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# Indirect Tax Alert

News from EY Americas Tax

## Brazil's first phase of tax reform would increase federal VAT tax rates for insurance sector

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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).

The replacement of PIS and COFINS, according to the Government, would be a first step in a broader tax reform, which aims to simplify the system and to reduce tax litigation in Brazil. 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 (see EY Global Tax Alert, [Brazilian Government proposes new federal VAT as first phase of comprehensive tax reform](#), dated 22 July 2020, for a broad discussion of the changes and potential impacts).

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. The CBS regular regime would have a tax rate of 12% and is intended to work as a federal value-added tax (VAT).

## Impact on insurance sector

The bill would subject the Brazilian insurance sector, among others (i.e., financial institutions), to a cumulative regime with a 5.8% tax rate (an increase of 1.15 percentage points relative to the current 4.65% PIS/COFINS combined rates) for domestic transactions and a 12% rate on the import of goods and services (which comprises the assignment and licensing of rights and intangibles).

Like PIS and COFINS, the CBS would apply to both local revenue and imports of goods and services. Exports of goods and services would remain exempt from the CBS. CBS would retain the existing cumulative regime methodology on the same tax basis as under PIS/COFINS, calculated on gross revenue that is directly related to the taxpayer's key activities. On this subject, the insurance sector has been challenging the PIS/COFINS tax on the financial income from reserves. We expect to have similar discussions on the CBS bill, as the tax base has not been changed.

The CBS calculation basis under the non-cumulative regime applicable to other sectors, however, would allow other taxes to be deducted, such as the municipal tax on services and the CBS itself. It is unclear from the wording of the bill whether deductions for other taxes would be allowed for the cumulative regime applicable to the insurance sector.

A provision in the bill that would immediately impact the insurance sector would remove an existing tax reduction for reinsurance transactions. Today, a 9.25% PIS/COFINS rate is levied on 15% of the premium paid abroad, which represents approximately a 1.39% effective rate. Under the new CBS tax, a 12% rate would apply on the premium, which would represent a 10.61 percentage points increase over the previous rate. This increase would affect the sector and its liquidity, as insurance companies may have to look locally to reinsure their premiums.

Further, under the cumulative regime, no input tax credits would be available for the insurance entities. Also, insureds will not be allowed to recognize input tax credits on the purchase of insurance.

## Next steps

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.

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