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Indirect Tax Alert

News from EY Americas Tax

Brazilian Government proposes new federal VAT as first phase of comprehensive tax reform

On 21 July 2020, the Brazilian Government proposed a bill that would replace the PIS and COFINS (Social Security Contributions on Sales) with a new tax, the Contribution on Goods and Services (CBS for its Portuguese acronym).

Like the PIS and COFINS, the CBS would apply to local sales, as well as imports, of goods and services. In the same manner, exports of goods and services remain exempt from the CBS. The bill, however, would include in services (especially imports of services) payments for licensing of rights and intangibles.

CBS rate

The CBS would be levied at a flat rate of 12% on gross revenue (reduced by taxes due on revenue, such as the State Value Added Tax – ICMS, and the Municipal Service Tax – ISS, as well as unconditional discounts). It is intended to work as a federal value-added tax (VAT) in the sense that full input tax credit would be available.

Excess CBS credits

The bill would allow taxpayers to have excess CBS credits refunded or to use those credits to offset federal taxes due at the end of the quarter. However, taxpayers would only be able to carry forward the credits for five years.

Application to existing regimes

The bill also would simplify and reduce the number of ancillary obligations related to the CBS, and eliminate several tax incentives and tax regimes, in an effort to simplify the Brazilian tax system. However, it would maintain certain regimes, such as the SIMPLES regime for small businesses and the Manaus Free Trade zone exemption.

Additionally, the bill would retain the special customs regimes that allow for the suspension of the import duty and the federal excise tax. These regimes could lead to the suspension of the CBS. It also would retain the agriculture regime, which would exempt small producers from the CBS and grant a credit to legal entities that acquire agricultural goods from small producers.

The bill would retain the single-phase system applicable to products, such as gas, diesel, alcohol and cigarettes. Different CBS rates would apply to those products. The bill also would retain the cumulative regime for financial institutions, and the CBS would apply at a 5.8% rate with no right to input tax credits.

Application to digital platforms and nonresidents

The bill would require digital platforms to collect the CBS due on sales in which they act as intermediaries, when the seller does not register the transaction by issuing a formal invoice. Nonresidents selling to Brazil would have to register for CBS purposes in Brazil and would be responsible for collecting the CBS whenever the importer is an individual.

Effective date

If enacted, the CBS would be effective the first day of the sixth month following enactment of the law, and the PIS and COFINS would cease to exist. Both chambers of the National Congress (i.e., Chamber of Deputies and Senate) still need to discuss and approve the bill, in different voting rounds. The legislative process usually takes time in Brazil, and the current wording of the bill may be changed during this process.

More tax reform to come

The Government reiterated its intention to implement a more comprehensive tax reform, in phases, as discussed in EY Global Tax Alert, *Brazilian Federal Government has announced comprehensive tax reform to be implemented in 2020*, dated 5 December 2019. Based on information made publicly available when the CBS bill was introduced, the tax reform would be phased in as follows:

- Phase I – replace PIS and COFINS with CBS
- Phase II – replace the Federal Excise Tax (IPI) with a selective tax
- Phase III – change the income taxation of legal entities and individuals, with a shift towards taxing dividend distributions (currently, dividends are exempt from taxation in Brazil)
- Phase IV – reduce the payroll tax (which may require the introduction of a new tax to be levied on payments – see EY Global Tax Alert, *Brazil's Minister of Finance announces intention to levy tax on payments and financial transactions at a rate that may be between 0.2% and 1%*, dated 11 September 2019)

In a further effort to simplify the Brazilian tax system, the Government also stated that it is talking with representatives of states and municipalities to try to incorporate the State VAT (ICMS) and the Municipal Service Tax (ISS) into the CBS.

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