

## THE FOUNDING FATHERS, THE AMERICAN FISCAL FEDERALISM AND THE FAILURES OF THE BRAZILIAN TAX SYSTEM.

OS *FOUNDING FATHERS*, O FEDERALISMO FISCAL AMERICANO E AS FALHAS DO SISTEMA TRIBUTÁRIO BRASILEIRO.



Marcos Bueno Brandão da Penha<sup>1</sup>

**ABSTRACT:** This paper analyzes two ideas that inspired the Founding Fathers to design the American tax system: (i) the need to provide each member of the federation with sufficient financial resources which enable them to perform their functions without depending on each other; and (ii) the advantage of adopting a flexible system of taxation. We aim to provide a comparative approach which demonstrates that these ideas explain, in part, some of the failures of the Brazilian tax system, considering that, in Brazil, the fiscal system suffers from an imbalance between tax revenues and duties assigned to the States and Municipalities; and that the Brazil's system's rigidity exacerbates the financial dependence of States and Municipalities.

**KEYWORDS:** Founding Fathers. Fiscal federalism. American tax system. Brazilian tax system.

**RESUMO:** Este artigo analisa duas ideias que inspiraram os *Founding Fathers* a projetar o sistema tributário americano: (i) a necessidade de fornecer a cada membro da federação os recursos financeiros suficientes que lhes permitam desempenhar suas funções sem depender um do outro; e (ii) a vantagem de adotar um sistema tributário flexível. Nosso objetivo é fornecer uma abordagem comparativa que demonstre que essas ideias explicam, em parte, algumas das falhas do sistema tributário brasileiro, considerando que, no Brasil, o sistema fiscal sofre de um desequilíbrio entre receitas tributárias e impostos atribuídos aos Estados e Municípios; bem como que a rigidez do sistema brasileiro exacerba a dependência financeira de Estados e Municípios.

**PALAVRAS-CHAVE:** *Founding Fathers*. Federalismo fiscal. Sistema tributário americano. Sistema tributário brasileiro.

**SUMMARY:** Introduction. 1. Brief notes about the context in which the American Constitution was drafted and the importance of the power to tax in the debates of the Convention of Philadelphia. 2. The basic ideas about the American tax system that prevailed at the Philadelphia Convention. 3. The American tax system designed in the Constitution of the United States. 4. The Brazilian tax system and its defects. 5. Conclusion. References.

**SUMÁRIO:** Introdução; 1. Breves notas sobre o contexto em que a Constituição dos Estados Unidos foi redigida e a importância do poder tributar nos debates da Convenção da Filadélfia;

---

<sup>1</sup>PhD candidate (Public Finance, Taxation and Development) at Rio de Janeiro State University - UERJ. Master of Laws (LL.M.) at New York University School of Law - NYU. Master of Laws (*stricto sensu*) in Public Finance, Taxation and Development at Rio de Janeiro State University - UERJ. LL.M. (*lato sensu*) in State Law and Regulation at Getúlio Vargas Foundation – FGV. State Attorney of the State of Rio de Janeiro.

2. As ideias básicas sobre o sistema tributário dos Estados Unidos que prevaleceram na Convenção da Filadélfia; 3. O sistema tributário projetado na Constituição dos Estados Unidos; 4. O sistema tributário brasileiro e seus defeitos; 5. Conclusão; Referências.

## Introduction

Among the many issues faced by the Founding Fathers in drafting the American Constitution,<sup>2</sup> the American tax system was among the most remarkable. The Framers had to reconcile the Federal Government's needs with the interests of the several States, ensuring their individual autonomy so that each could perform their duties properly.

The main ideas that formed the basis for the Founding Fathers' approach to taxation issues are exposed in the Federalists Papers, which can be considered, along with the Declaration of Independence and the American Constitution, one of the most important documents of political science that have been produced in the United States.<sup>3</sup> These are a series of essays published in newspapers of New York in defense of the Constitution proposed by the Philadelphia Convention, in 1787. Alexander Hamilton, who had in this endeavor the collaboration of James Madison and John Jay, devised the publication of the papers explaining the details of the new Constitution.<sup>4</sup>

Among the many excellent ideas, the authors formulated two basic notions upon which the American tax system was built: (i) the need to provide each member of the federation with necessary and sufficient financial resources enabling them to perform their necessary functions, which is a basic pre-condition in order to have a real political and administrative autonomy; and (ii) the advantage of adopting a flexible system of taxation, in which it a broad taxation power is assigned to all members of the federation, concurrently and coequal between the Federal Government and States, including the possibility of imposing taxes on the same economic basis.

---

<sup>2</sup> According to Roger H. Brown, “[h]istorians have described the [Philadelphia] convention as a continuous bargaining session at which delegates from small and large states, slave and free states, commercial and farming states, advocates of a strong and weak presidency, and so forth, negotiated, and compromised until they framed an acceptable plan. Thus the Constitution was a ‘bundle of compromises’- a product of compromise ‘at every point’. But in Leonard Levy’s words, ‘consensus, rather than compromise, was the most significant feature of the convention, outweighing in importance the various compromises that occupied most of the time of the delegates.’” (BROWN, Roger H. *Redeeming the republic: federalists, taxation and the origins of the constitution*. Baltimore: Johns Hopkins University Press, 1993, p. 184.

<sup>3</sup> COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. ix.

<sup>4</sup> COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. xi-xii.

Bearing in mind the peculiarities of time, context and type of federal system that has been adopted in each country, these two basic concepts (actually, the inobservance of them), may explain some defects of the Brazilian fiscal federalism designed by the Constitution of 1988. Regarding to the need to provide each member of the federation with sufficient financial resources, the Brazilian fiscal federalism suffers from an imbalance between tax revenues and duties assigned by the Constitution to the States and Municipalities. As most of the tax resources are concentrated in the central government, States and Municipalities become financially dependent on the Union. This situation undermines their political and administrative autonomy, generates numerous conflicts and disputes between these subnational entities for financial resources and threatens the idea of cooperative federalism mentioned in the Brazilian Constitution.

Concerning to the second idea mentioned above, the Brazilian tax system is characterized by its rigidity in the allocation of tax powers. This means that, with the exception of the Union that may establish residual taxes, each member of the federation has exclusive jurisdiction to impose certain types of tax which are thoroughly described in the Constitution. New taxes cannot be created. This rigidity in the Brazilian tax system exacerbates the financial dependence of States and Municipalities on the Federal Government, as they have narrow margin in which to adapt themselves to emergencies and to new economic realities.

The aim of this paper is to discuss how these two benchmark principles adopted by the American Founding Fathers can in large measure explain, save for obvious proportions and peculiarities, the failures of the Brazilian tax system.

### **1. Brief notes about the context in which the American Constitution was drafted and the importance of the power to tax in the debates of the Convention of Philadelphia.**

The American Constitution was drafted “after an unequivocal experience of inefficacy of the subsisting Federal Government”<sup>5</sup> under the Articles of Confederation, and in a historic moment when the United States was almost broken as a result of loans made to finance the American Revolution.

Independence did not lead to immediate prosperity.<sup>6</sup> The situation was aggravated due to the rudimentary taxing system in force in the American colonies, and the absence of a

---

<sup>5</sup> HAMILTON, Alexander. *The Federalist n. 01*, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 03.

