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ICMS Credits and the Consumption Tax Reform

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In the first part of 2025, Brazil enacted the legislation that will govern its new consumption tax system, which created the Goods and Services Tax (*"IBS" – Imposto sobre Bens e Serviços*, a state and municipal tax), the Goods and Services Contribution (*"CBS" – Contribuição sobre Bens e Serviços*, a federal tax), and the Selective Tax (*"IS" – Imposto Seletivo*, a federal excise tax). By 2033, the IBS will have replaced the current state value-added tax, the ICMS (*Imposto sobre a Circulação de Mercadorias e Serviços*), but the new legislation has little or nothing to say about how input credits recorded under the current system can be used or reimbursed.

According to Constitutional Amendment 132/23, taxpayers will be able to use or refund their ICMS input credit balances existing at the end of 2032 **in accordance with the legislation in force on December 31, 2032.** The recent Complementary Law 214 does not address this point, but the bill for the next Complementary Law (PLP 108/2024), which is now before the Senate, proposes that certified ICMS input credits can be set off against IBS owed starting in 2033, in up to 240 installments (20 years), with adjustment for inflation according to the consumer price index (*IPCA – Índice de Preços ao Consumidor Amplo*).

In summary, according to the law at the moment, taxpayers holding ICMS input credits will be able to offset the remaining credit balance (if certified) against IBS tax owed (in installments) or, alternatively, transfer those credits to third parties or apply for reimbursement.

The timeframe seems long, but the IBS legislation still does not specifically guarantee or govern the procedures for offset, and taxpayers are already well aware of the obstacles to using their ICMS input credits. This scenario suggests that the **transition to the IBS** will open up a **new dimension** to the long-standing ICMS credit dilemma, with the progressive extinction of the ICMS exercising pressure on the effective setoff of ICMS paid.

Various economic sectors are involved in this dilemma, including agribusiness and the export industry (with the concentration of ICMS credits accruing by reason of the exemption applicable to export products) and the retail industry (because of the single-point collection system and the effect of the ICMS rates charged by different states, among other factors).

Despite the fact that the law, and even the Constitution, provides that ICMS taxpayers are entitled to offset ICMS input credits against tax owed, in practice taxpayers have encountered obstacles to recuperating the full amount of their ICMS tax credits, sometimes due to restrictions under the legislation of each state and the Federal District, and sometimes simply because credits are not adjusted for inflation, so they lose value over time.

The State of São Paulo is one of the most advanced in recognizing accrued

ICMS credits, with programs to ensure that the credits can effectively be used, such as *“Nos Conformes”* (a simplified procedure), *“Acordo Paulista”* (ICMS tax settlements) and *“Resolve Já”* (settlement of tax assessments). In contrast, the State of Ceará and some other states have imposed a five-year limit for use of accumulated ICMS credits, subject to a heavy penalty of 100%.

Decisions by Brazil’s appeal courts, including those of São Paulo, reject time limits on the use of ICMS input credits, and even allow the transfer of credits to third parties – which are useful precedents for taxpayers that hold ICMS credits in some states, particularly in this period of transition to the IBS.

The IBS is based on the principle that it will be a neutral, simple, and non-cascading tax, which will have unified rules for input credits and the offset or refund of those credits in a short period of time. That concept should make today’s disputes over ICMS credits accrued and applied by taxpayers a “museum piece”.

Nonetheless, we are still far from the state of affairs promised by Constitutional Amendment 132, and close to the beginning of the transition to the IBS, starting in 2026.

There is still an opportunity for the legislation on the IBS to provide more detail on the use or refund of ICMS input credits, so that the much-vaunted “non-cascading tax reform” does not begin by sacrificing credits for tax paid. In the meantime, taxpayers should begin planning for the transition period, and review their strategies to optimize use of ICMS input credits well before ICMS becomes obsolete and ICMS credits are relegated to offsetting over hundreds of installments.

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