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Tax Reform: main impacts and challenges



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On July 7, 2023, the substitute for Constitutional Amendment Proposal (PEC) #45/2019, called the Consumption Tax Reform, was approved in the Chamber of Deputies. The approved text brings profound changes to the federative pact and reorganizes the entire revenue structure of the Brazilian Government.

The proposed changes will still be subject to analysis by the Federal Senate. In any case, according to the text approved by the Chamber of Deputies, the effects of the Tax Reform will begin in 2026, with a long and gradual transition period that will extend until 2034.



What will the new taxes be?

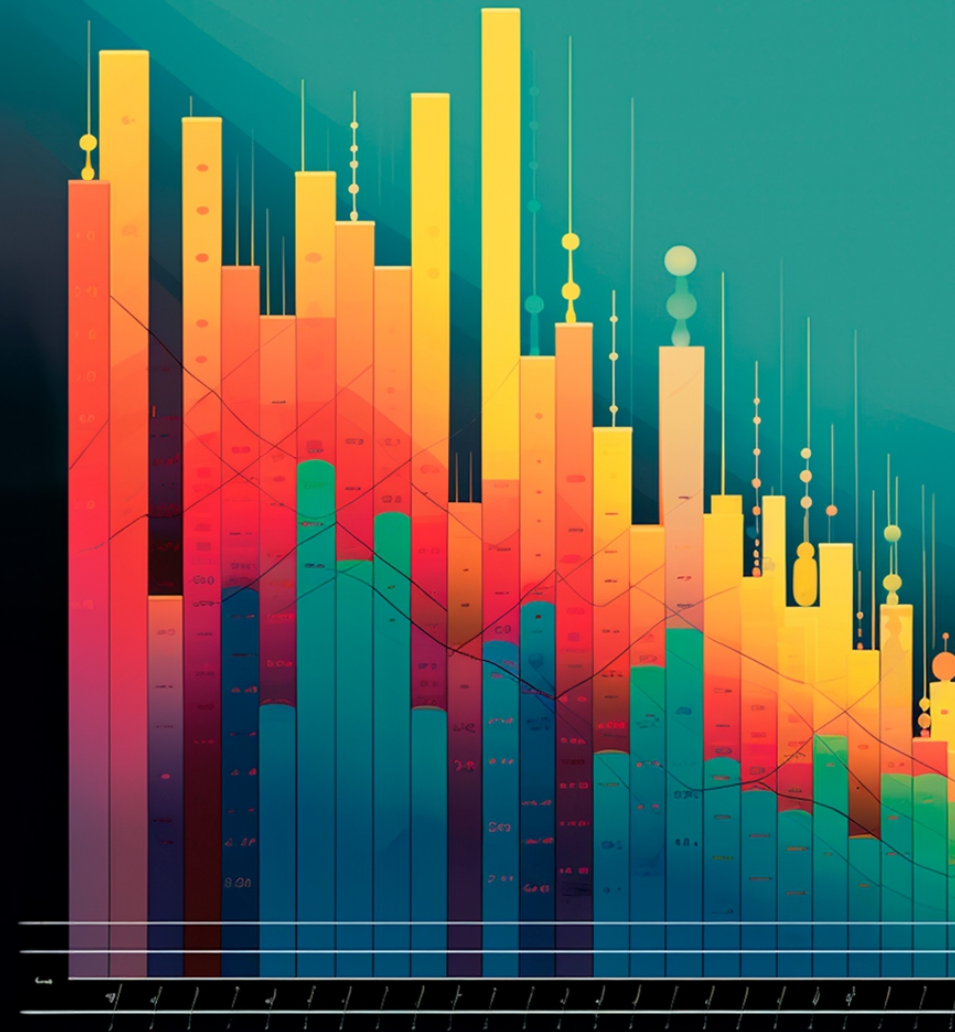
Firstly, it is crucial to highlight one of the main points of the Reform: the creation of a system that will have three value-added taxes, namely:

i) the Contribution on Goods and Services (CBS), under the jurisdiction of the Federal Government;

ii) the Tax on Goods and Services (IBS), under the jurisdiction of states and municipalities; and

iii) the Selective Tax (IS), which will be levied on products and services harmful to health or the environment.

