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INSIGHT BRAZIL POLITICAL RISK & MACRO

Brazil's senate approves tax reform framework

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The Brazilian senate approved a key framework for the consumer tax reform, paving the way for higher levies than initially projected.

In 2023, the country passed a reform aimed at simplifying the existing tax system, replacing levies like PIS, Cofins, IPI, ICMS and ISS with the federal and state IBS and CBS duties, equivalent to VAT in other countries.

This year, congress has been debating the specific framework of the reform, which will serve as guidance for the new tax regime that is expected to be implemented gradually between 2026 and 2033.

Earlier this year, the lower house approved the framework, which calculated the VAT-equivalent rate at 27.97%.

However, several amendments were made in the senate vote. These changes introduced tax benefits for some sectors while offsetting them with increases for others, resulting in a VAT rate of 28.55%, according to preliminary calculations, a senate spokesperson told BNamericas.

As the framework was subject to changes in the senate, the lower house must now vote on them again before they can be introduced.

The senate changes included some to the so-called selective tax, which will be applied to activities related to mining, oil and gas.

Under the framework passed by the upper house, the selective tax will be charged during the extraction phase instead of on exports. The maximum selective tax rate will be 0.25% on extraction, but it will be zero if the operation involves natural gas used for industrial processes.

BNamericas talks with Paulo Honório de Castro Júnior, head of tax affairs at law firm William Freire Advogados, about the key points of the tax reform.

BNamericas: Senators estimate that, after the changes made by the senate, VAT will rise to 28.55%, compared with approximately 27.97% projected in the text approved by the lower house. To what do you attribute this increase in VAT? Which sectors are likely to pay more taxes compared to current levels, and which ones will face reduced taxes?

Castro Júnior: The main changes introduced by the senate that may lead to higher rates include the inclusion of services such as sanitation, veterinary, funeral, event production, conservation and restoration of native vegetation, as well as mineral water and cookies for popular consumption, at the reduced 60% rate.

Additionally, the senate removed the 70,000-real [US$12,000] cap for vehicles for people with disabilities and professionals, which will now have a zero rate for IBS and CBS. It also eliminated the 50% limit on the deduction from the IBS and CBS tax base owed by health cooperatives.

The services sector is likely to be more burdened, especially when selling to non-taxpayers, such as individuals.

BNamericas: Regarding the selective tax, in the version approved by the senate, this tax will be applied at the point of mineral extraction instead of exports, as previously approved by the chamber of deputies. What is the impact of this change on the mining sector? Is this change better, worse or neutral for mining companies?

Castro Júnior: The change relates to the tax base.

We've been advocating for months that if the taxable event occurs during extraction, the tax base should be the valuation of the raw material product extracted. It is unconstitutional to impute values related to later stages of production, such as the value of the product transferred, consumed or sold.

The version approved by the chamber of deputies determined that the taxable event would not occur during extraction but during the first commercialization, non-onerous transfer, export, or consumption of the goods by the extractor-producer or manufacturer. Consequently, it established tax bases that measured not the value of the extracted product but the value of the sold, transferred, exported or consumed product.

The senate corrected this defect.

On the other hand, the version approved by the senate remains unconstitutional by authorizing the application of the tax on extracted mineral products intended for export, based on the argument that the constitution established the tax's appliance at extraction, regardless of its destination.

It’s not possible to interpret the phrase "regardless of its destination" as an exception to the general rule of non-incidence of taxes on exports. This phrase must be read in light of article 152 of the constitution, which prohibits discriminatory taxation of goods and services, of any kind, based on their origin or destination.

In practical terms, this constitutional provision implies that the tax cannot have differentiated rates or tax bases based on the origin or destination of products within the national territory.

For this provision to be interpreted as an exception to the general rule of non-taxation of exports, the text would need to be much clearer and more explicit about taxing exports in such cases.

The fact that the tax is levied at the point of extraction is not a valid reason to determine that, in this case, exports would be taxable. Constitutional immunities must be interpreted broadly and generously, giving them maximum effectiveness. Allowing the tax to apply to the extraction of a product destined for export effectively means imposing a tax burden on exports, which contradicts the constitutional guidelines.

BNamericas: Do you expect the lower house to make more changes to the senate's text? When do you believe we will have the final approval and version of the tax reform in Brazil?

Castro Júnior: If there are changes, they will be minimal in the lower house. The central part of the text is definitive and should be signed into law in January.

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