<sup>6</sup> STEPHAN, Paul B. *Guerras Fiscais nos Estados Unidos*. In DERZI, Misabel Abreu Machado; BATISTA

system of taxation in the Continental Congress,<sup>7</sup> which did not have the power to directly impose any tax on citizens.<sup>8</sup>

Under these conditions, "in order to feed, equip, and pay the state militias and the Continental army"<sup>9</sup>, it was necessary to resort to loans with the French and Dutch governments and also to the sale, by the Congress and the States, of bonds to wealthy American citizens willing to sacrifice its properties for the revolutionary cause. Thus, although the debts had been necessary to secure victory over England, after the battle for the independence the United States was born sunken in debt<sup>10</sup> and in the midst of a severe fiscal crisis.<sup>11</sup>

Additionally, the Articles of Confederation took a decentralized approach to national government, which handicapped the powers necessary to settle these problems.<sup>12</sup> The Founders feared to replace the English monarch by a strong central government.<sup>13</sup> Though the Articles of Confederation had attributed some important functions to the central government, such as the "responsibility for managing defense, foreign affairs, war and peace, treaties, relations with the Indians, disputes among the States over land, the postal service, a federal currency, and federal military and naval forces",<sup>14</sup> it did not assign to the central government the essential and necessary financial counterparts in order to perform these activities. One of the main reasons why the Articles failed (and why the central government was so weak) was its lack of an autonomous power of taxation.

Hence, in order to be able to perform its functions and guarantee the peace and liberty of the people, the new government depended on the financial resources provided through a system of requisitions, by which the state governments were called to raise the resources. This system was problematic because the Congress had no power to enforce payments. It all

---

JÚNIOR, Onofre Alves; MOREIRA, André Mendes (org.). *Estado federal e guerra fiscal no direito comparado*. Belo Horizonte: Arraes Editores, 2015, p. 161.

<sup>7</sup> GORDON, John Steele. *Hamilton's blessing: the extraordinary life and times of our national debt*. New York: Walker and Company, 1997, p. 11.

<sup>8</sup> JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005, p. 01.

<sup>9</sup> GORDON, John Steele. *Hamilton's blessing: the extraordinary life and times of our national debt*. New York: Walker and Company, 1997, p. 11-12.

<sup>10</sup> GORDON, John Steele. *Hamilton's blessing: the extraordinary life and times of our national debt*. New York: Walker and Company, 1997, p. 11.

<sup>11</sup> GORDON, John Steele. *Hamilton's blessing: the extraordinary life and times of our national debt*. New York: Walker and Company, 1997, p. 12.

<sup>12</sup> GORDON, John Steele. *Hamilton's blessing: the extraordinary life and times of our national debt*. New York: Walker and Company, 1997, p. 13.

<sup>13</sup> POLLACK, Sheldon David. *War, revenue, and state building: financing the development of the American state*. Ithaca: Cornell University Press, 2009, p. 147.

<sup>14</sup> BROWN, Roger H. *Redeeming the republic: federalists, taxation and the origins of the constitution*. Baltimore: Johns Hopkins University Press, 1993, p. 11.

depended on the “willingness and ability” of each state to comply with what was requested, and the resources provided were always far from the amount required.<sup>15</sup> This situation evidently entailed great difficulties to the central government, which was, in fact, unable to fulfill its activities, mainly due to delays in the transfer of funds by state governments or simply the non-transfer of funds.

As commented by Sheldon D. Pollack:

The lack of an independent source of revenue for the central government severely inhibited the institutional development of the early American state. As Madison himself put it, “No money is paid into the public Treasury; no respect is paid to the federal authority. Not a single State complies with the requisitions; several pass over them in silence, and some positively reject them.... It is not possible that a Government can last long under these circumstances.” Even if the constitution of the Confederacy has authorized stronger national political institutions and provided for a greater role for the central state within the federation, and even if there had been the desire and political will to build a more powerful central state, the Congress still lacked the revenue necessary to carry out such an endeavor. (...) Without adequate funding, the military force under the command of the Congress faced persistent and debilitating shortages of good and supplies. (...) As the Congress lacked the funds to pay what had been promised to soldiers, the troops grew restless.<sup>16</sup>

Thus, the changes in the fiscal system in force were urgent in face of the many dangers and threats to which the States were subject with a central government so weak and incapacitated to perform its most basic functions. For instance, the lack of funds prevented the Congress from reacting properly to the British refusal to evacuate some military posts in the American territory on the border with Canada, as required by the peace treaty.<sup>17</sup>

As the liberty and peace in the several States could only be assured by a strong Union,<sup>18</sup> the need for a major redesign of the system was evident. As noted by Alexander Hamilton in *The Federalist* n. 12, “[a] nation cannot long exist without revenue. Destitute of this essential support, it must resign its independence and sink into the degraded condition of a province.”<sup>19</sup> This impossibility of the central government to raise autonomously its revenue was

---

<sup>15</sup>BROWN, Roger H. *Redeeming the republic: federalists, taxation and the origins of the constitution*. Baltimore: Johns Hopkins University Press, 1993, p. 12.

<sup>16</sup>POLLACK, Sheldon David. *War, revenue, and state building: financing the development of the American state*. Ithaca: Cornell University Press, 2009, p. 159.

<sup>17</sup>BROWN, Roger H. *Redeeming the republic: federalists, taxation and the origins of the constitution*. Baltimore: Johns Hopkins University Press, 1993, p. 17. The author provides other examples of the Congress’s inability to react properly to foreign threats caused by the lack of resources (p. 17-21).

<sup>18</sup>HAMILTON, Alexander. *The Federalist* n. 09, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 50.

<sup>19</sup>HAMILTON, Alexander. *The Federalist* n. 12, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*.

preventing the institutional development of the United States.<sup>20</sup> The Philadelphia Convention, in 1787, was held in this context.

## **2. The basic ideas about the American tax system that prevailed at the Philadelphia Convention.**

The seriousness of the financial situation coupled with the failures of the taxation system under the Articles of the Confederation guided the works of the Philadelphia Convention.<sup>21</sup> The initial purpose of the Convention was to develop a proposal for modifying the defective points of the Articles of Confederation.<sup>22</sup> Thus, the central government's power to tax was one of the main issues raised during the Convention Debates.

---

Connecticut: Wesleyan University Press, 1961, p. 78-79.

<sup>20</sup> POLLACK, Sheldon David. *War, revenue, and state building: financing the development of the American state*. Ithaca: Cornell University Press, 2009, p. 159.

<sup>21</sup> BROWN, Roger H. *Redeeming the republic: federalists, taxation and the origins of the constitution*. Baltimore: Johns Hopkins University Press, 1993, p. 03. According to C. Randall Henning and Martin Kessler (2012, p. 03), “[b]efore 1790, the United States was effectively bankrupt, in default on most of its debt incurred during the Revolutionary War, and had no banking system, regularly functioning securities markets, or national currency. Reliant on the 13 states to collect and share tax revenue, the federal government was unable to pay war veterans or service, let alone redeem, debts. Under the Articles of Confederation, the federal government had no executive branch, judicial branch, or tax authority. As an ‘institutional equilibrium,’ the United States were decidedly unstable and the financial predicament largely drove the constitutional reform of 1787 in Philadelphia.” HENNING, C. Randall; KESSLER, Martin. *Fiscal federalism: US history for architects of Europe's Fiscal Union*. Peterson Institute for International Economics, Working Paper n. 2012-1, jan. 10, 2012, p. 02. Available at: <http://ssrn.com/abstract=1982709> (Accessed: 06 April 2019).

