



# Consumption Tax reform in Brazil

## Main points PEC 45/2019

KPMG Brazil

Tax SALT



# Summary

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# Introduction

It is with great satisfaction that we present this material from KPMG in Brazil on the consumption tax reform in the country.

Recently, we had an important milestone with the approval of PEC 45/2019 in the House of Representatives and the expectation is that the vote in the Senate will still occur in 2023.

## About this executive summary

This summary aims to share relevant information for entities and executives, about the main points and status of the consumption tax reform in Brazil. In this sense, KPMG in Brazil reinforces its commitment to providing accurate and relevant information to its clients and partners, contributing to a more transparent and secure business environment.

Furthermore, we are committed to analyzing the impacts generated by the reform and proposing tax solutions that meet the specific needs of each company. Thus, we fulfill our mission of turning insights and changes into opportunities for our clients.

We wish everyone a good read!



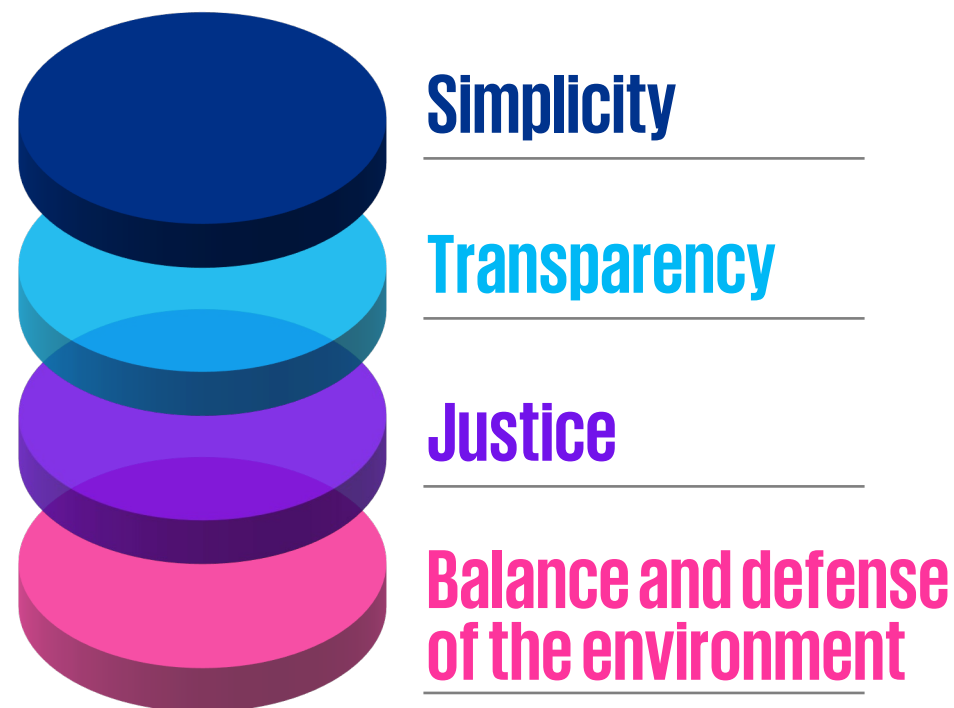
# Goals and pillars of tax reform

Tax reform in Brazil has three main goals and four pillars:

## Goals

- 1** To promote sustainable growth of the Brazilian economy, generating employment and income.
- 2** To reduce social and regional inequalities in order to make the Brazilian tax model fairer.
- 3** To reduce tax complexity in order to ensure transparency and provide greater fiscal citizenship.

## Pillars



Source: Treasury Ministry. Extraordinary Secretariat for Tax Reform.

# Motivations for the consumption tax reform

On July 6th, 2023, the House of Representatives approved PEC 45/2019, representing a significant step forward for the consumption tax reform of in the country. Below, we bring the main motivators for the reform:



## Bureaucratic cost

According to the World Bank report (Doing Business 2019), a Brazilian company spends 1,958 hours paying taxes, while the second-place Bolivia spends 1,025 hours, and the average of 190 surveyed countries is 206 hours.



