TAX REFORM
WHAT CHANGES?

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UNDERSTAND THE MAIN POINTS PRESENTED IN THE REPORT

On July 6, 2023, the Chamber of Deputies approved the text-base of the Constitutional Amendment Proposal (PEC) of the tax reform. This approval is a significant milestone after almost three decades of discussions about the need for a new tax system in Brazil.

The vote in the Chamber took place in two rounds. In the second round, the result was expressive, with 375 votes in favor, 113 votes against and three abstentions, while in the first round, the proposal obtained 382 votes in favor and 118 against. To approve the proposal, 308 votes were required. With this stage completed, the text will be sent for analysis in the Senate.

The text of PEC 45/19 approved has few changes compared to the substitute presented by the rapporteur of the reform, Aguinaldo Ribeiro.

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UNIFICATION OF TAXES

The proposed tax reform presents the unification of five taxes into a single system. In addition, the latest version includes important measures, such as the exemption of taxes on basic food basket, in order to alleviate the fiscal impact on consumers. Another relevant innovation is the creation of the so-called "sin tax", which will be levied on products that are harmful to health or the environment, such as cigarettes and alcoholic beverages.

These measures seek to promote a more just and sustainable tax system, while addressing public health and environmental protection issues.

THE FOLLOWING TAXES WILL BE UNIFIED:

The measure provides for the elimination of the current taxes, replacing them with the creation of two Value Added Taxes (VATs). One of the VATs will be managed exclusively by the Federal Government, while the other will have a shared management between states and municipalities.

- IPI (Industrial Products Tax) PIS (Social Integration Program Contribution) Cofins (Social Security Contribution on Net Income);
- ICMS (Tax on the Circulation of Goods and Services);
- ISS (Service Tax).

TRANSITION

The proposal provides for a seven-year transition period, from 2026 to 2032, to unify taxes.

From 2033, the current taxes will be abolished.
In this stage called test:

- Federal VAT will have a rate of 0.9%;
- State and municipal VAT will have a rate of 0.1%.

In the initial version of the opinion, the rapporteur proposed that the migration to the new tax system would begin in 2026, initially covering federal taxes, such as PIS, Cofins, and IPI.

TRANSITION

Subsequently, **after three years, the transition to ICMS and ISS will begin**. The decision to include states and municipalities in the rate testing phase was taken to meet the demands of the states, as stated by Ribeiro.

From 2027, the PIS and Cofins taxes will be eliminated, and the IPI rate will be reduced to zero, for all products including those produced outside the Manaus Free Zone (ZFM).

At this stage, the federal VAT will come into force with a reference rate. The temporary maintenance of the IPI for industrialized products outside the ZFM will function as "an instrument for preserving the preferential treatment of the Amazon region".

TRANSITION

The next stage foreseen in the transition begins in 2029, with a phased reduction in the collection of state and municipal taxes:

Each year, the applicable ICMS and ISS rate will be reduced by 1/10.

The end of the transition is scheduled for 2032. In the meantime, the state and municipal VAT rates will be gradually increased to match the original collection of the taxes that will be extinguished.

There will be a proportional reduction of tax benefits granted by states and municipalities in 2033, state and municipal taxes will be extinguished.

TRANSITION

The text of the tax reform does not establish the values for charging VATs, except for the test rate. The opinion proposes reduced charges and exemptions for various goods and services.

According to the text, the Senate will be responsible for defining the reference rates during the transition, which will remain in effect until federal, state or municipal laws establish the VAT rates. The objective is to keep the tax burden unchanged in each federative sphere, adjusting the rates to compensate for the loss of revenue from extinct taxes.

In the case of federal VAT, the collection of the so-called "sin" tax must be computed towards the reduction of the CBS federal rate.

FEDERAL COUNCIL

The Federal Council will take on the responsibility of centralizing the collection of the future state and municipal Value Added Tax (VAT), which will replace ICMS and ISS. It will be composed of:

- 27 representatives from each of the states and the Federal District;
- 14 representatives who will be elected, with equal weight votes, by the municipalities;
- 13 representatives who will be elected, with weight votes proportional to the number of inhabitants, by the municipalities.

