



First steps to a **reform**
on the taxation of good
and services in Brazil

Lefosse

Introduction

On July 7, 2023, the Brazilian House of Representatives approved the substitute wording of the Proposal for Amendment to the Constitution No. 45/19, in two rounds of voting (“**PEC 45**”). PEC 45 aims to substantially change the current framework for taxation of goods and services in Brazil by eliminating several of the “indirect” taxes (ICMS, IPI, ISS, and PIS/Cofins) and replacing them with three new taxes: the Tax on Goods and Services (“**IBS**”), the Contribution on Goods and Services (“**CBS**”), and the Excise Tax (“**IS**”).

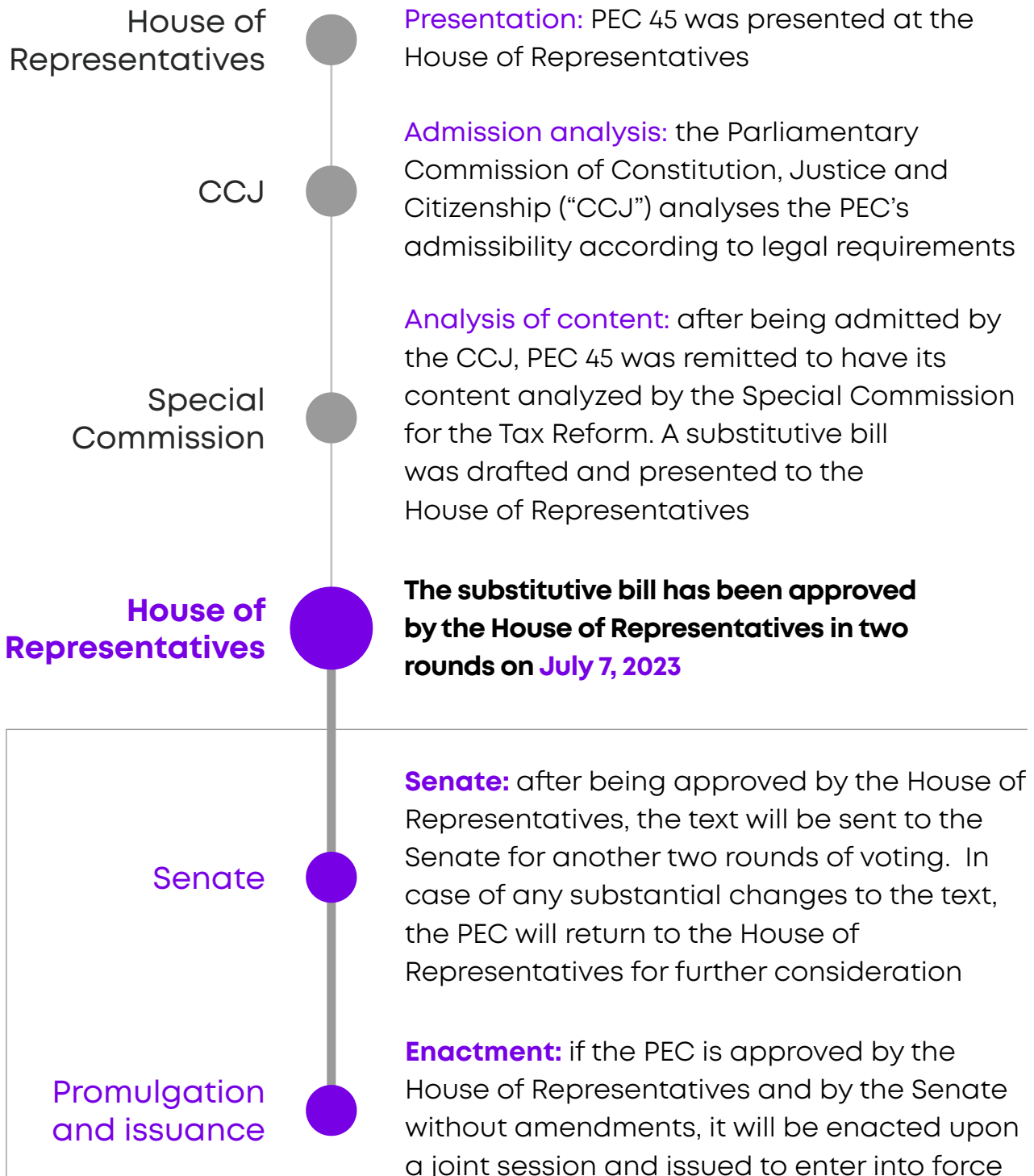
In addition to the IBS, CBS and IS, PEC 45 also provided for the creation of a contribution on local production of primary and semi-finished goods, to be invested by States in infrastructure and housing, replacing the contribution to State funds existing on April 30, 2023.