<sup>22</sup> According to Alexander Hamilton in *The Federalist* n. 21, “[t]he principle of regulating the contributions of the States to the common treasury by quotas” was among the main defects of the Confederation because of its inadequacy to supply the national exigencies, besides generating unfairness and inequalities given the existing disparities among the States.” HAMILTON, Alexander. *The Federalist* n. 21, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 129-135. Commenting about the system of requisitions and quotas, Alexander Hamilton, in *The Federalist* n. 30, stated: “Congress, by the articles which compose that compact (as has already been stated), are authorized to ascertain and call for any sums of money necessary, in their judgment, to the service of the United States; and their requisitions, if conformable to the rule of apportionment, are in every constitutional sense obligatory upon the States. These have no right to question the propriety of the demand; no discretion beyond that of devising the ways and means of furnishing the sums demanded. But though this be strictly and truly the case; though the assumption of such a right would be an infringement of the articles of Union; though it may seldom or never have been avowedly claimed, yet in practice it has been constantly exercised, and would continue to be so, as long as the revenues of the Confederacy should remain dependent on the intermediate agency of its members. What the consequences of this system have been, is within the knowledge of every man the least conversant in our public affairs, and has been amply unfolded in different parts of these inquiries. It is this which has chiefly contributed to reduce us to a situation, which affords ample cause both of mortification to ourselves, and of triumph to our enemies.” HAMILTON, Alexander. *The Federalist* n. 30, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 189.

However, rather than make changes to the Articles of Confederation, the Convention opted to draft an entirely new Constitution.<sup>23</sup> The new Constitution brought about significant changes in the institutional design of the United States, due to the creation of a new model of federation. To achieve the objectives outlined in the new Constitution, and to overcome the difficulties faced by the Confederation, the model proposed by the Philadelphia Convention necessarily implied the strengthening of the Federal Government and the increasing of its powers and duties. In fact, the redistribution of power would be an important outcome of the new Constitution.

The Founding Fathers desired to provide the central government with all the necessary and proportional means to achieve its ends.<sup>24</sup> A new fiscal and tax arrangement was a requisite for the new distribution of political power, since a strong and autonomous central government cannot truly exist if it is not provided with the financial resources necessary for fulfilling its duties. The new political dimension required a new financial dimension; otherwise the objects pursued by the new Constitution would remain frustrated.

It is worth quoting Alexander Hamilton's words regarding this point:

It has been already observed that the federal government ought to possess the power of providing for the support of the national forces; in which proposition was intended to be included the expense of raising troops, of building and equipping fleets, and all other expenses in any wise connected with military arrangements and operations. But these are not the only objects to which the jurisdiction of the Union, in respect to revenue, must necessarily be empowered to extend. It must embrace a provision for the support of the national civil list; for the payment of the national debts contracted, or that may be contracted; and, in general, for all those matters which will call for disbursements out of the national treasury. The conclusion is, that there must be interwoven, in the frame of the government, a general power of taxation, in one shape or another.

Money is, with propriety, considered as the vital principle of the body politic; as that which sustains its life and motion, and enables it to perform its most essential functions. A complete power, therefore, to procure a regular and adequate supply of it, as far as the resources of the community will permit, may be regarded as an indispensable ingredient in every constitution.<sup>25</sup>

---

<sup>23</sup> James Madison defends in *The Federalist* n. 40 the power of the Convention to frame and propose the new Constitution. According to him, the act from Annapolis and the recommendatory act of Congress empowered the Convention to “frame a *national government*, adequate to the *exigencies of government and of the Union*, and to reduce the articles of confederation into such form as to accomplish these purposes.” MADISON, James. *The Federalist* n. 40, 1788. In COOKE, Jacob Ernest (ed). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 259.

<sup>24</sup> HAMILTON, Alexander. *The Federalist* n. 23, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 147.

<sup>25</sup> HAMILTON, Alexander. *The Federalist* n. 30, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 187-188.

In this context, in order to implement the new federal system that had been proposed in Philadelphia, it was necessary to revisit the issues related to the distribution of taxation powers between the States and the Federal Government. This subject was one of the leading and most controversial issues involved in the new institutional arrangement,<sup>26</sup> raising numerous discussions about the tax system.

The new arrangement needed to enable “the national government to raise its own revenues by the ordinary methods of taxation authorized in every well-ordered constitution of civil government”.<sup>27</sup> In addition, the new system should also reconcile the interests of the States with those of the Federal Government, distributing adequately among them the power to tax in order to ensure each the opportunity to raise the necessary resources so that they could accomplish their duties without the need of intermediaries.

It was precisely based on this idea that the Founding Fathers designed the Federal tax system, namely, on the assumption that each member-State and the Union should be vested with the necessary and sufficient financial resources.

However, how should the nation strengthen the Union’s power without overly extracting the resources of the States, which was one of the main concerns of those opposed to the new Constitution? How should the nation distribute taxing powers without transferring resources more than the necessary to the Federal Government at the expense of state governments, or, on the contrary, transferring to the Union less resources than the necessary? How should the nation shape a balanced distribution of tax competence that could supply not only the resources needed in the present, but also allow a possible adaptation depending on the economic and social circumstances, or any unforeseen or unexpected situations?

The solution found by the Framers was the adoption of a flexible system of taxation, in which it is assigned to all members of the federation a broad power to tax, “concurrently and coequal”<sup>28</sup> between Federal Government and States, including the possibility to impose taxes on the same economic basis. The outcome of the discussions preceding the new Constitution was then the adoption of a document with very few provisions dealing with taxation, and none of them containing many details.<sup>29</sup>

---

<sup>26</sup> STEPHAN, Paul B. *Guerras fiscais nos Estados Unidos*. In DERZI, Misabel Abreu Machado; BATISTA JÚNIOR, Onofre Alves; MOREIRA, André Mendes (org.). *Estado federal e guerra fiscal no direito comparado*. Belo Horizonte: Arraes Editores, 2015, p. 163.

<sup>27</sup> HAMILTON, Alexander. *The Federalist n. 30*, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 189.

<sup>28</sup> HAMILTON, Alexander. *The Federalist n. 32*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 201.

