



Reform over tax consumption in Brazil

Main points of PEC 45/2019

Update after approval of
Senate

KPMG BRASIL

Tax SALT



Contents

01	Presentation	3
02	Drivers of tax reform for consumption	4
03	Tax reform purposes and pillars	5
04	Unification of Taxes approved by PEC 45/2019	6
05	Characteristics of the dual VAT	7
06	Characteristics of the Selective Tax	8
07	Exceptions to the single rate	9
08	Management of dual VAT	10
09	Tax incentives	11
10	Transition to the new model	12
11	Return of the credit for the taxes terminated	13
12	Other taxes affected by PEC 45/2019	14
13	Next steps of the reform is being pursued	15



Presentation

We are very pleased to present you this material from KPMG in Brazil about the Consumer Tax Reform in Brazil.

Recently, the Federal Senate approved pec 45/2019, making adjustments in the text that had been approved by the House of Representatives. This material brings the main points of the current text, which will return to the House for consideration and vote in the plenary of the modified items.

About this executive summary

The purpose of this summary is to share significant information for companies and executives about the main issues and the status of Brazil's Consumer Tax Reform. KPMG in Brazil is reinforcing its commitment to providing accurate and relevant information to its clients and partners, contributing to a more transparent and safe business environment.

Moreover, we are committed to analyzing the impacts generated by the reform and proposing tax solutions that meet each company's specific needs. Therefore, we fulfilled our mission of transforming insights and changes into opportunities for our clients.

We wish you all a great reading!



Drivers of tax reform for consumption

On November 8, 2023, the Federal Senate approved as changes the replacement for PEC 45/2019, which had been approved on July 6 by the House of Representatives. This milestone is a major breakthrough for Brazil's Consumer Tax Reform. Below are the main drivers of the reform:



Labor costs

According to a World Bank report (Doing Business 2019), a Brazilian company spends 1,958 hours to pay taxes, while the second place player, Bolivia, spends 1,025 hours and the average of 190 countries surveyed is 206 hours.



Lack of transparency

Thousands of regimes and rates + cumulative taxes + taxes charged on them (gross).



Tax war

The grant of tax incentives to attract companies and investments caused competition between different federal entities.



Conflicts of competence

The difficulty in classifying ICMS or ISS has caused conflicts between states and municipalities. This is because some activities have characteristics of both categories, which makes it difficult to define the tax to be applied.



Complexity of the tax system

Since the 1988 Federal Constitution, more than 460 thousand tax rules have been issued in Brazil, i.e. 37 tax rules per business day*. Source: *IBPT.



Litigation and legal uncertainty

Brazil's tax system generates a large number of judicial proceedings, with 26.8 million ongoing tax executions. The amount involved in tax litigation is 75% of GDP. Source: JASPER and Insper.



Regional and social inequalities

Taxation at the origin favors more developed federations and generates inequality in consumption among richer and poorer citizens.



Current scenario not boost businesses

Bureaucracy, legal uncertainty and tax complexity discourage investments and the setup of companies in Brazil, affecting economic growth.

Tax reform purposes and pillars

The Tax Reform in Brazil has three main objectives and is based on four fundamental pillars. Check below:

Objectives

- 1** Promote the growth of Brazil's economy in a sustainable manner, generating jobs and income.
- 2** Reduce social and regional differences to make Brazil's tax system more fair.
- 3** Lessen tax complexity to ensure transparency and provide more tax citizenship.

Source: Ministry of Finance. Extraordinary Tax Reform Department.