The current taxes PIS, COFINS, IPI, ICMS, and ISS will gradually be replaced by the Dual VAT composed of CBS and IBS.



How will these taxes work?

Both the Contribution on Goods and Services (CBS) and the Tax on Goods and Services (IBS) have the same triggering event, calculation base, and rules for offsetting and determination. The only difference lies in the proportion of the applicable rate, which will be determined by the Federal Government in the case of CBS, and by a council composed of representatives from States and Municipalities in the case of IBS.

Thus, these taxes have as their triggering event all operations involving tangible or intangible goods, including rights, cryptocurrencies, patents, or services of any nature, without distinction, including imported goods and services. Therefore, the tax levy is broad across all economic activities involving goods and services, including the digital economy.

It is worth noting that the taxes will not

apply to exports, and a system of tax credit will be created for the taxes incurred in the production chain. In this sense, an appropriate system is established to reduce the costs of products or services at the end, allowing for greater competitiveness of Brazilian products.

Since both CBS and IBS are calculated externally, meaning that the final price of the product is determined based on the tax rate, there will be no cumulateness, that is, it will not be levied on its own calculation bases. This is known as full non-cumulateness. In practice, companies will be able to credit the amounts of taxes incurred on the purchased goods in a segregated manner, that is, in the exact proportion of the price effectively paid.