<sup>29</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44, n. 2, article 2,



Defending the flexible and concurrent power to tax instead of the separation of the objects of revenue, Alexander Hamilton suggested in *The Federalist* n. 34 that

"a concurrent jurisdiction in the article of taxation was the only admissible substitute for an entire subordination, in respect to this branch of power, of State authority to that of the Union." Any separation of the objects of revenue that could have been fallen upon, would have amounted to a sacrifice of the great interests of the Union to the power of the individual States. The convention thought the concurrent jurisdiction preferable to that subordination; and it is evident that it has at least the merit of reconciling an indefinite constitutional power of taxation in the Federal government with an adequate and independent power in the States to provide for their own necessities.<sup>30</sup>

The extensive taxation power granted to the Federal Government was object of many critics from the opponents of the new Constitution. The so-called anti-federalists argued that this broad power could be exercised to oppress the people as well as to prevent the States from obtaining their needed resources.<sup>31</sup>

For example, in criticizing the broad taxing power granted to the central government, the anti-federalist Robert Yates, under of the pseudonym Brutus, argued that the central government, with this comprehensive power, would control and exhaust every source of revenue in America, leaving nothing to the States. In this situation, the proper existence of the States was at stake, considering that "the idea of any government existing, in any respect, as an independent one, without any means of support in their own hands, is an absurdity."<sup>32</sup>

Responding to the critics of the new Constitution, Hamilton argued that the Union's broad power to tax would not bring any risks to the States because they would continue to have their broad and independent taxation power, in accordance to their needs. In fact, with the exception of taxes on imports and exports, the States would "retain [the] authority [to tax] in the most absolute and unqualified sense; and that an attempt on the part of the national government to abridge them in the exercise of it, would be a violent assumption of power, unwarranted by any article or clause of its Constitution."<sup>33</sup>

---

p. 271-320, 1977, p. 271-272. The author points out, however, that this lack of constitutional provisions on fiscal federalism have been supplemented by numerous statutes and decisions of the Supreme Court, "which can be changed when the conditions change." (p. 274)

<sup>30</sup> HAMILTON, Alexander. *The Federalist* n. 34, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 215.

<sup>31</sup> CORNELL, Saul. *The other Founders: anti-federalism & the dissenting tradition in America, 1788-1828*. Chapel Hill and London: University of North Carolina Press, 1999, p. 30-31.

<sup>32</sup> YATES, Robert. *Brutus fifth essay*, *The New-York Journal*, Dec. 13, 1787. Available at: <http://www.thefederalistpapers.org/antifederalist-paper-32> (Accessed: 06 April 2019).

<sup>33</sup> HAMILTON, Alexander. *The Federalist* n. 32, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 199.

Moreover, in response to those who had suggested that the Federal Government should be assigned only with the power over external taxation, such as duties on imported articles, thus leaving the other taxes (internal taxation) to the States, Alexander Hamilton<sup>34</sup> contended that, based on the premise that “every power ought to be proportionate to its object”, the power to tax should not be confined because the future necessities of the government cannot be calculated or limited.

A government ought to contain in itself every power requisite to the full accomplishment of the objects committed to its care, and to the complete execution of the trusts for which it is responsible, free from every other control but a regard to the public good and to the sense of the people.

As the duties of superintending the national defense and of securing the public peace against foreign or domestic violence involve a provision for casualties and dangers to which no possible limits can be assigned, the power of making that provision ought to know no other bounds than the exigencies of the nation and the resources of the community.

As revenue is the essential engine by which the means of answering the national exigencies must be procured, the power of procuring that article in its full extent must necessarily be comprehended in that of providing for those exigencies.<sup>35</sup>

Only by granting of an extensive power to tax to the Union, could the Framers enable the central government to make inevitable adjustments that future circumstances would require on account of new developments. Further, considering the fiscal situation of the United States, a broad taxation power would also be valuable in the negotiations with creditors to obtain better interest rates.<sup>36</sup>

Despite the objections devised by the anti-federalists, the Constitution was approved and granted broad tax powers to the Union, which no longer would have to resort to

---

<sup>34</sup> HAMILTON, Alexander. *The Federalist n. 30*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 190.

<sup>35</sup> HAMILTON, Alexander. *The Federalist n. 31*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 195-196. Elsewhere, Alexander Hamilton stated that: “Constitutions of civil government are not to be framed upon a calculation of existing exigencies, but upon a combination of these with the probable exigencies of ages, according to the natural and tried course of human affairs. Nothing, therefore, can be more fallacious than to infer the extent of any power, proper to be lodged in the national government, from an estimate of its immediate necessities. There ought to be a capacity to provide for future contingencies as they may happen; and as these are illimitable in their nature, it is impossible safely to limit that capacity.” HAMILTON, Alexander. *The Federalist n. 34*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 210-211.

<sup>36</sup> “The power of creating new funds upon new objects of taxation, by its own authority, would enable the national government to borrow as far as its necessities might require. Foreigners, as well as the citizens of America, could then reasonably repose confidence in its engagements; but to depend upon a government that must itself depend upon thirteen other governments for the means of fulfilling its contracts, when once its situation is clearly understood, would require a degree of credulity not often to be met with in the pecuniary transactions of mankind, and little reconcilable with the usual sharp-sightedness of avarice.” HAMILTON, Alexander. *The Federalist n. 30*, 1787. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 192-193.

the requisitions. As a result, there was a natural decline of the influence of the States over the Federal Government.<sup>37</sup>

Such a system designed in 1787 by the Founding Fathers, if not perfect, has proven to be particularly adequate and efficient over the years. In comparison with other systems of distribution of taxing powers between the entities of the federation, such as the system adopted in Brazil, the American system seems uniquely able to allow all tiers of government in the federation the autonomy necessary to obtain their own resources, thus enabling a real political and administrative autonomy, as well as adaptation to new economic realities and social demands.

Evidently, this flexible system allows overlaps in the taxation of the Federal Government and the States (and even Municipalities). This situation was not ignored by the Founding Fathers, who relied on the prudence of the members of the federation to find a balance in regarding the expediency and quantity of taxation on a particular article.<sup>38</sup> According to Hamilton in *The Federalist* n. 33:

As far as an improper accumulation of taxes on the same object might tend to render the collection difficult or precarious, this would be a mutual inconvenience, not arising from a superiority or defect of power on either side, but from an injudicious exercise of power by one or the other, in a manner equally disadvantageous to both. It is to be hoped and presumed, however, that mutual interest would dictate a concert in this respect which would avoid any material inconvenience.<sup>39</sup>

The practice has confirmed the confidence of the Founding Fathers, showing that the central government and the States generally specialize by selecting certain kinds of taxes.<sup>40</sup> Moreover, although these overlaps and specializations vary according to the time, "[the]

---

<sup>37</sup> STORING, Hebert J. *What the anti-Federalists were for: the political thought of the opponents of the Constitution*. Chicago: The University of Chicago Press, 1981, p. 35.

<sup>38</sup> "It is, indeed, possible that a tax might be laid on a particular article by a State which might render it inexpedient that thus a further tax should be laid on the same article by the Union; but it would not imply a constitutional inability to impose a further tax. The quantity of the imposition, the expediency or inexpediency of an increase on either side, would be mutually questions of prudence; but there would be involved no direct contradiction of power. The particular policy of the national and of the State systems of finance might now and then not exactly coincide, and might require reciprocal forbearances." HAMILTON, Alexander. *The Federalist* n. 32, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 202.

<sup>39</sup> HAMILTON, Alexander. *The Federalist* n. 33, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 208.

<sup>40</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 273.

changes are slow, well-known, and seldom reversed"<sup>41</sup> being motivated not by partisan disputes, but rather by the need to reflect the changes of government's role in society.<sup>42</sup>

Furthermore, even in the case of inevitable overlaps, the members of the federation usually find the right balance so as not to cause damage between them or to taxpayers. An example of this is the income tax, which is solicited by the central government, many States and some Municipalities. In such cases, the States usually conform their income taxes to federal statutes.<sup>43</sup> Moreover, the competition of federated entities for funds deriving from income tax is limited by the rules contained in the Internal Revenue Code, which authorizes the deduction of income tax payments made to the States.<sup>44</sup>

The American model also does not preclude the existence and need for inter-governmental transfers through, for example, conditional grants-in-aid and general revenue sharing.<sup>45</sup> However, these transfers do not have the same impact of the transfers that are needed and effectively made in other federations, such as Brazil's. Because of the ample power to tax that the States have under the U.S. Constitution, these transfers do not compromise their political and financial autonomy as members of the federation. Thus, despite the inter-governmental transfers, "[t]he American fiscal system remains a federal system in practice and not merely in constitutional theory."<sup>46</sup>

Below, we analyze the American and Brazilian tax systems in order to demonstrate how the failure to comply with the basic ideas that have inspired the formatting of the American system may explain some defects of the Brazilian fiscal federalism.