The text approved by the House of Representatives, which will be submitted to the Senate for further review and approval, also in two rounds of voting, contains few changes in relation to the one presented by the rapporteur of the proposal, Representative Aguinaldo Ribeiro. Some of them, however, tend to generate relevant effects for certain business sectors.

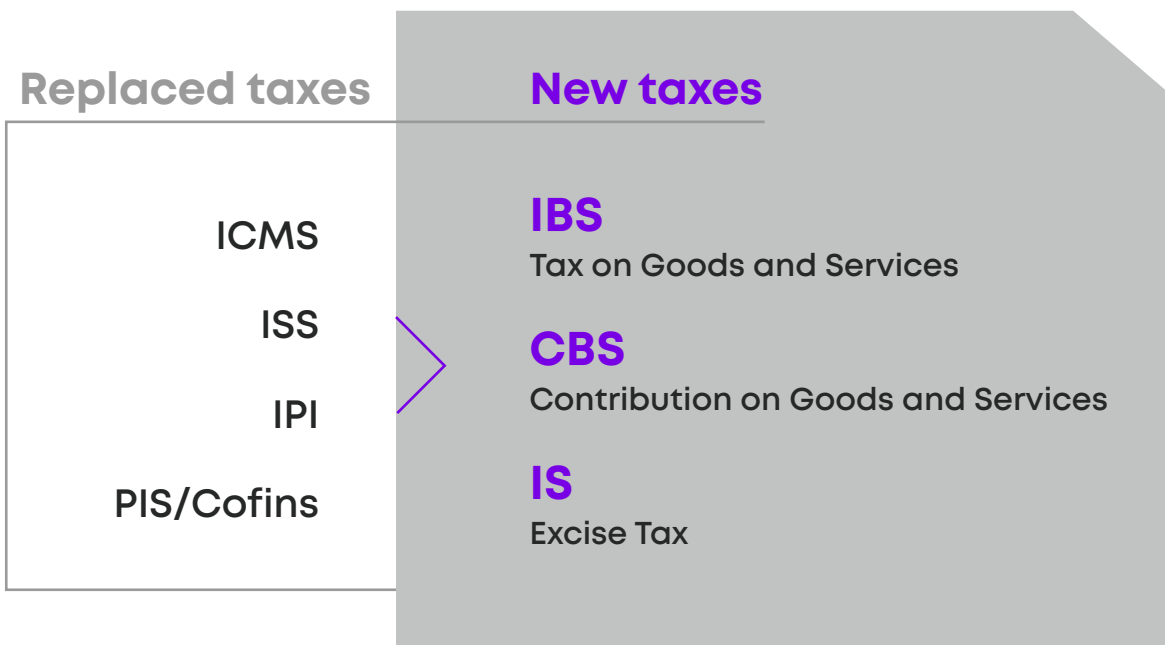
Please see below our comments on the main changes proposed by PEC 45, its procedural regime and expected impacts. At the end of this newsletter, you can find a Q&A with some key questions about the reform and how it may affect the business environment in the country.

1. Legislative process

Current status of PEC 45 in the National Congress



2. Changes in the taxation of goods and services



New contribution: The approved PEC also provides for the creation of a contribution on local production of primary and semi-finished goods, to be invested by States in infrastructure and housing, replacing the contributions to State funds existing on April 30, 2023 and which were condition for applying certain ICMS tax benefits. This new contribution will be temporary and expire on December 31, 2043.

Current taxes to be replaced: **ICMS** – non-cumulative state tax levied on goods, interstate/intercity transportation and communications services, including imports. It is subject to variable rates (between 4% and 25%) depending on the state of origin and destination and the product or regime applicable to the taxpayer or purchaser. **ISS** – cumulative municipal tax levied on services in general, including imports, subject to rates between 2% and 5% depending on the municipality and the nature of the service. **IPI** – partially non-cumulative federal tax levied on domestic and foreign industrialized products in various situations provided for in the legislation. Its rates vary between 0% and 20% depending on the product. **PIS/Cofins** – federal social contributions levied on the revenue according to two regimes: cumulative, taxed at 3.65%, or non-cumulative, at 9.25%. Financial income and financial institutions have a specific cumulative tax of 4.65%. They are also levied on the import of goods and services at rates of 11.65% and 9.25% respectively.



3. IBS and CBS

The approved wording of PEC 45 consolidates the idea of a dual value-added tax (“**VAT**”): a state and municipal tax and a federal contribution on goods and services. IBS and CBS have similar taxable events/basis but may have different tax rates and favored regimes (e.g., Perse and Prouni, applicable only to CBS).

3.1. Triggering event

- Levied on transactions with goods and services including rights and on imports. In the case of imports, the IBS and CBS will be required even if said imports are carried out by a non-habitual taxpayer (individual or legal entity).
- The IBS and CBS will not be levied on exports and the exporter will be assured the right to maintain the credits related to the transactions in which it is the purchaser of goods. The current wording of the PEC 45 does not define ‘exports’ for the sake of the triggering event of the IBS/CBS. That is especially relevant for the export of intangibles and services.

