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Indirect Tax Alert

News from Americas Tax Center

Brazil: Special Committee of Lower House approves proposed indirect tax reform

The Special Committee on Tax Reform in Brazil's Lower House approved Congressman Luiz Carlos Hauly's proposed indirect tax reform on 11 December 2018.

Background

The 1988 Federal Constitution established the current structure of Brazil's tax system. The structure consists of different taxes that are imposed by different taxing authorities (federal, state and municipal). The tax reform, therefore, would need to be carried out through a Constitutional Amendment. The amendment would then have to be approved by two-thirds of the Brazilian National Congress (Lower House and Senate). According to Mr. Hauly, Brazil "has a highly complex system, composed of excessive taxes, with excessive concentration on consumption, and that presents a high administrative cost both for the taxpayer and the Tax Administration."

Several taxation models were discussed in public hearings over the past three years. Brazil's Congress chose to move to a system similar to tax systems adopted by most European countries -- a system based on an income tax, a value-added tax (VAT) on goods and services, and a single-phase selective tax on specific items. As a result, the proposed indirect tax reform was introduced in Brazil's National Congress through Constitutional Amendment Proposal (PEC) Number 293.

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Proposed indirect tax reform

If enacted, this proposal would significantly change the system of indirect taxes in Brazil. Specifically, the proposal would:

- Replace the ISS (municipal service tax), ICMS (state VAT), PIS and COFINS (Social Security Contributions on Sales), IPI (federal excise tax) and some other taxes with a single federal VAT (*Imposto sobre Bens e Serviços*, or IBS) with only a few exceptions and special regimes
- Charge the IBS based on the destination of goods and services (rather than on origin, as is currently done)
- Centralize IBS collection
- Distribute IBS revenues to states and cities based on their contribution to the tax base and phase in the new distribution model over a period of years to avoid short-term impacts on state and municipal budgets

The proposal would provide transition rules to change from the current system to the new system in three stages, as follows:

1st stage: During the first year after the publication of the Constitutional Amendment, a temporary tax, similar to the IBS, would be imposed on transactions involving goods, services and intangibles. The tax rate would be 1% and taxpayers could use the tax paid to offset COFINS.

2nd stage: From the second to the fifth year after the publication of the Constitutional Amendment, the old system would be replaced by the new system. Each year, the bill would reduce the rates of IPI, IOF, ICMS, ISS, CIDE-Fuels, PIS/Pasep, COFINS, PIS-Import, COFINS-Import and Salary-Education by 20% of their current values, while the rates of IBS and the selective tax would be implemented in fractions of 20% of the amount determined in the previous stage. The distribution of the IBS and the selective tax revenue would be made in the same proportion of the previous taxes for the Federal Government, states and municipalities over the last three years.

3rd stage: From the 6th to the 14th year after the publication of the Constitutional Amendment, the distribution of the IBS revenue between federal, state and municipal governments will gradually transition from the 2nd stage methodology (based on the previous collection of the taxes that no longer exist) to the new rules proposed in the tax reform. This stage is very important to avoid abrupt disruption in the collection of the IBS revenue by the different levels of government.

The IBS would be regulated, collected and supervised by National Supervising, formed by all the state and municipal tax authorities. National Supervising would have a guarantee of indivisibility, functional independence and autonomy, among other conditions, and would be financed by a portion of the taxes it collects. Its directors would be chosen by the governors of the states and the Federal Government. The IBS would be charged at the destination of the merchandise or service, instead of being charged by the state from which the goods were shipped.

The proposal would maintain the current social security financing, as opposed to previous versions that suggested a reformulation with the creation of a new contribution on movements or transfers of values (i.e., banking transfers) and adjustments to payroll contributions (e.g., cutting or reducing benefits).

As the text has now been approved by the Special Committee on Tax Reform, the proposal will move to the Lower House Plenary, which is expected to happen in early 2019.

Given this development, although there may still be many discussions on this matter, taxpayers/businesses should consider the following questions:

1. How would the tax reform proposals affect their operations?
2. How would the special regimes and tax benefits be treated under the new rules? Would they be migrated into the new system? Or terminated?
3. Would accumulated balances of current tax credits be available to offset future taxes or should companies seek alternatives to accelerate the use of the accumulated credits?

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