

Tax reform in Brazil: Congress stalled; Supreme Court active

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The Brazilian tax system is one of the most complicated in the world, requiring huge amounts of work from in-house teams and outside counsel. The country is consistently positioned as one of the worst countries in the world to pay taxes in, sitting at the bottom of the Doing Business World Bank rankings for many years.¹

A tax reform agenda has been dragging on for decades, with attempts being made by various administrations, some broader in scope and some narrower. The main objectives are to simplify the system and reduce tax litigation (which has reached more than USD 1 trillion according to recent estimates²). Some also argue for greater progressivity and tax justice.

In Congress, the most recent efforts, under Mr. Bolsonaro's administration, are related to the "indirect taxes" (i.e. taxes on consumption), where many distortions exist. At federal level, Brazil has a one-of-a-kind tax on gross revenues (PIS/COFINS), which has been widely challenged in the courts, leading to substantial losses to the government. There is also a tax on sales of goods (the ICMS tax at state level, regulated by each of the 27 Brazilian states) and yet another tax on sales of services (the municipal ISS tax, with general rules in federal legislation and specific regulations by the more than 5000 municipalities of Brazil). There are special tax regimes that harm competitiveness.

Three main bills now being debated in Congress aim to move Brazil from this chaotic regime to a more unified taxation on consumption of goods and services, under a value-added (VAT) system, following the European model.

There are other bills in Congress dealing with corporate and personal income tax, although they are still in the early stages. Some bills propose taxation of dividends (currently exempt in Brazil), in combination with a reduction in the corporate income tax rate (currently at 34%), or even without a reduction (in which case the effective tax rate on corporate profits would increase significantly).

There is also talk of other changes to the tax law, varying from a tax on payments to a green tax on products with negative externalities, such as fuels.

In practice, however, we have witnessed political turmoil and a lack of real progress in Congress. The congressperson in charge of presenting a report on

tax reform has delayed his report more than once. In contrast, we have seen greater activism by Brazil's Supreme Court (STF – Supremo Tribunal Federal) on a variety of tax matters.

Helped along by the quicker virtual judgment sessions adopted by the court during the pandemic, the STF has decided a significant number of tax cases in various situations and economic sectors, usually upholding taxation:

- social security contributions are payable on the additional pay (equal to 1/3 of a month's salary) owed to employees when they take their vacation, reversing earlier decisions by the Superior Court of Justice and the STF itself, in a judgment binding on all lower courts and the administration;
- the IPI excise tax attaches to imported goods when they leave the importer's establishment, reversing decades of decisions to the contrary by the Superior Court of Justice (STJ – Superior Tribunal de Justiça);
- the PIS/COFINS gross revenues tax attaches to financial income and fees paid to credit card operators;
- software licenses are subject to the ISS service tax, not the ICMS tax on sales of goods, reversing a position established decades earlier;
- imports by persons and entities that are not ICMS taxpayers are subject to ICMS;
- the quasi-tax payroll contributions to SEBRAE and INCRA are constitutional;
- vehicle owners that have multiple tax domiciles (i.e. car rental companies) are subject to the IPVA vehicle tax in multiple states;
- indirect exports (i.e. through trading companies) are exempt from taxes;
- maternity benefits are not subject to social security contributions.

The STF has thus shown considerable activism in addressing gaps in the tax system, through decisions that go contrary to the court's earlier position and seem to be based on consequentialist considerations – elements of a financial or budgetary nature, aimed at containing losses to the public coffers.

In tax matters, therefore, it's fair to say that delays by the legislative and executive branches have pushed the STF into the protagonist's role.

NOTES:

¹ The latest rankings are available online at https://data.worldbank.org/indicator/IC.TAX.DURS?locations=BR&most_recent_value_desc=false.

² Report prepared by the Insper Center for Tax Studies in December 2020, in relation to the 2019 calendar year. Available online at https://www.insper.edu.br/wp-content/uploads/2021/01/Contencioso_tributario_relatorio2020_vf10.pdf

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