Pillars



Simplicity

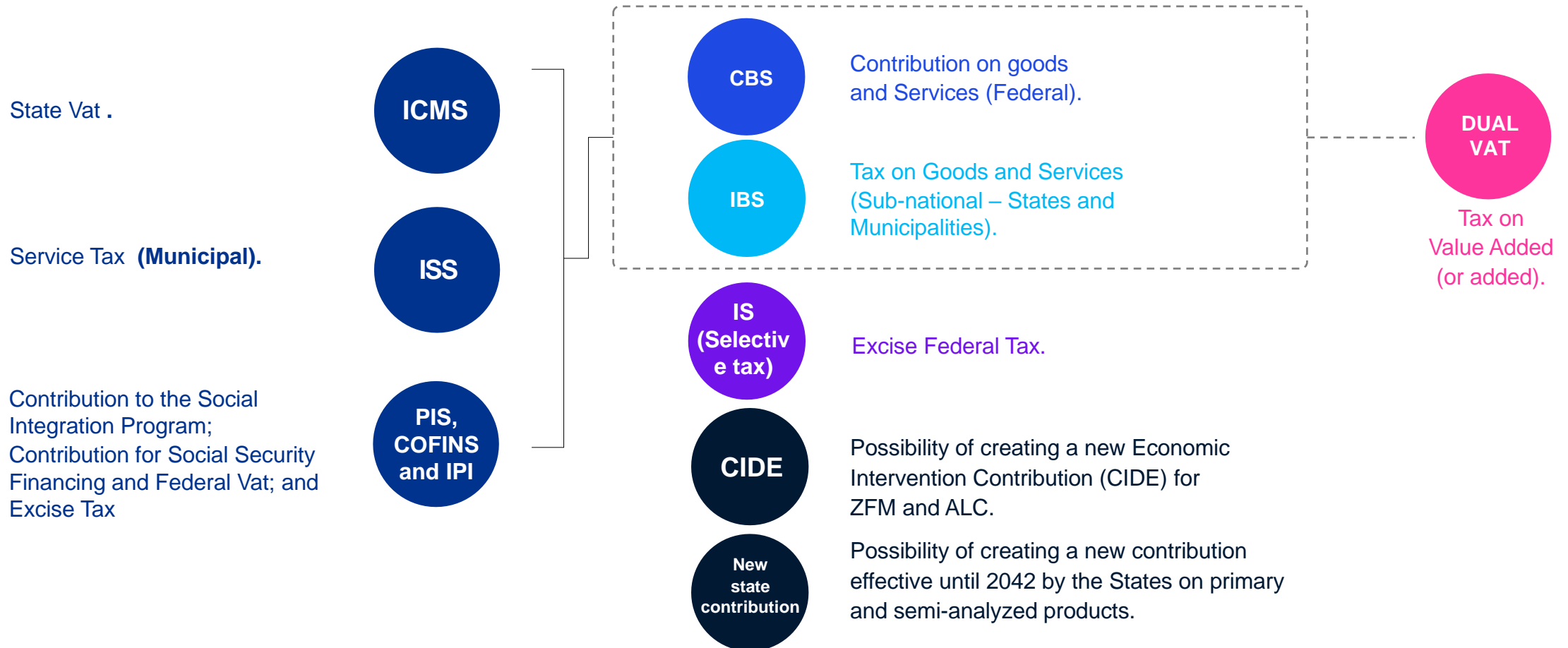
Transparency

Justice

Balance and defense of the environment

Unification of Taxes approved by PEC 45/2019

One of the main purposes of the Tax Reform is to unify taxes on consumption with the purpose of simplifying Brazil's tax system. This measure will allow the main five taxes levied on consumption - PIS, COFINS, IPI, ICMS and ISS - will be replaced by a dual value-added tax (VAT), a selective tax (IS), and the possibility of the imposition of a contribution on primary products and semi-elaborated products for a limited time.



Characteristics of the dual VAT

Both CBS and IBS will have their characteristics based on international value added tax (VAT) standards. Below are some of the main characteristics:

Rates

Single rate for goods and services, including rights.

Cashback

Returns from part of CBS and IBS charged from consumers, benefiting lower-income families with express provisions for domestic gas and electric energy.

Non-cumulative activities

All previous transactions, except acquisitions of personal use and consumption, may be considered as credit.

Quick returns of accumulated credits

Accumulated credits due to taxpayers are expected to be reimbursed in a fast manner.



Rate lock

Maximum benchmark ceiling, based on the average collection of taxes extinguished, GDP in the years from 2012 to 2021, revaluing in the fifth year.

Calculation "on the outside"

IBS and CBS will be calculated "outside", and will not be part of the calculation base itself.

Wide incidence

The Company will be charged on all transactions with material goods or services, including rights.

Principle of destination

According to law, taxes will be levied on the state and municipality where final consumers are located.

Uniform legislation

A single law establishes the collection of taxes on goods, services and rights nationwide.