3.2. Tax basis - Non-cumulative regime

- **Tax basis:** the transaction value without gross-up of taxes.
- **Non-cumulative regime:** full non-cumulative regime. Credits will be granted over virtually all purchases.
 - **Personal use and consumption:** transactions related to the benefit of shareholders, directors etc. will not be entitled to credits.
 - **Exemption and immunity:** as a rule, acquisitions covered by exemption or immunity rules will not generate IBS/CBS credits. Complementary law may, however, provide for the maintenance of credits even in case an immunity rule is applicable.

3.3. Destination principle

IBS and CBS will be levied (tax rate and collection) based on the destination (state and municipality) of the respective operation. Complementary law will set forth the criteria for determining the “destination” of a given operation (e.g. where the goods arrive or are made available or where the services are rendered; where the recipient of the goods and services is located etc.).

3.4. Tax rates

PEC 45 does not define IBS and CBS rates. Each state, municipality and the federal district will set its own rate for the IBS, which **must be the same for all transactions with goods and services**, except for certain specific cases (mentioned below). IBS will, therefore, be charged by the sum of the rates of the states, the Federal District and the municipality where the transaction is to be carried out. CBS rate will be provided by federal law and should also be the **same for any type of good and services**, with the exceptions mentioned below.

During the transition period, reference rates will be set by a Resolution of the Federal Senate for both IBS and CBS and the complementary law should provide for a ceiling for future rates.

- **The definition of the IBS rate depends on the state and municipality of destination of the operation**, which may be the “place of delivery, availability or location of the good, the provision or availability of the service or the domicile or location of the purchaser of the good or service”.
- **Collection of IBS will be centralized by the Federative Council**, which will be composed by 27 members from states and federal district and 27 members from municipalities and federal district.

3.5. Tax reduction

Although PEC 45 provides that IBS and CBS will have a single tax rate for any type of service and good, to be defined by the relevant federative entities, it also provides for specific reductions on the applicable tax rate:

60% reduction for:



education services; health, medical devices including accessibility devices for people with disabilities; medicines and basic menstrual health care products; personal hygiene products



public passenger transport services by road, rail and waterway



agricultural, aquaculture, fishing, forestry and plant extractive products, agricultural and aquaculture inputs, food intended for human consumption



national artistic, cultural, journalistic and audiovisual productions, sports activities



goods and services related to national security and sovereignty

100% reduction for:



certain medicines and medical devices



vegetables, fruits and eggs and staple basket items

100% reduction for (CBS only):



education services provided under Prouni



services benefited by Perse (up until February 28, 2027)

PEC 45 also provides for a favored regime for biofuels and the complementary law will define the applicable tax rates thereto.

3.6. Taxpayers and tax liability

- Generally, the taxpayer will be person or entity which habitually carries out transactions in the domestic market as well as import transactions (regardless of habituality in the case of imports). Complementary law may provide for specific tax liability cases for the IBS and the CBS.
- **Marketplaces and payment entities.** The current wording of the PEC leaves room for a complementary law to establish tax liability for any person/entity who contributes to the realization, execution or payment of the operations subject to IBS/CBS, even if located abroad.

3.7. Specific Regimes

- PEC 45 provides for specific IBS and CBS regimes for (a) fuels and lubricants (for which there will be a type of tax substitution); (b) financial services (e.g., credit foreign exchange, insurance and leasing operations, payment schemes, portfolio management); (c) certain real estate activities; (d) health care plans; (e) lottery contests; (f) cooperatives; (g) hotel services, amusement parks, restaurants, and (h) regional aviation.
- A complementary shall provide for the computation system of the taxes, which, in the case of these specific regimes, may be cumulative and subject to rates different from those applicable to the general IBS and CBS regime.

3.8. Impacts on the current tax incentives and special regimes

Manaus Free Trade Zone and Free Trade Areas (Áreas Livres de Comércio - ALC)

- During the transition period in which the IPI will continue to exist, but with a tax rate reduced to zero on most goods (starting from 2027), IPI tax rate **shall not be reduced** in relation to goods industrialized outside of the Manaus Free Trade Zone, but which are also produced in said free trade area.
- Relevant IS, the IBS, and CBS legislation are required to create mechanisms to preserve the competitive advantage of the Manaus Free Trade Zone and the ALCs.

Simple Nacional

- The favorable regime applied to companies under the Simples Nacional will be preserved.
- Options for taxpayers under the Simples regime:
 - **Collecting the IBS/CBS within the Simples regime** – purchaser of the goods or services will be entitled to IBS/CBS credit up to the amount paid by the taxpayer under Simples.
 - **Collecting the IBS/CBS aside from the Simples regime** – purchaser will be entitled to IBS/CBS credit for the full amount of the IBS/CBS levied on the transaction.