## Lack of transparency

Thousands of regimes and rates + incidence of cascading taxes (cumulativeness) + taxes charged on themselves (inside calculation).



## Tax war

The granting of tax incentives to attract companies and investments has generated competition between the different federal entities, known as fratricidal federalism.



## Conflicts of jurisdiction

The difficulty in classifying whether taxation should be done through ICMS or ISS has generated conflicts between states and municipalities. This occurs because some activities have characteristics of both categories, making it difficult to define the tax to be applied.



## Complexity of the tax system

Since the Federal Constitution of 1988, more than 460,000 tax rules have been issued in Brazil, which means 37 tax rules per business  
Source: \*IBPT.



## Litigiousness and legal uncertainty

The Brazilian tax system generates a large number of lawsuits in the judiciary, with 26.8 million tax execution proceedings in progress. The amount involved in tax litigation is 75% of GDP.  
Data: CNJ and Insper.



## Social and regional inequalities

Taxation at the origin favors the more developed federal entities and generates inequality in consumption between richer and poorer citizens.

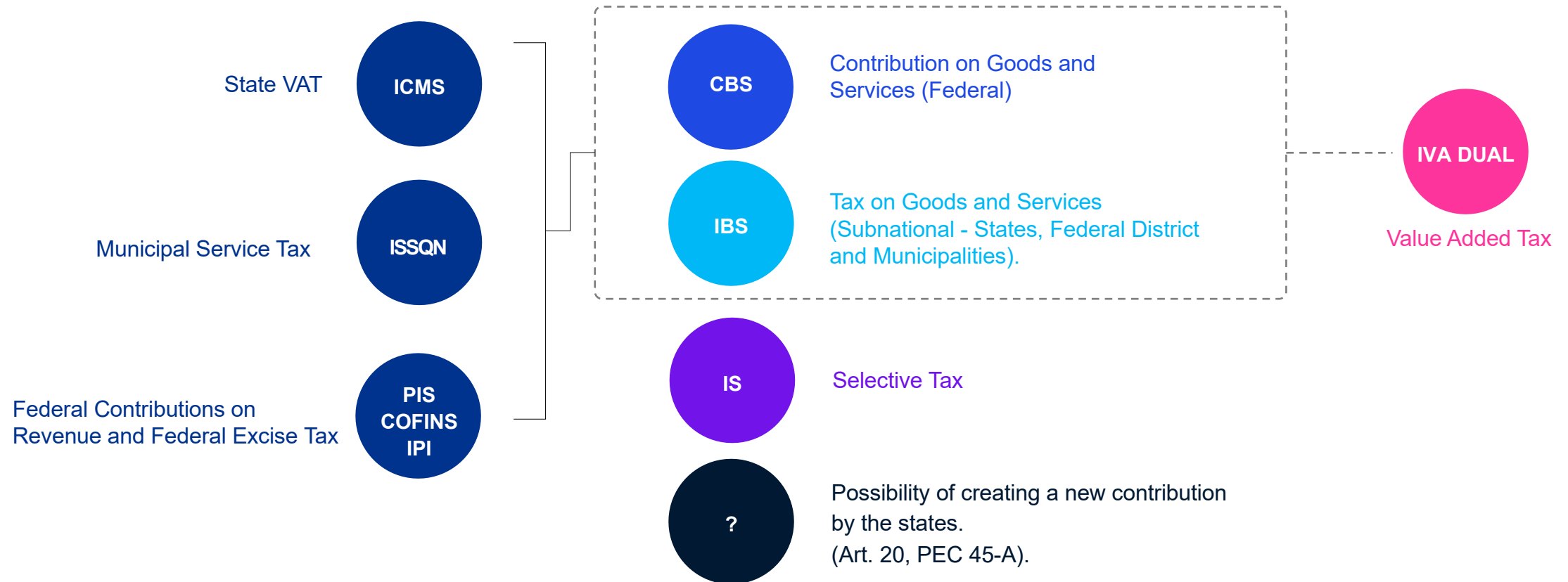


## Current scenario does not boost business

Bureaucracy, legal uncertainty, and tax complexity discourage investments and the establishment of companies in Brazil, harming economic growth.