### **3. The American tax system designed in the Constitution of the United States.**

The redistribution of tax powers was a matter of utmost importance in the new institutional design of the United States. Indeed, as we have seen, "[i]nvigorating the revenue

---

<sup>41</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 273.

<sup>42</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 273.

<sup>43</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 289-290.

<sup>44</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 300.

<sup>45</sup> See DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 304-319.

<sup>46</sup> See DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 311.

system was one of the primary reasons for a new constitution”.<sup>47</sup> And the enhancement of the fiscal powers of the central government, one of the most important outcomes of the Convention, was expressed at the beginning of Section 8, Article I of the Constitution, as follows: “The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States”.

The central government’s power to tax was understandably chosen to inaugurate the list of congressional powers. For the first time, the Federal Government was authorized to impose taxes on citizens directly, without any intermediary intervention by States, obtaining the position to exercise its functions with a necessary and essential autonomy.

However, it is important to note that it was not only granted to the Union the power to charge directly from citizens, but more that, the Constitution drafted by the Philadelphia Convention “put remarkably few restrictions on the new government’s power to tax, borrow, and spend.”<sup>48</sup> In fact, the Federal Government received a broad and almost unconstrained power to raise revenue, except for a few restrictions such as the Uniformity Clause (Article I, Section 8, clause 1, requiring the Congress to impose uniform duties, impostos and excises throughout the United States)<sup>49</sup>, the Direct-tax Apportionment Clause (Article I, Section 2 and Section 9, clause 4, establishing the necessity to apportion direct taxes, including land and capitation taxes, among the States on the basis on population)<sup>50</sup> and the Export Clause (Article I, Section 9, clause 5, prohibiting the Congress to impose taxes on articles exported form any State).<sup>51</sup>

The Export Clause was included in the Constitution as a compromise to guarantee that the Federal Government would not be financed through a levy on the agricultural exports,

---

<sup>47</sup> JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005, p. 01.

<sup>48</sup> GORDON, John Steele. *Hamilton’s blessing: the extraordinary life and times of our national debt*. New York: Walker and Company, 1997, p. 15. According to Chief Justice Chase, “[t]he power of Congress to tax is a very extensive power. It is given in the Constitution, with only one exception and only two qualifications. Congress cannot tax exports, and it must impose direct taxes by the rule of apportionment, and indirect taxes by the rule of uniformity. Thus limited, and thus only, it reaches every subject, and may be exercised at discretion.” (*Apud* DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 272).

<sup>49</sup> Article I, Section 8, clause 1: “[A]ll Duties, Imposts and Excises shall be uniform throughout the United States;”

<sup>50</sup> Article I, Section 2: “Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons.”; Article I, Section 9, clause 4: “No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.”

<sup>51</sup> Article I, Section 9, clause 5: “No Tax or Duty shall be laid on Articles exported from any State.”

which was in the foundation of the United States one of the main activities of the Southern States.<sup>52</sup>

In turn, the limitations imposed by the Uniformity Clause, which provides that indirect taxes should be distributed in a geographically uniform manner, and the Apportionment Clause, requiring that the amount of direct taxes raised per capita in accordance with the previous census shall be the same in each state, in practice have functioned as constraints to the type of taxes that the Federal Government will utilize because of the difficulties involved in apportioning property taxes. Indeed, the apportionment requirement could only be met “if the rate were set at a different level in each state so that the yield from the tax was in accordance with population.”<sup>53</sup> These difficulties have led to a specialization of the States in the collection of direct taxes on real and personal property instead of the Union.<sup>54</sup>

It should be added also some other few limitations arising from interpretations of the Supreme Court about other constitutional rules do not directly related to taxation, such as the prohibition to raise tax on speech or on the exercise of religion, or in violation of the due process or equal protection clause.<sup>55</sup>

It may be even be remarked, regarding this comprehensive power to tax conferred by the new Constitution to the Federal Government, that the Constitution had already authorized since 1789 the Congress to enact an income tax.<sup>56</sup> Actually, many commentators point out as a mistaken the decision of the Supreme Court in *Pollock v. Farmers' Loan & Trust Co.* (1895), which struck down the income tax in 1884 on the grounds that it was a “direct tax” that had not

---

<sup>52</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 288.

<sup>53</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 288-289.

<sup>54</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 289.

<sup>55</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 287. Erik Jensen states that although the power to tax of the Union had been extraordinarily strengthened, it is not unlimited. Citing Owen Fiss, Jensen points out that, given the historical context, it would be unlikely that the Founders, who were until recently involved in concerns about "taxation without representation", could now create an “unconstrained national taxing power.” JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005, p. 04. According to him, “[t]he technically accurate point—that the Constitution imposes almost no limits on the *kinds* of taxes Congress might impose—does not translate into no limits on the taxing power”. JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005, p. 06.

<sup>56</sup> According to Erick Jensen, “[w]hatever the Sixteenth Amendment did, the 1913 Amendment was not necessary to make an income tax possible (...).” JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005, p. 07.

been correctly apportioned,<sup>57</sup> requiring the approval of the Sixteenth Amendment in 1916,<sup>58</sup> in order to clarify that Congress could establish an income tax without an apportionment among the States and without regard to any census.

If, on the one hand, granting to the Union a general power of taxation has ensured its financial independence and autonomy from States,<sup>59</sup> on the other hand the States “survived the Constitutional Convention virtually intact as sovereign political organizations”, maintaining their usual broad taxation power.<sup>60</sup>

Thus, despite the strengthening of the Union’s power to tax, States have not been debilitated. The reconciliation of the interests of the Federal Government with those of the American States has been complemented with the maintenance of an extensive taxation power for the latter, with the exception of the limits imposed in Article I, Section 10, Clause 2 of the Constitution,<sup>61</sup> which prohibits the States from imposing tax on imports and exports concerning international commerce without the consent of Congress.

In addition to this express limitation, the Supreme Court, such as it occurs in relation to the Federal Government’s power to tax, has utilized other constitutional provisions to expand the limits on the power to tax by the States. For instance, the prohibition on States from taxing activities and people beyond their boundaries stems from the interpretation of the Due Process Clause, whereas the Commerce Clause is the basis for restricting the state from taxing with the purpose of protecting the local economy against competition derived from other States, inasmuch as the creation of a free trade area was one of the objectives of the formation of the United States of America.<sup>62</sup>

---

<sup>57</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 74. Erick M. Jensen emphasizes, however, that despite being technically correct to claim that Congress had the power to enact an apportioned income tax since the ratification of the Constitution, this was somewhat irrelevant, since it was only with the constitutional amendment that Congress was exempted from the apportionment rule, making possible the modern income tax system in force in the United States. JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005, p. 07.