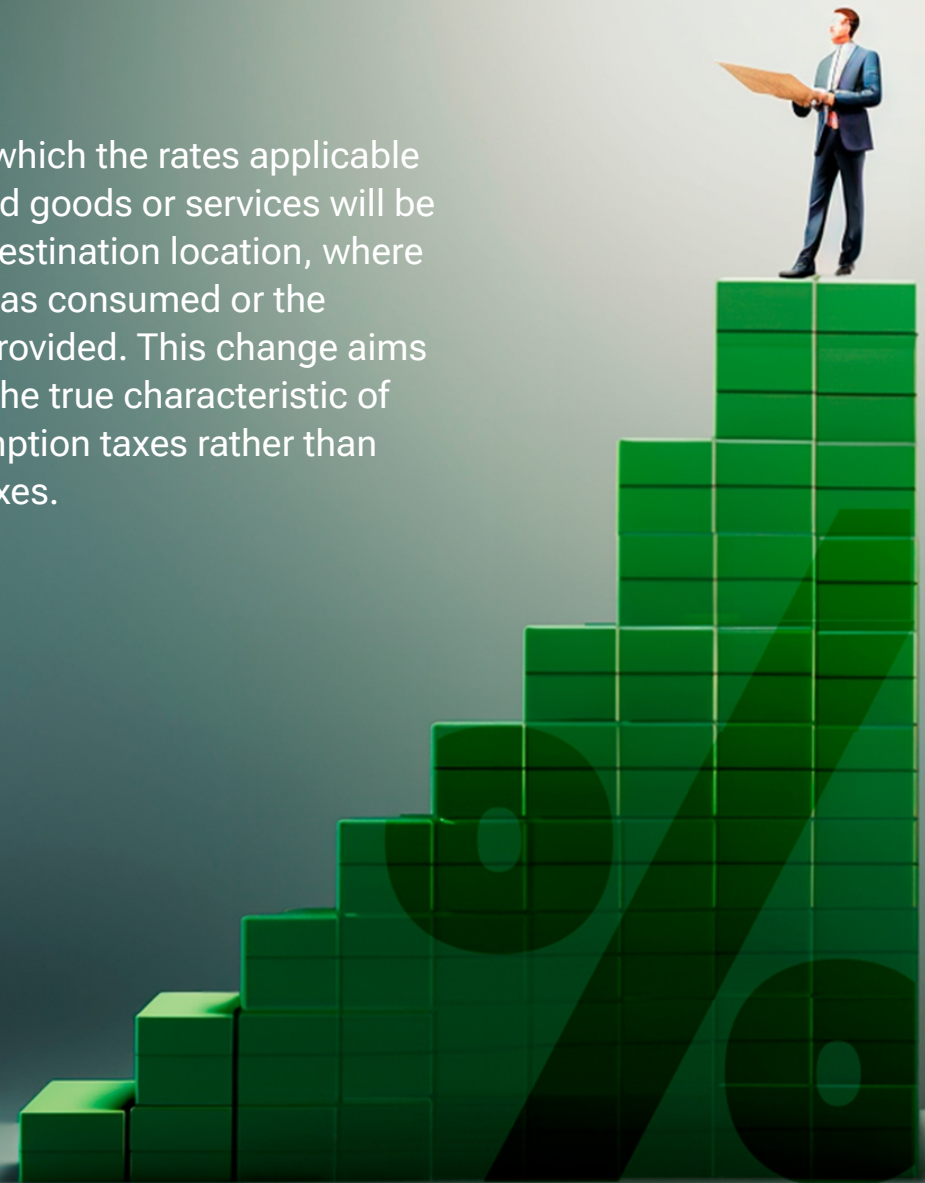


What will the tax rates be?

The Constitutional Amendment Proposal #45/2019 by the Chamber of Deputies has not yet defined the rates for IBS and CBS. However, it will be up to the Federal Senate to establish the reference rate. It is anticipated, however, that some products and services will have their rates reduced by 60%, such as education-related services, health services, national security services, public transportation services, agricultural products, among others. Basic basket products will have a 100% reduction.

State and Municipal rates will be defined by ordinary law and will be subject to the council composed of representatives from States and Municipalities. In addition, the principle of destination will be observed,

according to which the rates applicable to the acquired goods or services will be those of the destination location, where the product was consumed or the service was provided. This change aims to give taxes the true characteristic of being consumption taxes rather than production taxes.

