3 August 2020

Indirect Tax Alert

News from EY Americas Tax

Brazil's proposed VAT on royalties and digital platforms/marketplace could affect technology, media & entertainment, and telecom sectors

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On 21 July 2020, the Brazilian Government proposed a bill that would create a new tax, the Contribution on Goods and Services (CBS for its Portuguese acronym), which is intended to function as a federal Value Added Tax (VAT) and would replace the existing PIS and COFINS Contributions (Social Security Contributions on Sales). See EY Global Tax Alert, *Brazilian Government proposes new federal VAT as first phase of comprehensive tax reform*, dated 22 July 2020.

Similar to the PIS and COFINS, the CBS would apply to local sales (gross revenue) and imports of goods and services but not to exports.

The possible impact on the technology, media & entertainment and telecom (TMT) sectors includes (1) the extension of CBS to cross-border transactions involving rights and intangibles and (2) making digital platforms the responsible parties for collecting applicable taxes.

Rates and credits

The PIS and COFINS tax regime applies different rates of 0%, 3.65%, 4.65%, 9.25% and 11.75%, and others, depending on various factors. The CBS would be levied at a flat rate of 12% (with very limited exceptions for financial services, cigarettes, and the oil & gas industry) on gross revenue (reduced by taxes such as the State Value-Added Tax – ICMS, and the Municipal Service Tax – ISS, as well as unconditional discounts).

Building a better working world

The complex PIS and COFINS credit system currently limits the use of tax credits. In contrast, CBS excess credits could be refunded or used, at the end of the quarter, to offset federal taxes due. As such, the CBS would be a true VAT system, in the sense that a full input tax credit would be generally available.

The CBS's flat rate, straightforward taxable basis, and full tax credit system are expected to simplify tax computations. On the other hand, this flat rate could affect those currently collecting PIS and COFINS at a 3.65% rate.

Determining the effects on individual businesses will likely require careful analysis of both the level of tax and the availability of credits.

New taxable events

Under current law, PIS and COFINS Contributions do not apply to cross-border transactions involving rights and intangibles. Under the bill, the definition of "import of services" would include assignment and licensing of rights, including intangibles. Thus, payments for royalties and transfer of intellectual property that are not currently subject to PIS and COFINS would be subject to CBS.

Digital platforms/marketplaces

Digital platforms are defined as legal entities that act as intermediaries between suppliers and purchasers in the remote sale of goods and services.

The bill expressly excludes from the definition of digital platforms entities that provide internet access, payment processing, advertising or supplier searches, as long as these entities do not charge for the service based on the number of sales.

While the CBS payer generally would be the seller in local transactions, and the importer in transactions involving the import of goods or services, the bill would require digital platforms to collect the CBS due on sales in which they act as intermediaries (when the legal entity seller does not register the transaction by issuing a formal invoice).

For imported goods or services, the following entities, in addition to the importer, would also be required to collect CBS:

- The nonresident seller or digital platform that sells or intermediates a sale of service to an individual located in Brazil
- The nonresident digital platform intermediating sales of goods to entities or individuals in Brazil

These nonresident sellers or platforms would have to register online for CBS purposes.

The Government indicated informally that it may inspect digital platforms by tracking the transactions through financial institutions.

What's next?

If enacted, the CBS would be effective the first day of the sixth month following enactment of the law, and the PIS and COFINS would cease to exist. Both chambers of the National Congress (i.e., Chamber of Deputies and Senate) still need to discuss and approve the bill, in different voting rounds. The legislative process usually takes time in Brazil, and the current wording of the bill may be changed during this process.

Despite other bills that were previously proposed and are still awaiting approval, it is expected that this bill will likely move forward more quickly for a couple of reasons, including the facts that:

- The other bills, particularly the one proposing the taxation of digital platforms/marketplaces (CIDE-digital proposed in May this year), require several fixes before they are ready for legislative discussion
- Some of the proposals touching on PIS and COFINS (e.g., PEC 45 and PEC 110) are more complex, as they would replace taxes at the federal, state and municipal levels

As this new bill only involves the replacement of PIS and COFINS, which are federal contributions, it has rapidly gained the sympathy of the general public because of its simplicity, even though it may adversely affect some businesses.

Below a summary of the main difference between PIS/COFINS and CBS:

	PIS/COFINS	CBS
Tax base	Gross revenue, import of goods and services, financial operations	Operational gross revenue, import of goods and services, acquisition or license of rights and intangibles (including software), some financial operations
Rate	Generally, 0%, 3.65%, 4.65%, 9.25%, 11.75%	Generally, 0% or 12%
Credits	Tax credits only for expenses and costs expressly foreseen in the legislation. Controversy over items considered as input for the production of goods or rendering of services (tax authorities have a restrictive interpretation)	Full tax credit for costs and expenses, with few exceptions
Computation	Different formulas applicable on gross revenue, import of goods, import of services Taxable basis includes other taxes and the PIS/ COFINS itself	The taxable base is the gross revenue on each operation, excluding the amount of taxes levied on the operation
Taxpayer/Responsible	Seller of goods and services, the acquirer of goods and services in case of import	Seller of goods and services, the acquirer of goods and services in case of import The local or foreign digital platform and the nonresident seller may be responsible for the tax collection in some cases

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EYG no. 005356-20Gbl

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