Characteristics of the Selective Tax

The selective tax will be applied to the production, extraction, marketing or import of goods and services that may cause losses to the health or the environment. Below are listed its main characteristics:



It has an off-tax purpose because it aims

at encouraging the consumption of legal products to improve health, environmental sustainability and carbon emissions.



Complementary Law will establish the tax and define the merchandise and services on which the Selective Tax will be imposed.



Will not be levied on goods or services that are subject to reduced rates, as well as exports, electricity and telecommunications transactions.



It will make up the calculation base of ICMS, ISS, IBS and CBS.



Rates will be set by the Ordinary Law and the imposition must comply with the previous nonagesimal and annual rules.



Shall be levied on arms and ammunition, except when meant to to the government.



Cumulative tax, i.e., is an exception to the non-cumulative total, and does not have credits to be discounted.



One-phase levy, i.e. taxation will occur only once in the chain.



The tax will be charged regardless of destination.

Exceptions to the single rate

PEC 45/2019 establishes the application of a different taxation of CBS and IBS for certain goods and services. See:

0% Rate

✓ National Basic Basket	✓ Vegetables, fruits and eggs	✗ Events Industry Services – PERSE
+ Services provided by innovation, science and technology entities - ICT - not-for-profit	✓ Medical and accessibility devices for disabled people	✓ PROUNI Higher Education Services (CBS only)
+ Automobiles acquired by disabled people, autistic spectrum disorder or professional drivers for use in the rental category (taxis)	+ Acquisition of medicines and medical devices by state entity or social care	✓ Collective transportation services

Rate reduced in 60%

✓ Healthcare	✓ Education services	✓ Institutional Communication	✗ Personal hygiene products
✓ Related goods and services security and national sovereignty, information security and cyber security	✗ Collective transportation services intercity and interstate	✓ Medicines and basic health care products menstrual	
✓ Medical and accessibility devices for disabled people	+ Personal hygiene cleaning products mostly consumed by low-income families	✓ Agricultural and livestock products, aquaculture, fishing, and vegetable extractives in natura, agricultural and livestock inputs and aquaculture	
+ Artistic, cultural, event, national audiovisual and audiovisual productions, sports activities	✓ Extended Basic Basket - food for human consumption		

Specifics regimes

✓ Aviation regional	✓ Fuels and lubricants	✓ Cooperative Societies	✓ Hotel and restaurant services	✓ Fun and themed parks
+ Travel and Tourism agencies	+ Bars	+ Road Concession	+ Sanitation services	
+ Collective transportation services for intercity and interstate road passengers, railway, waterway and air	+ Sports activities carried out by a football corporation	+ Transactions arising from an international treaty or convention	+ Transactions related to providing a shared structure for telecommunications services	
✓ Financial Services, Property Transactions, Health Care and Prognosis Contests	+ Goods and services which promote the circular economy aiming at sustainable use of natural resources	✗ Transactions carried out with government agencies and public foundations		

Rate reduced in 30%

+ Services of intellectual profession, of a scientific, literature or artistic nature, provided that they are submitted to inspection by the professional council
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Special regimes

- **Manaus Free Trade Zone (ZFM) / Free Trade Areas (ALC's).**
- **Unified Special Regime for Payment of Taxes and Contributions due by Micro and Small Companies.**
- **Bio-fuels and green hydrogen.**



Management of dual VAT

Administrative changes are expected to be made to manage the new model.

The management of dual VAT will be made by:

Contribution on Goods and Services (CBS): Brazilian Federal Revenue Service

Tax on Goods and Services (IBS): IBS Management Committee

Responsibilities of the IBS Management Committee:

- ✓ Edit a single regulation and standardize the interpretation and application of tax law;
- ✓ Collect the tax, offset the proceeds and distribute the proceeds from collections between states, the Federal District and Municipalities; and
- ✓ Decide on administrative litigation.

The top decision-making body of the Management Committee shall be made up of:

27 members representing each State and the Federal District



27 members representing the set of Municipalities and the Federal District



The amendment sets the criteria to be met for decisions to be approved.

Tax incentives

During the transition, existing tax benefits will be gradually reduced and terminated, with some provisions expected to be offset by federative entities and companies. We highlight below important issues:

Maintenance until 2032

Expected maintenance of the tax benefits granted under Statutory Law 160/2017 until December 31, 2032.