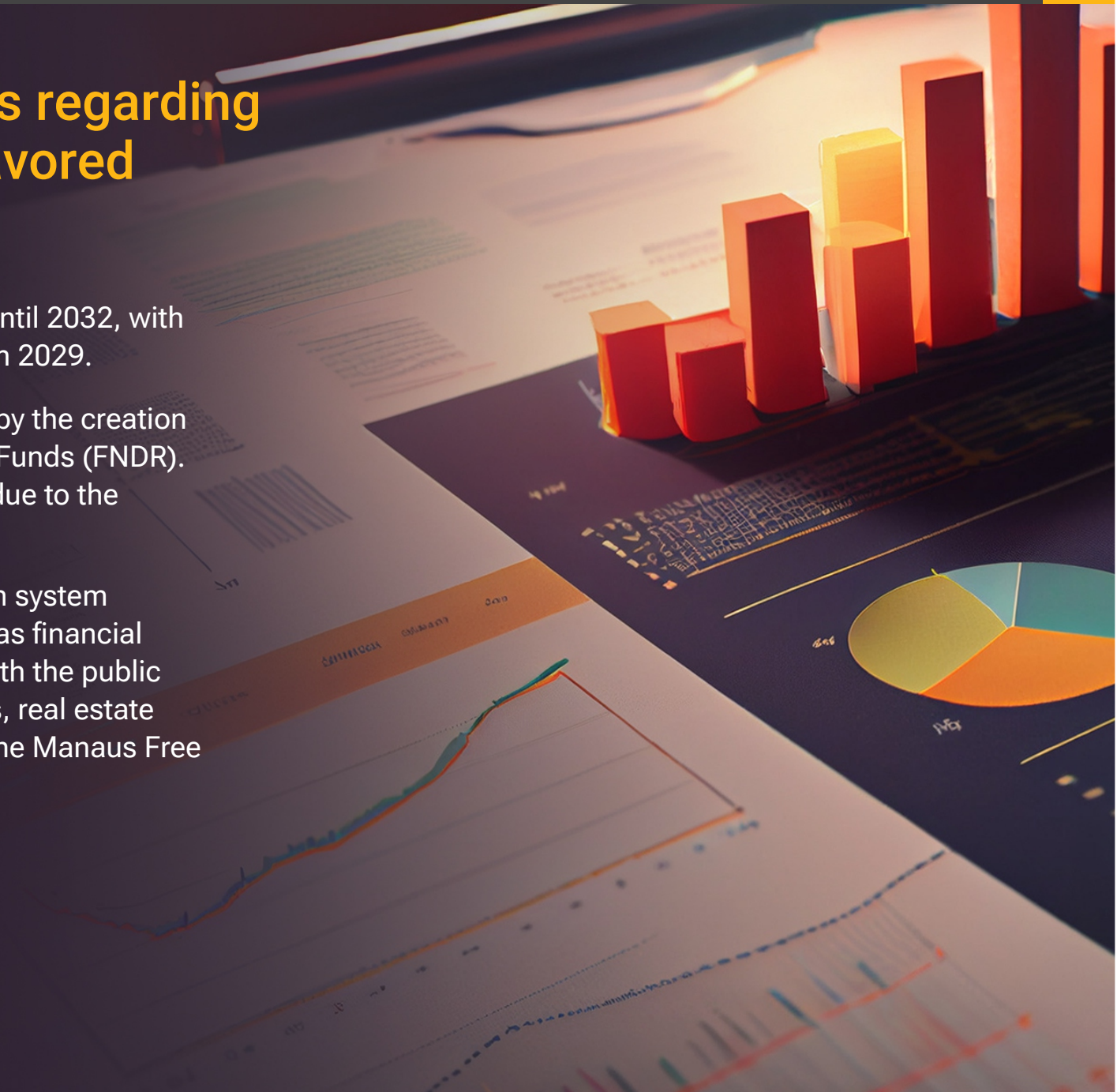


What are the changes regarding fiscal benefits and favored regimes?

- **Fiscal benefits** will be maintained until 2032, with proportional reduction starting from 2029.

Regional inequalities will be offset by the creation of National Regional Development Funds (FNDR). Companies may be compensated due to the reduction of benefits.

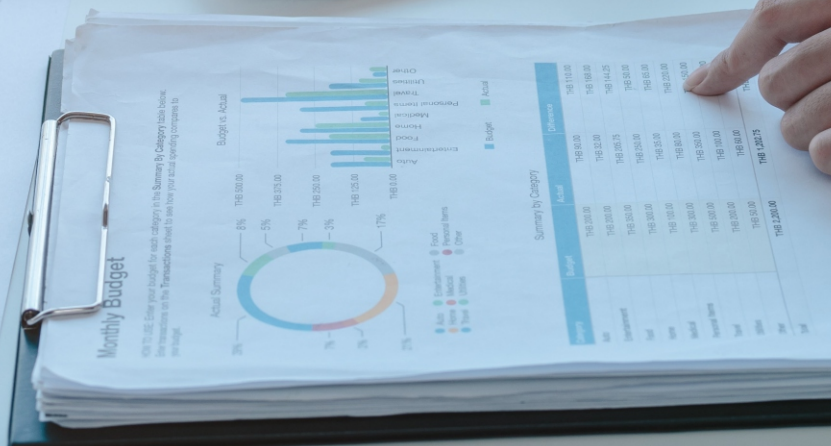
- **Favored regimes** will have their own system designed for certain sectors (such as financial services, health plans, contracts with the public administration, fuels and lubricants, real estate transactions, among others), and the Manaus Free Trade Zone will be maintained.



What is the Selective Tax (IS)?

The Selective Tax will have as its triggering event the import, production, or commercialization of goods and services considered harmful to health or the environment, as determined by law. Thus, in addition to cigarettes and alcoholic beverages, the definition of goods and services considered harmful to health and the environment will still be subject to determination by law.

It is worth noting that the rates will be determined by the Executive Branch, which is an exception to the principle of legality, and they will not apply to export operations.