<sup>58</sup> Amendment XVI: “The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”

<sup>59</sup> POLLACK, Sheldon David. *War, revenue, and state building: financing the development of the American state*. Ithaca: Cornell University Press, 2009, p. 176.

<sup>60</sup> POLLACK, Sheldon David. *War, revenue, and state building: financing the development of the American state*. Ithaca: Cornell University Press, 2009, p. 184.

<sup>61</sup> Article I, Section 10, Clause 2: “No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing it’s inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Controul of the Congress.”

<sup>62</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 282-283. Nonetheless, the author notes that “it would be a mistake to leave the impression that goods imported into a state from another state, and the income earned thereby are totally immune from taxation in the importing state. When a tax is nondiscriminatory and fairly apportioned-and hence does not serve to protect local industry,

Nevertheless, it is undeniable that the taxation power of the States is still very broad.

According to Kenneth W. Dam:

When a state taxes what is clearly property, income, or activities within its borders, and thus not raise issues of protectionism, extraterritoriality, or multiple burdens, there are few federal constitutional limitations to its powers. (...) [T]he federal Constitution limits neither the kinds of taxes that may be imposed nor the maximum rate of tax. As the Supreme Court has repeatedly said, even a state tax so burdensome as to destroy a business does not violate the Constitution.<sup>63</sup>

Thus, the States have been assured in the new institutional design about the possibility to raise their own resources in order to carry out their political and administrative obligations. As stated by Kenneth W. Dam, “[h]owever one looks at the American States, they retain an independence and vitality that is all the more remarkable when compared with the role of the constituent units of other federal nations.”<sup>64</sup>

This model of fiscal federalism adopted in the United States, with a flexible allocation of taxing powers, has allowed over the years the adaptation of the Union and of the States to the new economic realities and needs of the society, taking into account several elements linked to an efficient taxation, such as mobility.

For instance, it has been precisely this flexibility that has allowed the Federal Government, from whom originally it was expected to collect revenues primarily from taxes on commerce and consumption, including customs revenue,<sup>65</sup> to obtain now most of its revenues from personal and corporate taxes, especially given the difficulty faced by the States to maintain efficient collection at the regional level by virtue of the facility that owners of capital have in transferring their property between States. The Federal Government, by contrast, is more able than the States to take advantage of the results generated by economic growth and industrialization of the country by imposing a national income tax.<sup>66</sup> Nowadays, the central

---

to impose overtly the burden of taxation on citizens of other States, or to subject interstate business to a cumulative or multiple tax burden not borne by local business—chances are the tax will be upheld against constitutional objections. Certainly, the fact that a business firm operates in interstate commerce will not prevent a state from taxing an aliquot portion of its sales or income.” (p. 285).

<sup>63</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 286.

<sup>64</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 276.

<sup>65</sup> HAMILTON, Alexander. *The Federalist n. 12 (1787); The Federalist n. 21 (1787)*. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961, p. 73-83, 129-135. See also, DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 284.

<sup>66</sup> STEPHAN, Paul B. *Guerras Fiscais nos Estados Unidos*. In DERZL, Misabel Abreu Machado; BATISTA JÚNIOR, Onofre Alves; MOREIRA, André Mendes (org.). *Estado federal e guerra fiscal no direito comparado*. Belo Horizonte: Arraes Editores, 2015, p. 164.



government also obtains significant portion of its revenues from the collection of social insurance taxes and contributions.<sup>67</sup>

Many States (and Municipalities), in turn, while still maintaining an income tax, have raised much of their resources through other species of tax, such as the indirect tax on consumption levied on the sale of goods, and the direct tax on real estate, which possesses a low portability.<sup>68</sup> In relation to the sales and gross receipt taxes, although there is some overlap in the collection between the States and the Federal Government, this situation is also harmonized between the members of the federation, since “the federal ‘excise’ tax is limited to sales by manufacturers on a limited number of products while state and local sales taxes apply to virtually all final sales to consumers.”<sup>69</sup> Moreover, as mentioned above, the overlaps between the taxes levied by the central government and state governments are usually prevented by a natural specialization of each entity in collecting certain species of taxes.<sup>70</sup>

The great advantage of this form of allocation of tax powers is to allow, from time to time, the central and state governments to make the necessary corrections in light of the new economic realities, without prejudice to the respective autonomy of the federated entities. The system avoids conflicts and other problems that may arise with freezing fiscal powers.<sup>71</sup>

Therefore, this flexible system of taxation, which allows the members of the federation to adapt themselves to the new economic realities and social demands, and in which all members of the federation were assigned with a broad power to tax, concurrently and coequal, even on the same economic basis, has guaranteed, if not perfectly, at least in an effective way the autonomy of the Union and States, preventing financial pressures from influencing the political and administrative autonomy of each member.

#### **4. The Brazilian tax system and its defects.**

---

<sup>67</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 299.

<sup>68</sup> STEPHAN, Paul B. *Guerras Fiscais nos Estados Unidos*. In DERZI, Misabel Abreu Machado; BATISTA JÚNIOR, Onofre Alves; MOREIRA, André Mendes (org.). *Estado federal e guerra fiscal no direito comparado*. Belo Horizonte: Arraes Editores, 2015, p. 168.

<sup>69</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 299-300.

<sup>70</sup> For instance, “[s]ince 1861, we have not seen a federal tax on real estate” JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005, p. 11.

<sup>71</sup> STEPHAN, Paul B. *Guerras Fiscais nos Estados Unidos*. In DERZI, Misabel Abreu Machado; BATISTA JÚNIOR, Onofre Alves; MOREIRA, André Mendes (org.). *Estado federal e guerra fiscal no direito comparado*. Belo Horizonte: Arraes Editores, 2015, p. 168.

The democratic Brazilian Constitution of 1988 was enacted after a period of over 20 years of military dictatorship, in which the power was heavily concentrated in the hands of the Federal Government. During this period, despite being a federation, Brazil had displayed characteristics of a unitary state.<sup>72</sup> One of the achievements of the new Constitution was to strengthen the federation by redistributing political power between the federal entities. This strengthening occurred through the transfer to the States and Municipalities of a series of competencies and duties.<sup>73</sup>

As had occurred with the United States, the new distribution of political power and duties demanded a new fiscal arrangement that could guarantee the necessary resources to the members of the federation for the performance of their functions, protecting their political and administrative autonomy.

However, unlike the flexible system of taxation adopted by the American Constitution, in which all the tiers of government in this federal system are assigned a broad power to tax, concurrently and coequal, the Brazilian Constitution has adopted a rigid system of distribution of taxing power since that for each level of government is expressly provided exhaustively and exclusively, the taxing basis on which they can exercise their power to tax and the taxes that may be imposed. There is no possibility of creating new taxes by the members of the Federation beyond those that have been thorough and expressly described in the Constitution, with the sole exception that the Federal Government may impose residual taxes (article 154).

Besides the inflexible distribution of the power to tax, Brazil's fiscal federalism is also characterized by the distribution system of the tax collection's product among the federation members, forasmuch as the Constitution also establishes in certain circumstances a compulsory transfer of part of the revenues raised by a superior entity to another lower-level entity (articles 157 and 159). This system of participation ensures resources to the benefited entities because the entity responsible for the imposition and collection of the tax has no interference on this portion to be transferred. Once the taxes are collected, the portion to be allocated to the entity benefited no longer belongs to the one who imposed and collected the tax.