Extension restriction

ICMS tax benefits may not be granted after 2032.

Proportional reduction

Under the proposal a proportionate reduction in benefits is expected as from 2029.

National Regional Development Fund (ENSR).

With the end of tax incentives the Regional Development Fund will be created with the purpose of supporting less favored regions.

Fund for the Offsetting of Tax and Financial-Tax Benefits (FCBF).

Purpose of offsetting companies that have reduced and/or interrupted benefits.

R\$570 billion

Amount expected to be invested by the Federal Government from 2029 to 2042 in the **National Regional Development Fund (GRACIEDR)**.

THE RESOURCES of THE UNDUE DR will gradually increase as ICMS incentives are reduced.

As from 2043 the fixed amount will be R\$60 billion per year.

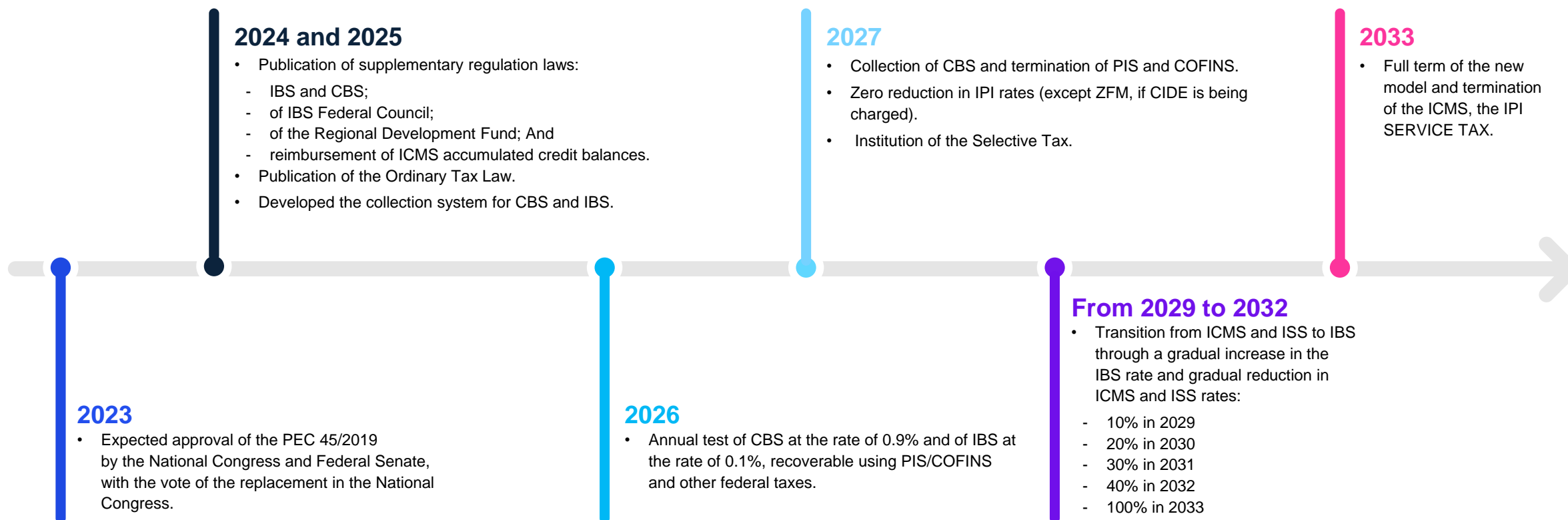
R\$160 billion

Amount to be deposited by the federal government from 2025 to 2032 in the Fund for the Offset of Tax and Financial Benefits (FCBF).

The funds will be provided to companies from 2029 until 2032.

Transition to the new model

PEC 45/2019 establishes a transition period for taxpayers to adapt to the new rules.



Source: Ministry of Finance. Extraordinary Tax Reform Department.

Return of the credit for the taxes terminated

Value-Added Tax on

- The balance of approved credits, remaining at the end of 2032, will be offset against IBS in 240 equal and successive monthly installments;
- Credits on property, plant and equipment will be offset considering the current legislation in 48 installments; And
- As from 2033, credit balances will be adjusted for inflation using the Extended National Consumer Price Index (IPCA).

