

Policies to harvest the potential of services value-added

Kick-start services talk:

Policies affecting services' value added in Brazil's exports



International meeting on services value-added in exports

Services and trade policies for diversification and upgrading

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MINISTÉRIO DA ECONOMIA



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* Opinions expressed herein are strictly personal



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1. Context: Accepting services' importance

- Services and the economy:
 - More than 2/3 of GDP
 - Direct and indirect effects.
- Services and exported value-added:
 - About half of all exported value-added
 - About half of all embedded employment
- Services and MSMEs:
 - Services are less concentrated than other sectors
 - MSMEs dominate the scene – including direct exports
- Services and gender:
 - Services are relatively less gender biased than other sectors



2. The national agenda and services value-added

- A 'Brazilian agenda'? Well, it's been difficult...
 - ✓ Institutional complexity, coordination challenges, and heterogeneity:
 - ❖ **'Horizontal regulators', e.g., the new 'super' Ministry of Economy (and a threat to SISCOSEV?).**
 - ❖ 'Regulated sectors', e.g., land transportation and the truck freight minimum price policy.
 - ❖ 'Regulated professions', e.g., the engineering sector supply challenges.
- Focus on horizontal measures:
 - ✓ Business simplification, e.g. the Economic Freedom Act.
 - ✓ Tax reform.
 - ✓ Trade liberalization and economic integration.

Will horizontal, business simplification and liberalization focus suffice?



2.1. The 'super' Ministry of Economy and services

- The new 'super' Ministry of Economy is the main default service regulator at the Federal Level
 - ✓ Current Ministry is basically a merger of four previous Ministries:
 - ❖ Concentration of powers? Lack of industry focus?
 - ❖ Before, services heavily concentrated on one 'Secretariat' with MDIC
 - ❖ Now, services under two 'Special Secretariats': trade in services (SECINT) and domestic regulation (SEPEC/SDIC)
 - * But goods focus (and expertise) remains dominant overall

- SISCOSERV:
 - ✓ Allocation to SECINT/SECEX could catalize SISCOSERV's use to guide trade in services policy.
 - ✓ Important policy tool, but gap in notifications and lack of a value-added perspective.
 - ✓ Burdensome to businesses and redundant with other tax systems and obligations.
 - ✓ Likely to be superseded by standard electronic fiscal invoice for services .
 - ❖ Project could potentially eliminate redundancies , reduce cost to government, boost informational capacities
 - ❖ Recommendation: information sharing between Internal Revenue and policy areas and publicly available database will be crucial.



3. Services taxation

- There is widespread recognition that the Brazilian tax system hampers diversification and upgrading.
- Tax burden / GDP was 32% in 2016 (up from 25% in 1996), in the rest of LatAm, it was 23% (FIRJAN: 2018).
 - ✓ It is unlikely that the overall burden will lower unless there are unprecedented structural reforms.
- But the challenge is not only the level of burden...
 - ✓ System excessively relies on production/consumption taxation (of both goods and services)
 - ✓ System is excessively complex
 - ❖ 184th in 190 countries regarding payment of taxes. 1958 company hours/year to process tax payments: last place worldwide. (WB Doing Business: 2018)
 - ❖ Cost of tax compliance is higher for medium sized/small companies and takes 3.53% of the revenues of companies with average revenues up to BRL 100 million/year (DELOITTE: 2013).
 - ❖ Amount of litigation is almost 70% of the GDP (SENATE Working Group Report, 2017)
 - ✓ System has an 'anti-services' bias

Is it possible to at least simplify the system and make it less distortive and unfriendly towards services?



3.1. The lack of definition of service export

- There is no overarching definition of service export for the purposes of tax law.
- Legal provisions are murky and subject to different interpretations, and the case law is not established.
 - ✓ Different cities apply different notions of 'service export' in applying the same Federal legislation for the purposes of the City Service Tax
 - ✓ The Federal Revenue adopted (in October 2018) a definition of service export as a default definition 'for the purposes of tax law'.
 - ❖ This definition did not pay any regard to a value-added perspective and focused exclusively on a pre-supposed objective to favour local economic activity in direct competition with foreign economic activity.
- Legal uncertainty is a major obstacle to business planning and is a disincentive for exports.
- Recommendation: default definition of service exports should take into account other dimensions in addition to local economic activity in direct competition with foreign economic activity.