---

<sup>72</sup> See ZIMMERMANN, Augusto. *Teoria geral do federalismo democrático*. Rio de Janeiro: Editora Lumen Juris, 1999, p. 325.

<sup>73</sup> It is worth noting that Brazil adopts a unique three-dimensional federation, since the Municipalities, along with the Union and States, are members of the federation with status of autonomous unity of power (ZIMMERMANN, Augusto. *Teoria geral do federalismo democrático*. Rio de Janeiro: Editora Lumen Juris, 1999, p. 343).

The Brazilian Constitution distributes power to tax as follows: (a) the Union, the States and the Municipalities may impose commonly, but only in connection with the services rendered or business carried on by them, fees (article 145, II), assessment for benefits (article 145, III) and social-security contributions of its public servants (article 149); (b) the Union may impose exclusively compulsory loans (article 148), general social contributions (article 149 and 195), customs tax (article 153, I), export tax (article 153, II), income tax (article 153, III), tax on manufactured products (article 153, IV), tax on financial transactions (article 153, V), rural real estate tax (article 153, VI) and wealth tax (article 153, VII); (c) the Union has the residual power to create other taxes than those expressly designated to it by the Constitution (article 154,I); (d) the Union may impose extraordinary taxes in the case of war or its imminence, encompassed or not by its power to tax; (e) the States and Federal District may impose exclusively tax on inheritance and gift (article 155, I), tax in the circulation of goods and on services of interstate and intercity transportation and communication (article 155, II) and tax on vehicles (article 155, III); and (f) the Municipalities may impose exclusively urban real state tax (article 156, I), tax on the non-gratuitous *inter vivos* conveyance of real (article 156, II), tax on municipal services of any kind that are not included in the State tax power (article 156, III) and contribution to the service of public lightening (art. 149-A).

In addition, the Brazilian Constitution has adopted a rigid system of distribution of taxing power, enumerating exhaustively the taxes that may be imposed and collected by each member of the federation, as well as determining the manner in which the exercise of such power can be exercised. All taxes are also heavily regulated in the Constitution itself, which leads the entire system of taxation to a rigidity that makes it difficult to amend.<sup>74</sup>

Despite its complexity, the truth is that the Brazilian tax system has not been enough to assure States and Municipalities own necessary resources. The constitutional transfer of revenue sources to States and Municipalities has not been proportional to the new functions they have been assigned.<sup>75</sup>

Indeed, while the States and Municipalities have received numerous new responsibilities, the central government has continued to concentrate the largest portion of the tax resources. Moreover, the distribution of taxing powers has significant distortions such as, for example, the granting of the power to the Municipalities to impose taxes with urban

---

<sup>74</sup> ÁVILA, Humberto. *Sistema constitucional tributário*. 4. ed. São Paulo: Saraiva, 2010, p. 109-111.

<sup>75</sup> ZIMMERMANN, Augusto. *Teoria geral do federalismo democrático*. Rio de Janeiro: Editora Lumen Juris, 1999, p. 352.

characteristics while most of them have rural vocation.<sup>76</sup> In addition, increasingly the Union has concentrated its tax collection on contributions whose revenues are not mandatorily shared with States and Municipalities.<sup>77</sup>

There is therefore an undeniable imbalance between tax revenues and duties assigned by the Constitution to the States and Municipalities, which has generated numerous conflicts and disputes between the sub-national entities for financial resources, contributing to undermine the idea of cooperative federalism also conceived in the Constitution of 1988. The tax competition in Brazil, also called a “tax war”, is a serious problem that has caused a lot of damage to the entities involved.

Thus, in Brazil, the rigid tax system designed by the Constitution, unlike the United States’, has not been able to provide States and Municipalities with the sufficient financial resources which enable them to perform their functions autonomously. Because of this situation, States and especially the Municipalities have become financially dependent on conditional and voluntary transfers from the Union. As such transfers are true financial aids made on a fully discretionary basis, they undermine their political and administrative autonomy by forcing the Brazilian States and Municipalities to adhere to the central entity’s policies in order to obtain resources.<sup>78</sup>

In addition to compromising the autonomy of federation entities, a federal system strongly based in intergovernmental transfers may, ultimately, produce the serious consequence of "destabiliz[ing] the public sector and the economy as a whole."<sup>79</sup> As mentioned above, while in the United States the intergovernmental transfers are also common, they do not have the same weight and do not jeopardize the autonomy of members of the federation as occurs in Brazil, mainly because in the United States the Constitution has endowed a broad power to tax to the States.

---

<sup>76</sup> RIBEIRO, Ricardo Lodi. *Paternalismo federativo e a competência para a concessão de benefícios fiscais no ICMS e no ISS*. Revista Fórum de Direito Tributário – RFDT, v. 10, n. 59, p. 133–151, set./out., 2012, p. 138.

<sup>77</sup> BARROSO, Luís Roberto. *Parecer n. 01/2009: Sentido e alcance do parágrafo único do art. 160 da Constituição: parâmetros para a retenção de receitas estaduais pela União Federal*. Revista de Direito da Procuradoria Geral do Estado do Rio de Janeiro, n. 64, p. 295-321, 2009, p. 298-299

<sup>78</sup> LOBO, Rogério Leite. *Federalismo fiscal brasileiro: discriminação das rendas tributárias e centralidade normativa*. Rio de Janeiro: Editora Lumen Juris, 2006, p. 83. According to Ricardo Ribeiro Lodi, the situation may be characterized as a "fiscal parasitism". RIBEIRO, Ricardo Lodi. *Paternalismo federativo e a competência para a concessão de benefícios fiscais no ICMS e no ISS*. Revista Fórum de Direito Tributário – RFDT, v. 10, n. 59, p. 133–151, set./out., 2012, p. 138.

<sup>79</sup> OATES, Wallace E. *Toward a second-generation theory of fiscal federalism*. International Tax and Public Finance 12, p. 349–373, 2005, p. 354. Available at: <https://doi.org/10.1007/s10797-005-1619-9> (Accessed: 06 April 2019).

Moreover, as it can be concluded from the example of America's flexible system and the advantages that are inherent to it, the fiscal problems of States and Municipalities in Brazil are exacerbated by the extremely rigid tax system that was adopted, which allows no room for States and Municipalities to adapt themselves to new social needs and economic realities and to make the corrections that are necessary.

It is interesting to note that an overwhelming majority of the Brazilian jurists defend the rigid tax system on the grounds that it is the one that best guarantees the autonomy of the members of the federation, as well as with claims similar to those used by the anti-federalists, i.e., as an instrument of legal security to avoid an oppressive taxation and overlaps between the taxation of the federation entities, although the American experience has shown that those risks are clearly avoidable, as the Founding Fathers anticipated.

Nevertheless, renowned jurists have also criticized the absolute rigidity of the system adopted in Brazil precisely because this system not only does not guarantee the financial autonomy of States and Municipalities, but also it has the potential to deny it.<sup>80</sup> Furthermore, this inflexible system prevents the federated members from exploring the most efficient manner possible to tax their respective bases available from the peculiarities and economic realities found in each territory.<sup>81</sup>

Comparing the American fiscal Constitution with the Constitution of the Federal Republic of Germany, which also divides the taxing powers between the members of the federation, Kenneth W. Dam asserted that “[t]he specificity of the [German Constitution], if not a mistake, has certainly been its costs. The revenue sharing provisions have at times served as an impediment to the type of financial equilibrium between the Federation and the *Länder* that the governments of both have desired.”<sup>82</sup> The same problem, as we have tried to demonstrate, also happens in Brazil due to the extreme rigidity of the distribution of tax powers in the 1988 Constitution.