Moreover, PEC 45/2019 establishes that Supplementary Law will be provided for:

- Procedure for transferring credit balances to third parties; And
- Refund of the residual tax if offsetting has not been possible in 240 months.

Federal taxes

Supplementary law will regulate the utilization of PI, PIS and COFINS credits that had not been utilized until their termination. Only credits that meet the requirements of the law in effect at the time of termination may be offset against other federal taxes or cash refunds.

Other taxes affected by PEC 45/2019

IPVA

Levy on land, water and air vehicles, except:

- (i) Agricultural aircraft and air service provider to third parties;
- (ii) Water transportation vessels or vessels that practice fishing;
- (iii) Platforms which may move on their own; And
- (iv) Tractors and agricultural machinery.

There is the possibility of the IPVA being progressive due to the value and environmental impact of the vehicle.

IPTU

The executive branch may update the calculation base according to general criteria set to facilitate the attainment of tax collection potential by valuing them.

ITCMD

Progressivity based on the value of transmission or donation.

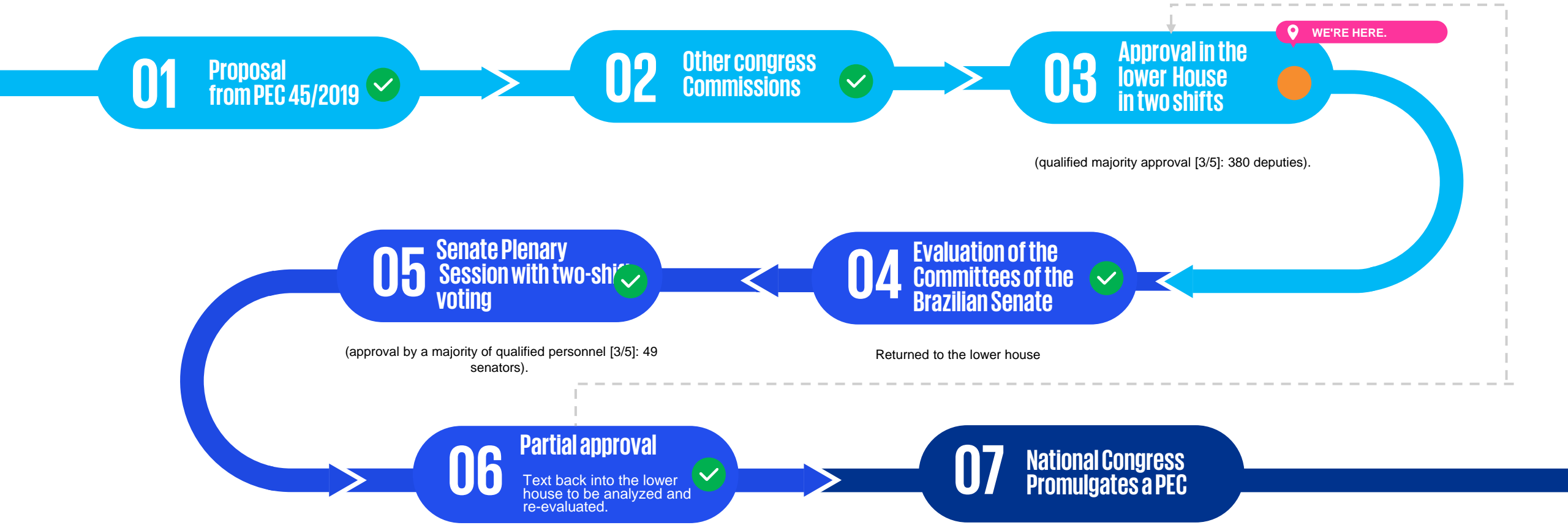
Setting the tax accrual basis for the domicile state of *cujus* with respect to movable property, securities and credits.

The Bank will not be levied on transmissions or donations to not-for-profit entities.

Corporate Tax

A draft bill will be presented within 90 days from the enactment of PEC 45/2019, which reforms income taxation and a bill that reforms payroll taxation.

Next steps of the reform is being pursued



Chamber of Deputies



U.S. Senate



National Congress



Stage completed



Stage in progress



Thank you!

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