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An ICMS exemption for donations to elections supports democracy, but reveals the tax challenges faced by the third sector

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The Superior Electoral Court or TSE (Tribunal Superior Eleitoral) has faced considerable challenges in structuring the 2020 municipal elections in the middle of a worldwide pandemic. One of the biggest is that the election must be carried out in compliance with health standards that will offer voters and poll workers a safe environment on the day of the election.

One of the measures taken by the TSE to ensure that the municipal elections can be held has been to publish a call for donations of various types of personal protective equipment (PPE) – masks, alcohol-based hand sanitizer and 70% alcohol, among others – to the different divisions of the electoral courts, to be used to prevent the spread of the novel coronavirus at the polls and electoral sections.

To ensure that the donations do not impose an additional burden on their donors, the possible tax impacts must be considered: although no charge is made for the PPE, the donors will be manufacturers and commercial businesses, which normally pay the state value-added tax, ICMS, on this type of transaction.

With a view to encouraging donations and at the same avoiding potential challenges by state tax authorities, at the beginning of September the National Council on Tax Policy, Confaz (*Conselho Nacional de Política Fazendária*), by resolution adopted by representatives from all Brazil's states, approved ICMS Agreement no. 81, granting an exemption from ICMS for all donations to the Electoral Courts, including any transportation services donors might hire to deliver the donated merchandise.

ICMS is a non-cumulative tax, which means that the tax owed when the merchandise exits the taxpayer's establishment is offset by credits for tax paid at earlier stages in the chain of production and marketing. In practical terms, when acquiring merchandise for resale or inputs for manufacturing products, taxpayers record credits for the amount of ICMS paid on the acquisition. These credits are then offset against the amount of ICMS attaching to the sale of the merchandise or products, so that the amount of ICMS effectively remitted is usually reduced to the amount of tax attaching to the value added by the taxpayer.

In light of this non-cumulative system, along with the fact that donations are philanthropic in nature and therefore do not generate a profit for their donors, ICMS Agreement 81 sought to maximize the benefit of the exemption by making it possible for the states not to require their taxpayers to exclude the credits recorded on acquisition of the donated merchandise.

The terms of ICMS Agreement 81 thus allow taxpayers to keep the ICMS credits recorded on acquiring donated products or the inputs used to produce the donations. The credits can then be used to offset ICMS owed by the taxpayer on other transactions, so that the benefit conferred by ICMS Agreement 81 is not only efficient, but constitutes an effective incentive for the donations requested by the TSE. There is no question that ICMS Agreement 81 demonstrates the states' support for the democratic process, and deserves to be recognized. Under the current tax system, however, the Agreement must be promulgated by the legislative assembly of each state before it can be applied.

It is thus worrisome that, with the municipal elections a little more than one month away, less than half the states have passed legislation to validate the benefit under Agreement 81. Worse, some states, such as Bahia, Rio Grande do Norte, and Sergipe, have passed legislation adopting the exemption, but decided not to allow donors to keep the tax credits related to their donations.

Requiring the exclusion of ICMS credits recorded on acquisition of merchandise or inputs, so that they cannot be used to offset ICMS owed by donors on other, taxable transactions, significantly reduces the benefit provided for under ICMS Agreement 81.

To make good use of Confaz's support of the democratic process, states must adopt legislation validating Agreement 81's provisions; if they fail to do so, they are effectively discouraging donations and undermining Confaz's initiative. This is also a good opportunity for the municipalities to consider an ISS service tax exemption for transportation services hired to deliver donations of merchandise covered by ICMS Agreement 81.

We hope that all our states and the federal district will collaborate, because elections are held in the interest of everyone and for the good of our country. At the same time, this case is a perfect illustration of the complexities and inefficiencies of our national tax system: even a specific exemption, limited to the movement of merchandise to serve a clear public interest in preserving the democratic process, requires action by a collegial body like Confaz, followed by ratification by each member state, in order to become effective and achieve its intended purpose. It is clear that the tax reform, so long awaited and urgently needed, must also consider the third sector.

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