so as to not frustrate taxpayers.

5.3 Improving Tax Rulings and Integrating Them with Cooperative Compliance Programs

When considering the state-level experience with cooperative compliance, it is apparent that the state programs lack mechanisms to provide certainty for taxpayers. The same applies to the 2018 tentative federal-level cooperative compliance program and the other federal initiatives toward an open relationship with taxpayers. Put differently, except for the AEO, none of the programs have mechanisms to strengthen taxpayers' certainty regarding the tax administration's position.

It has been observed that, to build a relationship based on mutual trust and collaboration, countries have adopted cooperative compliance programs. These programs are expected to have some essential features to be effective and, according to the OECD (2013, 29), they can be best characterized as “transparency in exchange for certainty.”

Providing a certain degree of certainty for taxpayers about their tax positions is an essential feature of cooperative compliance programs. This certainty can be achieved through different instruments including informal communica-

tions with tax authorities. Tax certainty can also be obtained through tax rulings, which are usually binding for the tax administration.

Brazilian legislation provides that taxpayers may request a ruling regarding the “legislative provisions applicable to a certain fact” (Presidência da República, 1972). Accordingly, rulings are limited to clarifying the interpretation and application of existing rules. However, rulings are somewhat underused by taxpayers. A more attractive ruling system would most likely reduce uncertainty regarding the tax administration's position on various matters.

A more flexible ruling system or another instrument that enables taxpayers to learn the tax administration's position on a particular tax issue could strengthen the relationship with taxpayers by mitigating tax uncertainty. Integrating these instruments with cooperative compliance programs by prioritizing ruling requests and establishing shorter time limits for tax authorities to answer ruling requests from participant taxpayers could also make cooperative compliance programs more appealing.

Another way to improve tax certainty would be implementing *ex ante* rulings on taxpayers' tax planning structures. Currently, tax planning structures are only examined by the tax authorities upon tax audits. *Ex-post* examinations of tax arrangements provide uncertainty for taxpayers in that it is unclear how revenue agents will react to their tax arrangements upon future examination.

Accordingly, a type of ruling could be tailored to provide certainty and avoid long-lasting litigation between the tax administration and taxpayers regarding the validity of their tax planning structures. This could be done initially for taxpayers participating in cooperative compliance programs in order to test it with a small group of taxpayers and, if it works, it could be later extended to other taxpayers.

Because taxpayers will be informed in advance of the revenue authorities' position

regarding their tax planning structures, tax disputes could possibly be avoided. That does not mean taxpayers must conform to the tax authorities' position, but at least they will know in advance what the tax administration's under-

standing is with respect to a given transaction before completing it. This alone seems to be an important step toward an improved relationship between taxpayers and tax administrations in Brazil.

Conclusion

Historically, tax administrations and taxpayers have had a confrontational relationship. In the last two decades, a number of countries have tried to change that by adopting cooperative compliance programs, which are based on collaboration and mutual trust. The OECD had a crucial role in assisting the development of such programs and encouraging countries to adopt them; other international organizations had a secondary role.

Cooperative compliance programs normally rely on characteristics that inspire a trust-based environment and a more collaborative relationship. Having a tax control framework in place helps to change tax administrations' approach to taxpayer monitoring, thereby strengthening their relationship. Additionally, cooperative compliance regimes are expected to benefit tax administrations and taxpayers, including by offering a level of certainty and a reduction in disputes.

Brazilian tax administrations have shown mounting interest in cooperative compliance programs in recent times with the Authorized Economic Operator (AEO) program for customs and duties, state-level regimes, and other federal initiatives toward an open relationship with taxpayers. More recently, the Brazilian Federal Revenue

(RFB) launched a nationwide federal cooperative compliance program called Confia. The program is still in its early stages and its contours are still to be defined.

Given the country's particular circumstances, a few recommendations can be made to make state-level programs and the federal program underway more effective: (i) implementing sub-national cooperative compliance to address state-level VAT problems; (ii) including various taxes in the proposed federal program, notably the contentious PIS/COFINS social contributions; and (iii) improving tax rulings and integrating them with cooperative compliance programs to mitigate uncertainty and prevent disputes.

Brazil's incipient cooperative compliance programs still need to be perfected to address the country's unique needs. There are certainly challenges that will have to be overcome in the process, but the country is on the right path. Brazil's experience with cooperative compliance can also be used as inspiration for other Latin American and Caribbean countries to develop a more collaborative trust-based relationship between their tax administrations and taxpayers, as well as to reduce tax disputes, which normally end in litigation.



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