# Tax unification approved in PEC 45/2019

The tax reform consists, among other aspects, in the unification of taxes on consumption, simplifying the Brazilian tax model. With this measure, the five main taxes that focus on consumption - PIS, COFINS, IPI, ICMS and ISS - will be replaced by a Dual Value Added Tax (VAT), a Selective Tax (IS), in addition to the possibility of the institution of contribution on primary and semi-manufactured products.



# Characteristics of dual VAT

The CBS and IBS will have their characteristics based on international standards of a VAT. We highlighted below some of the main characteristics:

## Rates

Single tax rate for goods and services, including rights.

## Cashback

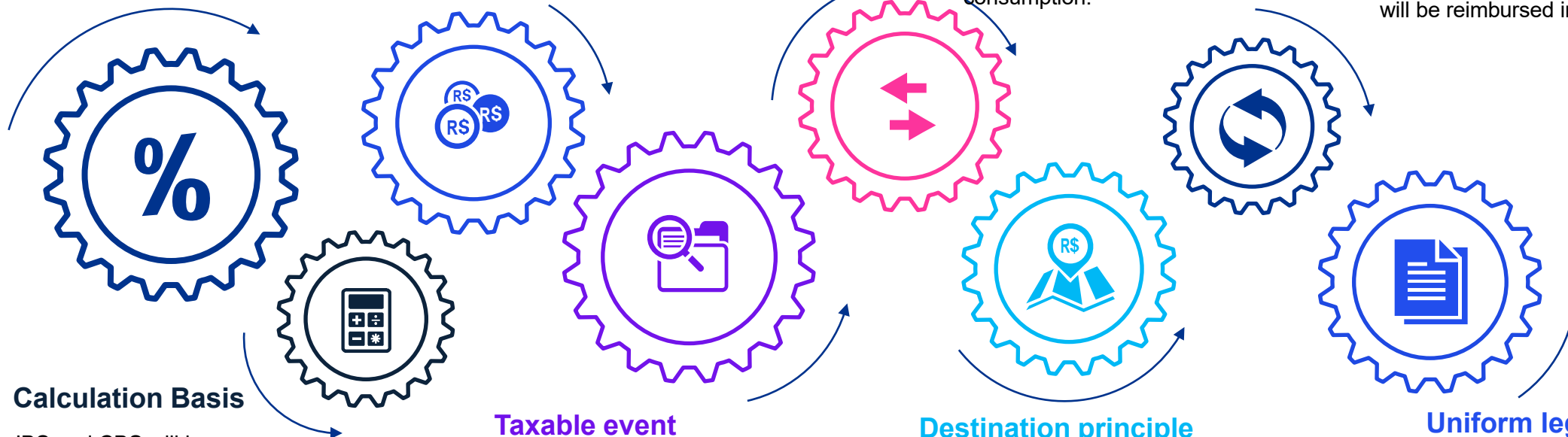
Refund of part of CBS and IBS to individuals, benefiting low-income families.

## Complete non-cumulativity

All previous operations may be considered as credit, except for acquisitions of personal use and consumption.

## Quick return of accumulated credits

For the accumulated credits due to taxpayers there is provision that they will be reimbursed in an agile way.



## Calculation Basis

IBS and CBS will be calculated externally, not integrating the calculation base itself.

## Taxable event

It shall cover all transactions involving material or immaterial goods and services, including rights.