Current federal special regimes

- Eliminated as of 2027.

Current state and municipal special regimes and tax incentives

- IBS transition regime provides for a phase out of current state tax incentives.

3.9. Points of attention:

- **Financial revenues:** doubts on whether financial operations would fall within the scope of IBS and CBS.
- **Expenses with non-taxpaying individuals** will not generate IBS/CBS credits.
- **Capital goods:** complementary law may specifically provide for the mechanics of crediting IBS and CBS on amortization and depreciation expenses.
- **Accumulated credits:** complementary law will provide for the mechanics and timing for reimbursement of credits accumulated by IBS and CBS taxpayers.



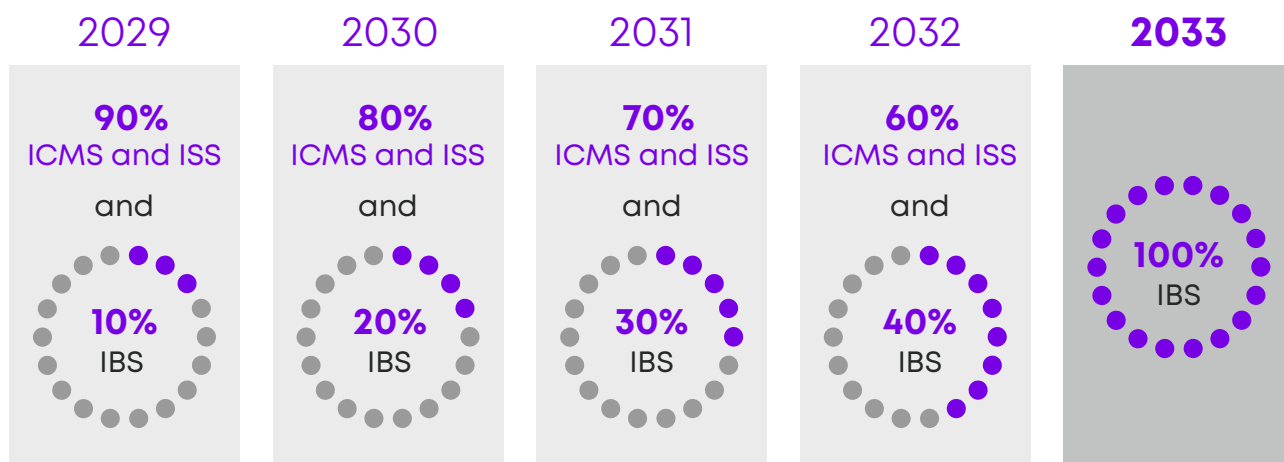
4. IS

The federal excise tax will be collected on the importation, production, or trade of goods and services considered harmful to the population's health or the environment.



5. Transition Regime

- As of 2026, CBS will be collected at a **0.98%** rate, and the contribution will be deductible from the PIS/Cofins tax base. If there is no PIS/Cofins due, taxpayers will be able to offset the CBS against other federal taxes or request a refund.
- As of 2026, IBS will be collected at a **0.1%** rate.
- As of 2027, the PIS/Cofins will be eliminated and the IPI tax rate applicable in relation to most goods will be lowered to zero*. With the elimination of the PIS/Cofins, CBS will start to be collected at a rate to be defined by Senate Resolution.
 - * Except for IPI rates on products that are also manufactured in the Manaus Free Trade Zone until December 2026. These will not be lowered to zero as the others.
- As of 2029, there will be a progressive reduction of the ICMS and ISS rates. The IBS rate during this period will be fixed in order to compensate for the reduction of ICMS and ISS:



- The reduction does not apply to the ICMS benefits granted prior to the reform, since the current rules already provide for a gradual reduction of these benefits by 20% per year starting in 2029 until the final deadline in 2032, regardless of the tax reform.

6. Other relevant changes

- **ITCMD (inheritance and donation tax):** possibility of establishing progressive rates for the computation of ITCMD and rules on the collection of the tax on inheritances received from abroad.
- **IPTU (urban property tax):** municipalities will be allowed to update the tax base of the IPTU by means of a decree.
- **IPVA (motor vehicle property tax):** may be levied on water and air vehicles, with exceptions (tractors, agricultural aircrafts and machinery, for example), and states may establish differentiated tax rates depending on the environmental impact caused by the vehicle.



Access [here](#) our Q&A with the main questions and answers regarding the tax reform and check our upcoming newsletters with exclusive analysis on the impacts of PEC 45 on specific sectors and the market.

Lefosse's Tax Team closely monitors the changes that impact the Brazilian market. For further clarification on this matter, or others that may be of interest to you, contact our professionals.

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