---

<sup>80</sup> For example, the rigidity has been criticized by, among others, Rubens Gomes de Souza, Sampaio Dória, Luís Roberto Barroso and Rogério Leite Lobo (LOBO, Rogério Leite. *Federalismo fiscal brasileiro: discriminação das rendas tributárias e centralidade normativa*. Rio de Janeiro: Editora Lumen Juris, 2006, p. 139-153).

<sup>81</sup> LOBO, Rogério Leite. *Federalismo fiscal brasileiro: discriminação das rendas tributárias e centralidade normativa*. Rio de Janeiro: Editora Lumen Juris, 2006. p. 188. Rogério Leite Lobo (p. 149-153) suggests, for instance, among other measures that can help mitigate the fiscal problems of States and Municipalities, the granting to them by constitutional amendment of the power to impose residual taxes such as the Union.

<sup>82</sup> DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44 , n. 2 , article 2, p. 295.

## 5. Conclusion.

The American tax system designed by the Founding Fathers is based on two important ideas: (i) that it is essential to provide each member of the federation the necessary and sufficient financial resources which enable them to perform their functions with autonomy, without depending on federated entities, which is a basic pre-condition in order to have a true political and administrative autonomy; and (ii) that there are more advantages than disadvantages in adopting a flexible system of taxation, in which a broad power to tax is assigned to all members of the federation, concurrently and coequal between Union and States, including the possibility to impose taxes on the same economic basis.

If not perfect, the American's taxation system has proven to be adequate and efficient over the years, ensuring to all members of the federation the autonomy necessary to obtain their own resources for the achievement of their objectives, as well as allowing them to adapt themselves to the new economic realities and demands of society.

Eventual overlaps in the taxation of the Federal Government and of the several States permitted by the flexible system are bypassed by the fact that the central government and the States generally specialize by selecting certain kind of taxes and economic basis, as well as by the prudence of the members of the federation in finding an appropriate balance in order to avoid losses to them or to taxpayers.

Unlike the flexible system of taxation adopted by the Constitution of the United States, the Brazilian tax system is characterized by its rigidity in the allocation of tax powers. Nonetheless, unlike what was expected, this rigid distribution of the taxing power has not ensured enough resources for States and Municipalities to perform their duties properly.

Besides favoring the central government, the distribution of the power to tax in Brazil has significant distortions such as the granting of urban taxes to members with rural characteristics. There is therefore an undeniable imbalance between tax revenues and duties assigned by the Constitution to the States and Municipalities. They have become heavily dependent on conditional and voluntary transfers from the Union, which are true financial aids made in a discretionary manner. This dependency undermines the political and administrative autonomy of the States and Municipalities, which are compelled to adhere to the Federal Government's policies in order to obtain resources.

The rigidity of the Brazilian system has also exacerbated the financial dependence of States and Municipalities on the Union considering that they have little margin to adapt

themselves to emergencies and to new economic realities. This situation not only has worsened their fiscal problems, but also generated numerous conflicts and disputes between the subnational entities for financial resources, and also jeopardized the idea of cooperative federalism conceived in the Constitution of 1988. Due to this situation, the tax competition, also called tax war, has been a serious problem in Brazil as it causes huge damages to the members involved.

## References

ÁVILA, Humberto. *Sistema constitucional tributário*. 4. ed. São Paulo: Saraiva, 2010.

BARROSO, Luís Roberto. *Parecer n. 01/2009. Sentido e alcance do parágrafo único do art. 160 da Constituição: parâmetros para a retenção de receitas estaduais pela União Federal*. Revista de Direito da Procuradoria Geral do Estado do Rio de Janeiro, n. 64, p. 295-321, 2009.

BROWN, Roger H. *Redeeming the republic: federalists, taxation and the origins of the constitution*. Baltimore: Johns Hopkins University Press, 1993.

COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.  
CORNELL, Saul. *The other Founders: anti-federalism & the dissenting tradition in America, 1788-1828*. Chapel Hill and London: University of North Carolina Press, 1999.

DAM, Kenneth W. *The American fiscal constitution*. University of Chicago Law Review, v. 44, n. 2, article 2, p. 271-320, 1977.

GORDON, John Steele. *Hamilton's blessing: the extraordinary life and times of our national debt*. New York: Walker and Company, 1997.

HAMILTON, Alexander. *The Federalist n. 01, 1787*. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 09, 1787*. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 12, 1787*. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 21, 1787*. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 23, 1787*. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 30, 1787*. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 31*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 32*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 33*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

\_\_\_\_\_. *The Federalist n. 34*, 1788. In COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

HENNING, C. Randall; KESSLER, Martin. *Fiscal federalism: US history for architects of Europe's Fiscal Union*. Peterson Institute for International Economics, Working Paper n. 2012-1, jan. 10, 2012. Available at: <http://ssrn.com/abstract=1982709> (Accessed: 06 April 2019).

JENSEN, Erick M. *The taxing power: a reference guide to the United States Constitution*. Connecticut: Walker and Company, 2005.

LOBO, Rogério Leite. *Federalismo fiscal brasileiro: discriminação das rendas tributárias e centralidade normativa*. Rio de Janeiro: Editora Lumen Juris, 2006.

MADISON, James. *The Federalist n. 40*, 1788. In: COOKE, Jacob Ernest (ed.). *The Federalist*. Connecticut: Wesleyan University Press, 1961.

OATES, Wallace E. *Toward a second-generation theory of fiscal federalism*. *International Tax and Public Finance* 12, p. 349–373, 2005. Available at: <https://doi.org/10.1007/s10797-005-1619-9> (Accessed: 06 April 2019).

POLLACK, Sheldon David. *War, revenue, and state building: financing the development of the American state*. Ithaca: Cornell University Press, 2009.

RIBEIRO, Ricardo Lodi. *Paternalismo federativo e a competência para a concessão de benefícios fiscais no ICMS e no ISS*. *Revista Fórum de Direito Tributário – RFDT*, v. 10, n. 59, p. 133–151, set./out., 2012.

STEPHAN, Paul B. *Guerras Fiscais nos Estados Unidos*. In DERZI, Misabel Abreu Machado; BATISTA JÚNIOR, Onofre Alves; MOREIRA, André Mendes (org.). *Estado federal e guerra fiscal no direito comparado*. Belo Horizonte: Arraes Editores, 2015.

STORING, Hebert J. *What the anti-Federalists were for: the political thought of the opponents of the Constitution*. Chicago: The University of Chicago Press, 1981.

YATES, Robert. *Brutus fifth essay*, *The New-York Journal*, Dec. 13, 1787. Available at: <http://www.thefederalistpapers.org/antifederalist-paper-32> (Accessed: 06 April 2019).

ZIMMERMANN, Augusto. *Teoria geral do federalismo democrático*. Rio de Janeiro: Editora Lumen Juris, 1999.



Recebido em: 23/11/2020  
1º Parecer em: 09/12/2020  
2º Parecer em: 14/12/2020  
Aceito em: 29/12/2020