## Destination principle

It provides that the taxes will be destined to the state and municipality where the final consumers are located.

## Uniform legislation

Creation of a single legislation for the collection of taxes on goods and services throughout the country.

# Characteristics of the Selective Tax

The selective tax will have a regulatory nature and will be levied on the production, sales, or importation of goods and services considered harmful to health or the environment. Note the main characteristics:



Extra-fiscal nature since it aims to discourage the consumption of products harmful to health and the environment.



It will be part of the calculation basis for ICMS, ISS, IBS, and CBS (and ICMS and ISS as long as they are not extinct).



Ordinary law will define the goods and services harmful to health or the environment, on which the selective tax will be levied.



The executive branch may alter the selective tax rates.



The imposition of the tax or an increase in its rates must respect the non-cumulative period.



It will not apply to goods and services that are subject to reduced rates.



The tax is cumulative, meaning it is an exception to full non-cumulativity and does not have credits to be deducted.



# Exceptions to the single rate

The PEC 45/2019 proposes the application of differentiated VAT taxation for certain goods and services. Let's take a look:

### Zero tax rate

- Basic Food Basket
- Horticultural products, fruits, and eggs
- Event sector service – PERSE regime (CBS - until 02.28.2027)
- Medical and accessibility devices for people with disabilities
- Higher education under the terms of PROUNI (Only CBS)

### Reduced rate by 60%

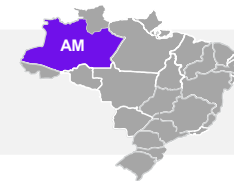
- Health services
- Education services
- Collective public transport
- Medical and accessibility devices for people with disabilities
- Medicines and basic menstrual health care products
- National artistic, cultural, journalistic, and audiovisual productions
- Goods and services related to national security, information security, and cybersecurity
- Agricultural inputs, food for human consumption, and personal hygiene products

### Differentiated regimes

- Fuels and lubricants
- Regional aviation
- Cooperative Societies
- Amusement parks and theme parks
- Hotel and Restaurant Services
- Financial Services, Real Estate Operations, Health Care Plans and Prognosis Contests
- Public contracting

## Favored Regimes

- Manaus Free-trade Zone (ZFM) / Free Trade Zones (ALC's)
- Simples Nacional



# Dual VAT management

Administrative changes are expected for the management of the new model:

## The administration of dual VAT will be done by:

**Contribution on Goods and Services (CBS):** Federal Government (RFB).

**Tax on Goods and Services (IBS):** IBS Federative Council.

The IBS Federative Council will be jointly managed by states and municipalities, with autonomy in oversight and defense of their interests. Its function is to ensure the quick return of IBS credits to taxpayers and ensure transparency and equity in the collection and distribution of the tax.

## Functions of the IBS Federative Council:

- ✓ Edit infra-legal norms on issues related to IBS;
- ✓ Standardise the interpretation and application of the tax legislation;
- ✓ Collect tax, making offsets, and distributing revenues; and
- ✓ Resolve issues within the administrative tax litigation scope.

Source: Treasury Ministry. Extraordinary Secretariat for Tax Reform.

## The highest deliberative body of the IBS Federative Council will be composed on a parity basis by:

27 members representing each state and the Federal District



27 members representing the set of municipalities and the Federal District



PEC establishes the criteria to be observed for the resolutions to be approved.

# State VAT tax incentives

Existing tax benefits will be gradually reduced and phased out at the end of the transition. Some provisions are provided for compensation to federative entities and companies. Below are some important points about the topic:

## Maintenance until 2032

Forecast of maintenance of ICMS tax benefits granted under Complementary Law no. 160/2017 until December 2032.

## Restriction on extensions

ICMS tax benefits can not have a date beyond 2032.

## Proportional reduction

The proposal provides for proportional reduction of benefits starting in 2029.

## Regional Development Fund (RDF)

With the end of tax incentives, the Regional Development Fund will be instituted, with the aim reducing regional and social inequalities.