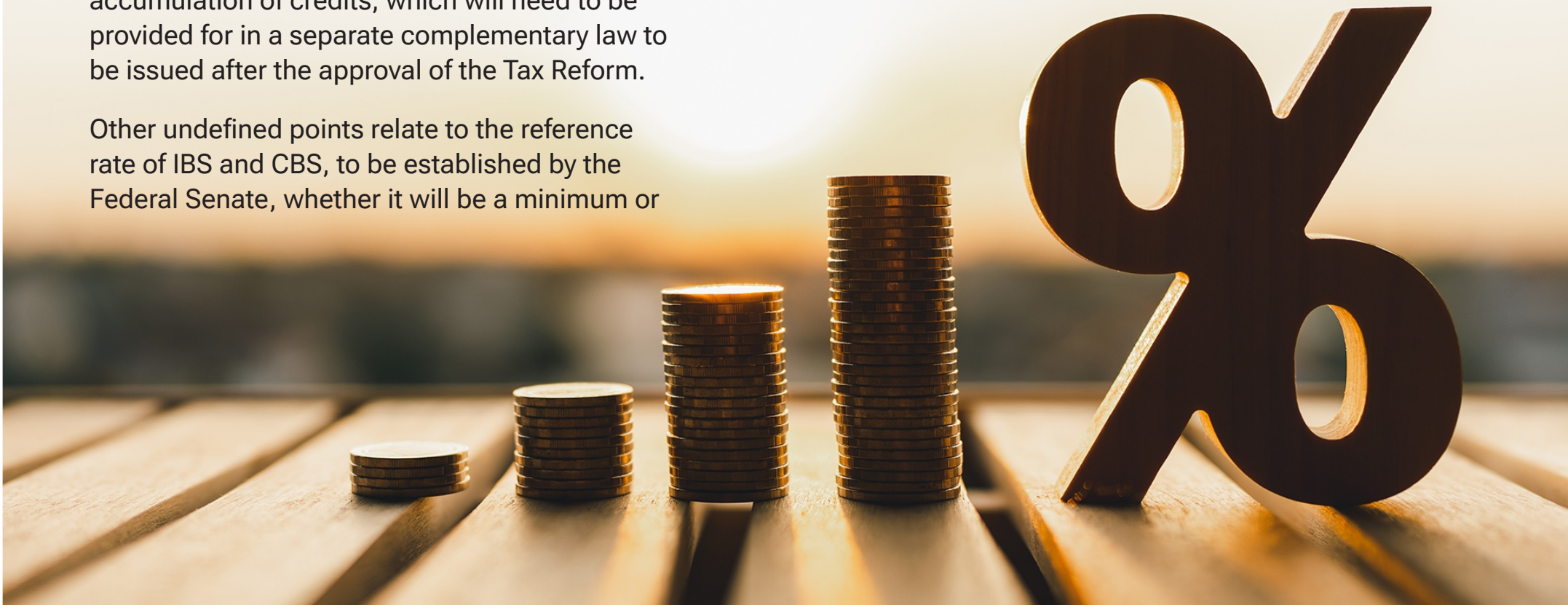


Controversial issues

Some points of the Tax Reform were not entirely clear as they were delegated to complementary law and may be subject to discussion, such as the IBS and CBS levying on financial operations, the methods of crediting in cases of amortization and depreciation charges, and the accumulation of credits, which will need to be provided for in a separate complementary law to be issued after the approval of the Tax Reform.

Other undefined points relate to the reference rate of IBS and CBS, to be established by the Federal Senate, whether it will be a minimum or

maximum rate, and whether the ancillary obligations will be unified or not. There is also no exact delineation of the exact competence of the Federative Council in the case of IBS or who will oversee IBS and CBS, whether there will be overlapping oversight or not.



Changes regarding other taxes

ITCMD

The Tax Reform also foresees significant changes for other types of taxes. The ITCMD, a tax levied on inheritances or donations, may have progressive rates that vary according to the inherited or donated assets.

IPTU

In the case of IPTU, the tax calculation base may be changed directly by the mayors of Municipalities through Municipal decrees.

IPVA

IPVA may be levied on other vehicles that were previously exempt, such as yachts, private jets, helicopters and boats. In addition, differentiated rates may be established based on the environmental impact of vehicles.