REGIONAL DEVELOPMENT FUND

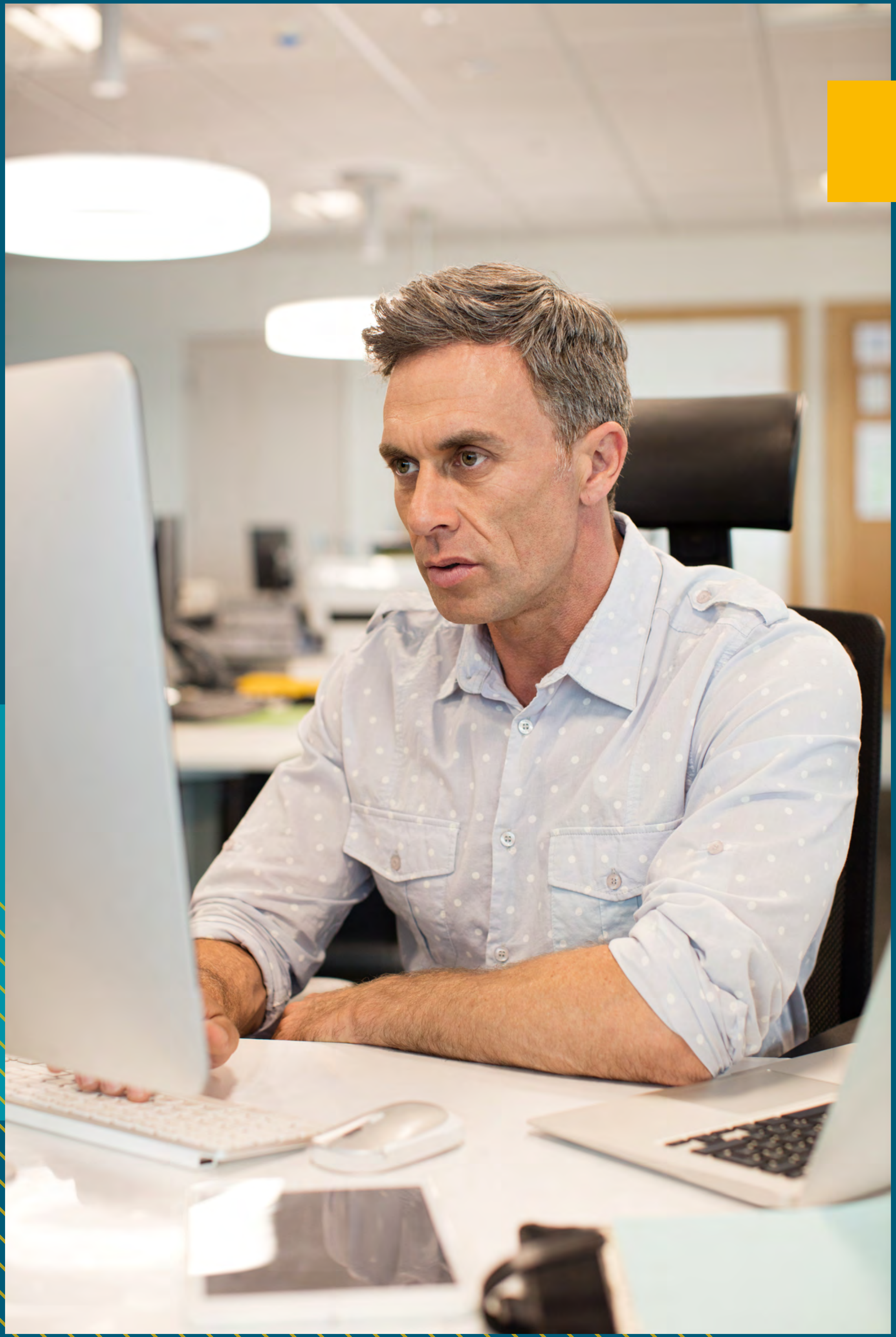
The proposal includes the creation of the **Regional Development Fund (FDR)** with the aim of mitigating regional inequalities. The FDR will start in 2029, without a set deadline for its end.

As for the total value of the fund, R$ 8 billion will be allocated in the first year, with a progressive increase until 2032. From 2033, the federal government will allocate R$ 40 billion annually to the FDR.

NATIONAL BASIC FOOD BASKET

In the days leading up to the vote, critics of the proposal raised concerns about the possibility of an increase in the prices of basic food items due to the new taxes. In the approved text, rapporteur Aguinaldo Ribeiro stipulated the creation of the **"National Basic Food Basket"**.

For these products, the federal, state, and municipal VAT rates will be reduced to zero. According to the text, a complementary law will be responsible for defining which **"products for human consumption"** will be included in the basic food basket.



CASHBACK

Currently, the Constitution provides for the exemption of taxes on goods considered essential - which, in practice, benefits products consumed by the low-income population. The tax reform proposal introduces the concept of **"cashback"** as a mechanism to return taxes to a certain public and reduce income inequality.

However, the specific regulation of this mechanism will be established later through a complementary law.

REDUCED RATES

The new opinion by **Aguinaldo Ribeiro** presented updates on the devices related to the reduction of the rates of the two VATs for certain goods and services, including the addition of three sectors.

In addition, there was a change in the percentage of tax rate reduction. Initially, Ribeiro had proposed a 50% reduction. However, the PEC now establishes a 60% cut, resulting in a rate equivalent to 40% of the IBS (state and municipal VAT) and the CBS (federal VAT).