## Tax Benefit Compensation Fund

The objective of the Compensation Fund for ICMS tax benefits is to compensate entities for the loss of tax incentives and benefits.

## R\$ 120 billions

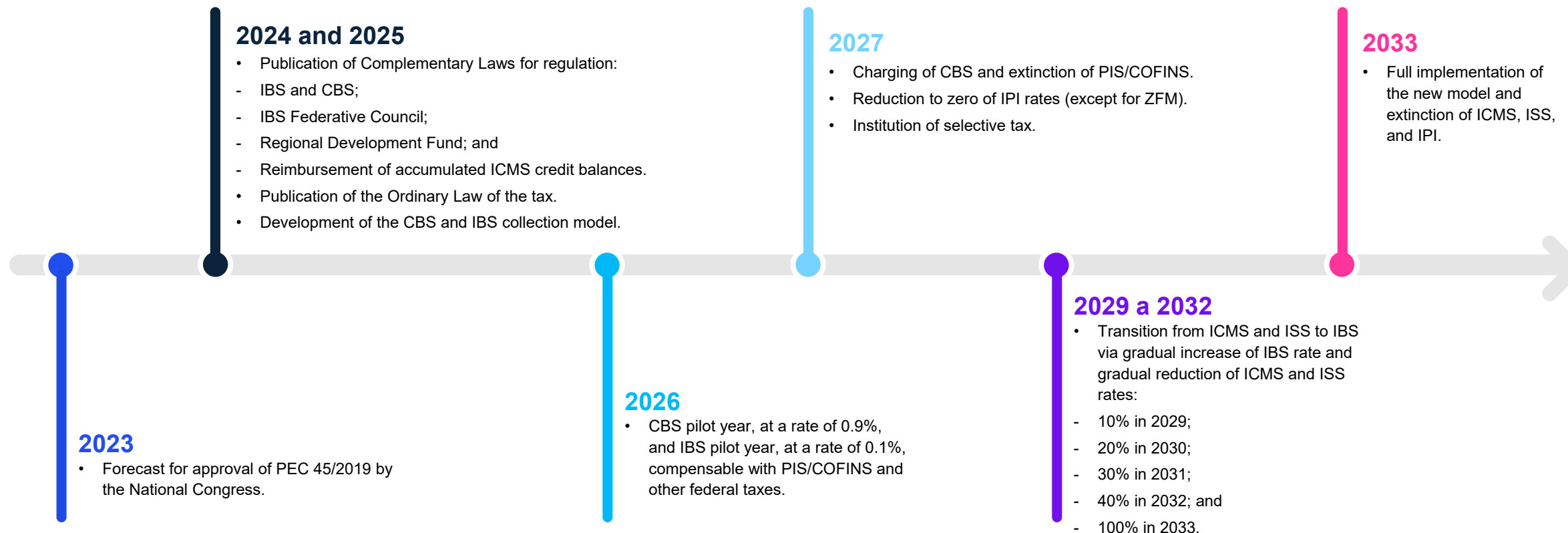
The amount to be invested by the Union in the **Regional Development Fund (RDF)** from 2029 to 2033 is in billions of reais. The resources of the RDF will gradually increase as ICMS incentives are reduced.

## R\$ 160 billions

The amount to be deposited by the Union from 2025 to 2032 in the **Tax Benefit Compensation Fund** will be in billions of reais. The resources of this fund will be made available to entities starting in 2029.

# Transition to the new model

PEC 45/2019 provides a transition period for taxpayers to adapt.



Source: Treasury Ministry. Extraordinary Secretariat for Tax Reform.

# Refund of credits from extinct taxes

## ICMS

- Accumulated
- ICMS credit balances remaining at the end of 2032 will be offset with IBS in 240 equal and successive monthly installments;
- Credits related to acquisition of assets will be offset considering the current modality provided by the legislation, in 48 installments; and
- As of 2033, the creditor balances will be updated by the monetary correction (IPCA).

