

Consumption tax reform moves forward towards a VAT – Value Added Tax

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Topics

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The need to reform the Brazilian tax system is one of the few matters on which there is unanimity in Brazil's political scene. The tax reform agenda has been dragging on for decades, with attempts being made by various administrations, some broader in scope and some narrower.

Distortions can be found principally in our indirect taxation mechanisms. In a country of “puxadinhos” (the word refers, rather tolerantly, to an addition to a house built without a license, and has been used to describe the chaotic tax system), special tax regimes and exemptions granted to some sectors and companies to the detriment of others make exceptions the rule, and end up harming free competition. The existence of dozens of pieces of state legislation and thousands of municipal laws generate enormous compliance costs for business, and have repeatedly put Brazil at the bottom of the worldwide “ease of doing business” rankings. The distinction between goods (subject to the state ICMS tax) and services (subject to the municipal ISS tax) is rapidly being lost with the digitalization of the economy and the proliferation of different means of offering products to final consumers.

It is precisely the taxation of consumption that is tackled by the first part of the tax reform that is under debate. There are two main constitutional amendments under evaluation in Brazilian Congress by a mixed commission of representatives and senators, which aim to unify consumption taxes and solidify the concept of a value-added tax (VAT) that would have broad application, at a single rate, at the place of destination, with tax credits permitted throughout the production chain.

In July 2020, the federal government made its contribution by sending to Congress Bill 3887/2020, which creates the Social Contribution on Goods and Services (CBS – *Contribuição Social sobre Operações com Bens e Serviços*), which is intended to replace the current social contributions on gross revenues (PIS and Cofins). The CBS is intended to reflect the idea of a federal VAT, while at the same time resting on the legal foundation found in Article 195 of the Federal Constitution, which gives the federal government powers to tax “gross revenues or turnover”.

Based on the various provisions of the Bill and its accompanying Explanatory Notes, it appears that the taxable event for CBS purposes will be the “earning of gross revenues in transactions with goods and services”. The text of the Bill needs to be refined to better delimit this taxable event, and to include definitions of terms used in the Bill.

We have a legalistic tradition in the interpretation of tax legislation that cannot be ignored. Experiences with taxes that were poorly defined in the law (such as PIS and Cofins) have been disastrous: years, and sometimes decades, pass in the process of conceiving the law, applying it in practice, tax audits and litigating its application.

The CBS's "transactions with goods and services" (*operações com bens e serviços*), in particular, should be defined as legal transactions between two or more parties that are valid, effective, and unconditional, performed in the course of business, involving

an obligation to do or to give tangible or intangible assets, or both to give and to do, in exchange for value. The Bill should also be adjusted to ensure consistency amongst all provisions (taxable event, calculation basis to which the tax applies, and the basis for recording credits).

Although the Bill got off to a good start, recently the federal administration downgraded its status to a non-urgent matter in Congress. We continue to believe that migration to the VAT model is an important step in improving the Brazilian tax system. And we anxiously await further chapters in the tax reform, which may include transformation of the IPI (*Imposto sobre Produtos Industrializados*, or Manufactured Products Tax) into a true excise tax on harmful products, changes in income tax, and cuts on payroll taxes.

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