3.2. Tax residues along value chains and a 'goods bias'

- Lack of a definition for the concept of 'service input' constrains tax credits from service inputs to exported goods.
- City Service Tax on service inputs to exports is not creditable.
- Duty Drawback and Special Regime for Preponderantly Exporting Persons provide tax relief to goods' inputs, not service inputs. REINTEGRA provides relief for goods' exporters, not service exporters. Controlling entities domiciled in Brazil are allowed to deduct credits of up to 9% of actual profits for investing in goods' industries and construction companies abroad, not on other service industries. IOF-exchange is 0.38% on service imports and zero on good imports.
- A step in the right direction: after ten years, payments of sales commissions on exports for agents located abroad have been exempted from the Income Tax both for goods and services, provided that the operation is registered.
- Recommendation: Revamp tax incentives (especially duty drawback, and deduction on foreign investment) taking into account role of services to upgrading and diversification. Eliminate IOF discrimination on service imports.



3.3. SIMPLES: advantages and drawbacks

- ‘Simples’ is the Special Unified Regime for the Collection of Taxes and Contributions Owed by Micro and Small Enterprises (yearly revenues up to BRL 4.8 million and export yearly revenues up to BRL 4.8 million).
 - ✓ 87% of small businesses in the country are under SIMPLES;
 - ✓ One combined rate for most taxes, regime is generally advantageous compared to others;
 - ✓ Successful business formalization policy (FAJNZYLBBER et al:2009);
 - ✓ Recognizes importance of exports also for small companies;
 - ✓ Applies to goods and services;
 - ✓ Limitation on tax credits curbs integration of micro/small companies into value chains;
 - ✓ Ceiling on export revenues limits export ambition;
 - ✓ Transition to more complex regime is traumatic ;
 - ❖ On average, companies that exit SIMPLES suddenly have to pay 40% more taxes (ENDEAVOUR: 2018)
 - ❖ 62% of exiting companies become tax debtors in just two years (ENDEAVOUR: 2018)
- Recommendation: eliminate export revenue thresholds for Simples eligibility or base them on revenues in USD rather than BRL, establish transition regime out of Simples.




4. Trade policies and services

- Trade policies have historically focused on goods, and disregarded a services value-added perspective.
- Current 'stated' trade policy: two tracks?
 - ✓ Intensification of economic integration by means of (1) FTAs and (2) unilateral tariff reduction.
 - ❖ In some respects, the two tracks are complementary, e.g., their timing is different.
 - ❖ However, from a negotiation standpoint, the unilateral track may undermine the FTA track.
 - ❖ Higher MFN tariffs may enable more concessions in exchange for more reciprocal concessions.
 - ❖ More goods concessions on the FTA track may enable more service concessions on the same track.

Should unilateral and preferential liberalization be pursued together and how?



4.1. Rules of origin and services

- Rules of origin negotiations have focused exclusively on goods. However, services value-added can be impacted.
 - ✓ Generally, value-added requirements provide more flexibility for services' value-added than changes in tariff classification.
 - ✓ Specific processing requirements influence assembly operations .
 - Intra-Mercosur and Mercosur-EU rules of origin that focus on value-added provide significant flexibility for exporters.
 - ✓ Only extra-preferential materials (not services) count for extra-preferential value-added thresholds.
 - ✓ Extra-preferential value-added thresholds are significantly higher than current foreign value-added in Brazilian exports.
 - ❖ Highest estimated share of imported inputs value-added to Brazilian exports is 18.8% in electronics and IT goods (only 3.9% in services).
 - Intra-Mercosur and Mercosur-EU rules on several IT goods are based on specific processing operations and are identical. Harmonization is important as it simplifies fulfilling requirements.
 - However, for many sensitive goods the rules are based on value-added and changes in classification, or changes in classification.
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Proposals

- Reporting obligations and service policymaking: Synchronizing SISCOSEV and the planned standard national invoice for services: make sure that SISCOSEV's acquis is not lost.
- Service taxation to boost service exports and value-added – screen and eliminate anti-service bias in taxation: (i) establish business-value-added-, and export-friendly definition of service exports; (ii) establish duty drawback regime for services, (iii) eliminate IOF on service imports, (iv) revise export revenue-thresholds for SIMPLES, (v) establish transition regime out of SIMPLES.
- Trade policies and services: (i) revise two-track policy to favour bilateral/preferential liberalization over unilateral liberalization, and (ii) cross-link rules of origin negotiations with other topics (both goods (including agriculture) and services negotiations).



Thank you! Comments? Critique?

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