Furthermore, PEC 45/2019 provides that a Complementary Law will provide:

- The process for transferring credit balances; and
- reimbursement if said balance is not compensated.

## Federal taxes

The treatment to be given to the credit balances of IPI, PIS, and COFINS after their extinction is not clear in the PEC 45/2019.

# Other taxes affected by PEC 45/2019

## IPVA

Incidence on land, water and air vehicles, except for:

- (i) agricultural aircraft and third-party air service providers;
- (ii) water transport vessels or those engaged in fishing;
- (iii) platforms capable of moving on their own;
- (iv) tractors and agricultural machinery.

There is the possibility of IPVA being progressive based on the value and environmental impact of the vehicle.

## IPTU

The calculation basis may be updated by the executive branch, according to established general criteria, in order to facilitate the achievement of the potential revenue through appreciation.

## ITCMD

Progressivity based on the value of the transfer or donation.

It will not apply to transfers and donations to non-profit institutions.

## Income

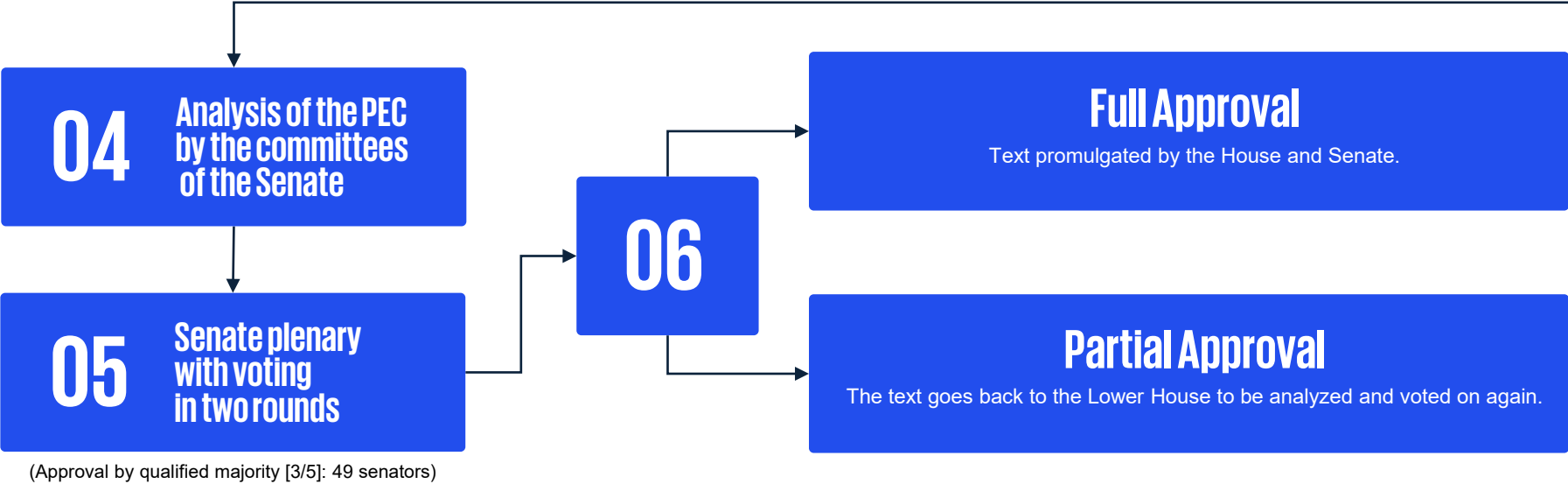
A bill will be presented within 180 days of the promulgation of the constitutional amendment that reforms income taxation.

# Next steps in the reform's processing

**House of Representatives**  
✓ Stage completed



**Senate**  
● Stage in progress





# THANK YOU!

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