

# Global Tax Alert

News from EY Americas Tax

## Brazilian Federal Government announces comprehensive tax reform to be implemented in 2020

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Members of the executive branch of the Brazilian Federal Government, including the current secretary of the Internal Revenue Services, have announced that they will start presenting their comprehensive tax reform proposals in phases, with the first proposal being presented to Congress in 2019. According to the Government, the proposals will be presented and implemented in phases to allow the Government to properly manage the impact of the reform on the economy and tax collection. The Government's intention is to maintain the country's tax collections at 35% of Gross Domestic Product (GDP).

The different phases would be as follows:

#### **Phase 1: Replacement of Program of Social Integration (PIS) and Contribution for the Financing of Social Security (COFINS) with a single federal value-added tax (VAT)**

*Details:* The proposal would replace the PIS and COFINS with a contribution on goods and services (CBS, as per the Brazilian acronym), which is expected to work as a federal VAT, with credits available for any acquisitions made by taxpayers.

*Expected rates:* The rates are still under consideration but are expected to start at a rate of 12% or 13%. There would be few or no exceptions available.

*Necessary legislative change:* The proposal could be made through a bill or the Executive Power could issue a Provisional Measure. A Provisional Measure is effective as of the date of publication but must be converted into law by Congress within 90 days; otherwise the measure will expire.

*Timing:* The proposal is expected to be presented before the end of 2019.

## **Phase 2: Elimination of both the contribution for intervention on economic domain (CIDE) and the federal excise tax**

*Details:* The CIDE is currently levied on remittances abroad of royalty fees, technical, administrative and similar services, and technical assistance. The proposal would incorporate the CIDE into the CBS. Additionally, the federal excise tax (IPI) would be replaced with a selective tax. The IPI is currently levied at different rates on the import of goods, as well as on the sale of manufactured and imported products. The selective tax would be levied only on certain products, such as cigarettes and alcohol, to discourage consumption.

*Expected rates:* The expected rates have not been disclosed.

*Necessary legislative change:* The CIDE/CBS change would require enactment through a complementary law. A constitutional amendment would be required to replace the IPI with the selective tax.

*Timing:* The proposal is expected to be formally presented at the beginning of 2020.

## **Phase 3: Changes to corporate and individual income taxation**

*Details:* The proposal would reduce the combined income tax rate from 34% to 20% over a period of five to eight years for corporate taxpayers. Taxable income would no longer be calculated based on net profit as per local accounting GAAP (IFRS). Separate "tax accounting" would be prepared by taxpayers, following instructions still to be released. The proposal would likely eliminate certain tax incentives and deductions, such as the interest on net equity incentive.

For individual taxpayers, the proposal is expected to make changes to the income tax brackets. While it is expected that the proposal would increase the exempt income bracket, the rate applicable to the highest income tax bracket could potentially increase from the current 27.5% to 35%. The proposal would cap a few deductions, including the deductions for education and health expenses.

Dividends paid to individuals and nonresident shareholders, currently exempt from withholding income tax, would be subject to taxation. The withholding income tax rate is still under discussion.

*Expected rates:* The income tax rates would be 20% for corporations and 15% to 35% for individuals. A tax rate for dividends has not been announced.

*Necessary legislative change:* The proposal would be enacted through passage of an ordinary law or issuance of a Provisional Measure.

*Timing:* The proposal is expected to be presented at the end of the first quarter of calendar year 2020. The proposal would apply beginning in 2022 with an option to elect to apply the proposal to 2020 or 2021.