Therefore, the rates will be reduced in the following segments:

Urban, semi-urban or metropolitan public transport services; Medicines and medical devices and health services; Education services; Agricultural, fishing, forestry and natural plant extractive products in natura; Agricultural inputs, food for human consumption and personal hygiene products; National artistic and cultural activities; Journalistic, audiovisual and sporting productions; Medical and accessibility devices for people with disabilities; Goods and services related to national security and sovereignty, information security and cybersecurity; and Medicines and basic menstrual health care products.

SIN TAX

The proposal includes the creation of a **Selective Tax**, under federal responsibility, which will apply to goods and services harmful to health and the environment, such as cigarettes and alcoholic beverages. This tax may be applied in one or more stages of the production chain, such as production and marketing, and will only be charged on imports, not affecting exports.

THE DETAILS WILL BE DEFINED LATER.

EXEMPTIONS

The opinion proposes the possibility of exempting the collection of VATs on various goods and taxes. However, decisions on these exemptions will be made through complementary law.

The following may be exempt from collection:

- Some specific medicines, such as those used for cancer treatment;
- Basic menstrual health care products;
- Medical and accessibility devices for people with disabilities;
- Vegetables, fruits and eggs;
- Reduction of 100% of the federal VAT (called CBS) rate on higher education education services (Prouni);
- Possibility of a rural producer, natural or legal person, with an annual revenue of up to R$ 3.6 million, being "free" to collect the future VAT;
- Possibility of zeroing VATs on urban rehabilitation activities in historical areas and critical areas of urban recovery and redevelopment.

TAXATION OF INCOME AND PROPERTY

Property tax on private jets, yachts and boats: The text allows the collection of the tax in the states and provides for the possibility of the tax being progressive due to the environmental impact of the vehicle.

Progressive taxation on inheritances: The proposal determines that the collection of taxes will be made at the place of residence of the deceased person, in order to avoid strategies to seek locations with lower taxation. In addition, the proposal allows the collection of taxes on inheritances abroad. The rapporteur also included an exemption from the ITCMD for donations made to non-profit institutions with a purpose of public and social relevance.

Updates in IPTU: At the request of the National Confederation of Municipalities (CNM), rapporteur Aguinaldo Ribeiro included in the opinion a device that allows the municipalities to update the basis of calculation of the Property and Territorial Urban Tax (IPTU) by decree, following criteria previously established in municipal law.

DIFFERENTIATED TREATMENTS

According to the proposal, certain types of goods and services may receive a specific treatment due to their peculiarities and for not falling within the general regime of incidence of the Value Added Tax (VAT). They are:

Fuels and lubricants: uniform rates charged in a single phase of the chain and possibility of granting credits to taxpayers;

Financial services, operations with real estate, health insurance plans and prognostic contests (such as lotteries): changes in rates, crediting rules and tax base, as well as the possibility of taxation based on revenue or turnover;

Government purchases: no incidence of dual VAT (IBS and CBS), provided that the credits related to previous operations in the chain are maintained;

Cooperative societies: the tax will not be charged on operations carried out between the cooperative society and its members, and the tax credits will be transferred between the members and the cooperative society;

Hotel services, amusement parks and theme parks, restaurants and regional aviation: changes in rates, crediting rules and tax base.

OTHER FUNDS

Compensation Fund for Fiscal Benefits: A fund will be established to compensate for the currently granted fiscal benefits, which are guaranteed until 2032. This fund will have a duration of 2025 to 2032, with a total value of R$ 160 billion.

Sustainability and Economic Diversification Fund of Amazonas: A fund will be established with resources from the Union to promote economic development in Amazonas. The complementary law will establish the minimum annual value of resources and the adjustment criteria.

The fund may be used to compensate for any revenue losses of the state due to the tax reform. In return for the reduction of fiscal benefits, the Union may contribute additional resources to the fund, in accordance with an agreement with the state government.

Infrastructure Contribution: At the request of the governors of 4 states (MT, MS, GO and PA), Aguinaldo Ribeiro also added to the text the possibility of establishing a contribution on primary and semi-finished products, produced in the respective states, for investment in infrastructure and housing works.

The measure was taken to replace specific funds, linked to infrastructure and that already exist in these states.

CONCLUSION

Despite the differences of opinion regarding the text, there is a consensus that the simplification of the tax system is crucial to attract investment and boost the country's development, resulting in a significant growth of the Gross Domestic Product (GDP).

In the current scenario, the Brazilian tax system is recognized for its high tax burden and the existence of a multiplicity of taxes, which makes it difficult for businesses and individuals to comply with their tax obligations. This imposes a significant burden on the economy and makes it difficult for the country to compete in the global arena.

CONCLUSION

Therefore, a successful tax reform could simplify the system, stimulating entrepreneurship, investment and job creation, as well as reducing social and regional inequalities, making the tax system more progressive and ensuring that everyone contributes fairly according to their economic capacity.

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