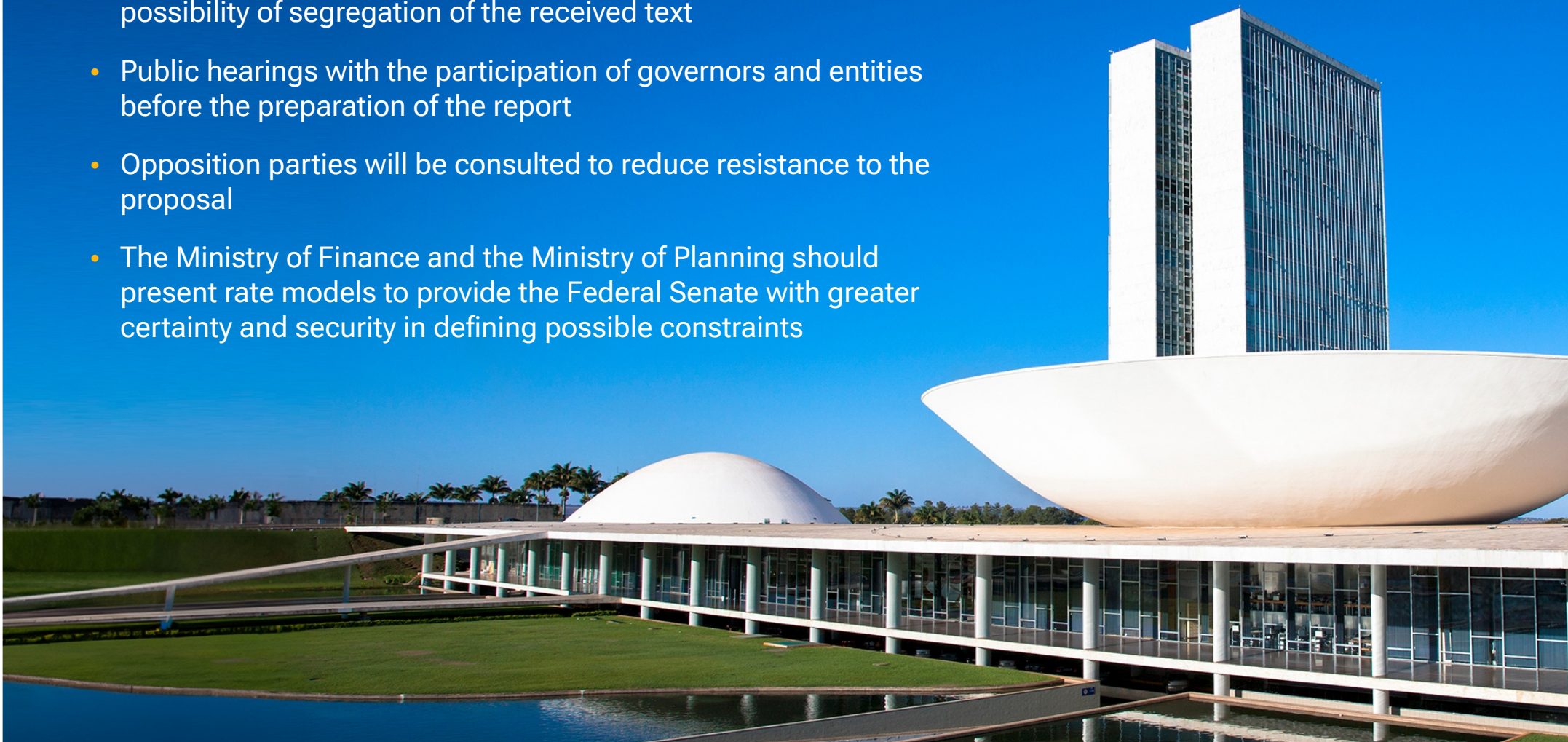
IR and CSLL

Finally, the Tax Reform stipulates that within 180 days from the promulgation, a complementary law shall be enacted to reform income taxes for individuals and legal entities, as well as the Social Contribution on Net Income.



What will the next steps be?

- Technical analysis by the Senate will begin
- Presentation of the work plan in August, after the break, with the possibility of segregation of the received text
- Public hearings with the participation of governors and entities before the preparation of the report
- Opposition parties will be consulted to reduce resistance to the proposal
- The Ministry of Finance and the Ministry of Planning should present rate models to provide the Federal Senate with greater certainty and security in defining possible constraints



What could be discussed in this next phase?

Some points that senators are likely to discuss starting in August:

- Re-inclusion of tax benefits for automakers in the North and Northeast regions
- Changes in the Federative Council and the Regional Development Fund
- Possible presentation of a parallel constitutional amendment proposal (PEC) so that the part of the taxes that apply to goods and services can proceed without obstacles and, in a second stage, the discussions on income and wealth taxes can take place

- Review of exceptions to address possible scenarios of increase in the tax burden

Loeser e Hadad Advogados will continue to closely monitor all updates on the Tax Reform and be available to provide any clarifications on the subject matter.





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