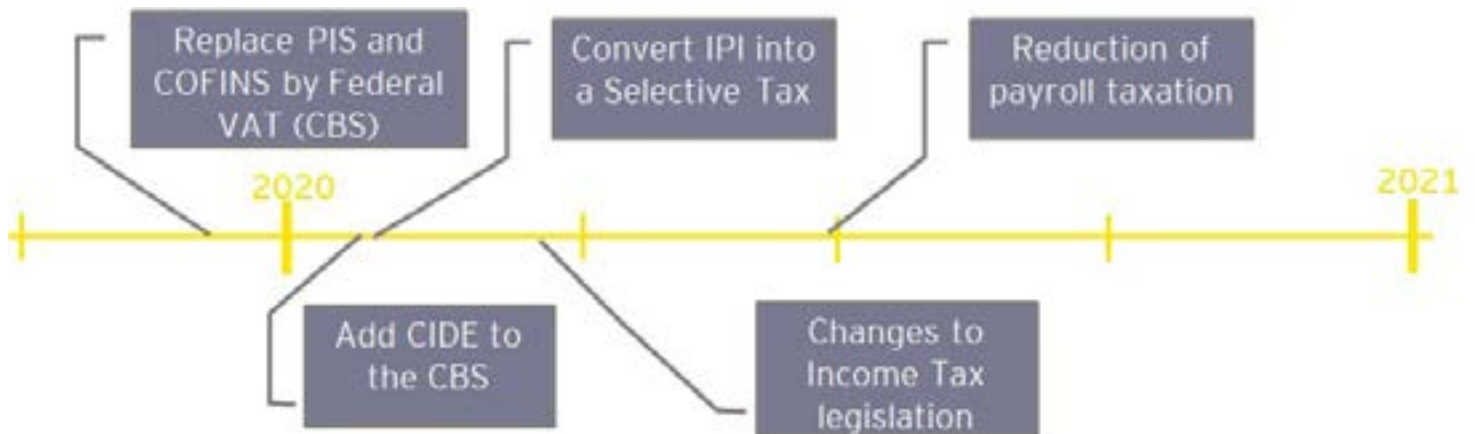
## **Phase 4: Reduction of payroll taxation**

*Details:* No details are available yet, but the proposal is intended to reduce the cost of employment to reduce unemployment.

*Timing:* The proposal is expected to be submitted to Congress in mid-2020.

## Overall timing of the phases

The overall timing of the submission of the proposals to Congress could be depicted as follows:



## Implications

Taxpayers in Brazil should evaluate whether there are actions they need to take before year end in view of the expected changes to Brazilian tax legislation. Some relevant aspects to be considered include (but are not limited to):

- a) Evaluating the Double Tax Treaty network and impact on future withholding taxes on dividends
- b) Reassessing repatriation alternatives, including sharing of management costs and financing structures
- c) Taking maximum advantage of allowable deductions in 2019/2020
- d) Analyzing alternative ways of structuring activities in Brazil
- e) Expediting use of existing balances of indirect tax credits

For additional information with respect to this Alert, please contact the following:

**Ernst & Young Assessoria Empresarial Ltda, São Paulo**

- ▶ Washington Coelho                      washington.coelho@br.ey.com

**Ernst & Young LLP (United States), Latin American Business Center, New York**

- ▶ Gustavo Carmona Sanches              gustavo.carmona1@ey.com
- ▶ Tiago Aguiar                              tiago.aguiar@ey.com
- ▶ Stefania Dalfre                          stefania.dalfre1@ey.com
- ▶ Marcus Segnini                          marcus.segnini1@ey.com
- ▶ Ana Mingramm                          ana.mingramm@ey.com
- ▶ Enrique Perez Grovas                  enrique.perezgrovas@ey.com
- ▶ Pablo Wejcman                          pablo.wejcman@ey.com

**Ernst & Young LLP (United Kingdom), Latin American Business Center, London**

- ▶ Luciana Rodarte                          luciana.rodarte@uk.ey.com
- ▶ Jose Padilla                              jpadilla@uk.ey.com

**Ernst & Young Tax Co., Latin American Business Center, Japan & Asia Pacific**

- ▶ Raul Moreno, *Tokyo*                      raul.moreno@jp.ey.com
- ▶ Luis Coronado, *Singapore*              luis.coronado@sg.ey.com

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