Brazil's Tax Environment and Macroeconomic Scenario

Brazil's tax outlook for 2023 prompts the (re) discussion of many important topics, mostly due to the change in the federal administration (the newly elected government took office as of January 2023). This may lead to a renewed emphasis on certain matters that the Congress has been discussing for some time, such as tax reform, but also a change in certain policies adopted by the previous administration.

The current macroeconomic scenario – with high inflation and interest rates – may push the government to pursue the implementation of measures to reduce public debt. From its first actions since taking office, the economic team of the new administration has shown that its focus is on balancing public accounts through measures that mainly aim to increase revenue.

In addition, the new government has a more pro-environment position, as well as being more inclined towards the development of social programmes for the (re)distribution of income. Hence, it is possible that, in the next four years, there will be a growth in governmental initiatives related to the ESG agenda.

The current administration is less predisposed to the privatisation of public companies and other relevant assets or entities. However, although less likely than in the previous administration, certain sectors that require significant capital investment, such as infrastructure, may still be subject to auctions or concessions.

In view of the above, and due to the depreciation suffered by Brazil's currency in recent years, there may be interesting opportunities for foreign investors that seek strategic or high-yield assets that may be under-priced.

Tax Reform

Two tax reform proposals with broad scope, both of which require changes in the Federal Constitution, are being discussed in the Brazilian Congress: Proposta de Emenda à Constituição (PEC) 45 and PEC 110. Such proposals were not supported by the previous administration, which intended to implement a reform in stages. However, the economic team of the current administration intends to resume discussions of PECs 45 and 110.

These proposals aim to unify several municipal, state, and federal value-added taxes. There are also initiatives looking to ensure that the tax reform agenda addresses issues related to key contemporary matters, such as environmental concerns and taxation of the digital economy. Initially, the goal is to have the tax reform approved by the end of 2023. However, this will depend on political alignment at all three levels of the federation. It is important to monitor the development on the discussions around tax reform to assess whether it will effectively be approved in 2023.
In addition, there are discussions regarding a potential repeal of the income tax exemption applicable to dividends paid by Brazilian companies, as well as the repeal of the interest on net equity (INE). INE is a form of shareholder remuneration that may be interesting for profitable entities, especially those with foreign shareholders. INE is usually subject to withholding tax (WHT) at a 15% rate. However, provided some requirements are met, INE may be deducted from the paying entity’s corporate income tax (CIT) basis (subject to a 34% rate). Hence, payment of INE allows for a 19% tax saving within the group.

There are also discussions regarding the revision of the progressive rates table for individual income tax payers, which has not been updated since 2015, and an increase in the exemption bracket.

Return of the Tie-Breaking Vote in the Administrative Council of Tax Appeals (CARF)

Via Provisional Measure 1,160 (MP 1,160), published on 12 January 2023, the newly elected federal administration repealed Section 19-E of Law 10,522/2002. Section 19-E was included by Law 13,988/2020, enacted in April 2020, and stated that, whenever there is a tie in a trial of federal administrative proceedings on tax matters, the case should be resolved in favour of the taxpayer.

Since the enactment of Section 19-E, many issues of corporate taxation sensitive to Brazilian companies have undergone a change in their jurisprudence. Taxpayers began to be victorious in matters that CARF historically judged in favour of tax authorities. Please refer to the Brazil Trends & Developments chapter of the 2022 Chambers Global Practice Guide to Corporate Tax for more information on CARF’s role in Brazil’s tax system and the subjects on which there was a shift in jurisprudence with the end of the tie-breaking vote. Besides the subjects mentioned therein, in 2022, CARF also issued favourable decisions in relation to cases involving the tax amortisation of the good will paid in M&A transactions, a very controversial matter in Brazilian tax courts.

Since the enactment of MP 1,160, however, CARF has again issued unfavourable decisions on some of the subjects above.

The government and representatives of taxpayers are negotiating the terms for the approval of MP 1,160 by the Brazilian Congress. Representatives of taxpayers are attempting to impose certain conditions that aim at the settlement of debts charged in tax assessments that were sustained due to the tie-breaking vote, such as exclusion of any fines charged upon issuance of the tax assessment, exclusion of interest if the debt is paid within 90 days of the final administrative decision and settlement of the debt in instalments.

Notwithstanding the above, there is uncertainty on what the outcome of this negotiation will be and even if MP 1,160 will be effectively converted into law. Please note that MP 1,160 must be converted into law by the Congress within 120 days of its issuance for its provisions to become effective in the Brazilian tax system.

Settlement of Federal Tax Debts via the Institute of the Tax Transaction

Law 13,988/2020 regulated the institute of the tax transaction (transação tributária), whereby taxpayers and tax authorities may negotiate the settlement of debts that may or may not be the object of litigation.
Law 14,375, published on 2 June 2022, included a possibility that was not foreseen in the original wording of Law 13,988: the discussions for the settlement of a tax debt being triggered at the initiative of the taxpayer. Law 14,375 also included other relevant amendments to Law 13,988, as follows:

- It allowed the use of credits derived from tax-loss “carryforwards” (TLCFs) assessed in CIT calculations to settle a portion of the debts included in the transactions, if such debts were classified as “irrecoverable” or “difficult to recover” based on the rating assigned by the Attorney General Office of the National Treasury (PGFN) and the Brazilian Federal Revenue Service (RFB).
- It allowed the use of TLCFs of a direct or indirect controlling or controlled company, or of companies that are directly or indirectly under the same corporate control.
- It allowed the use of credits related to public bonds (precatórios) obtained against the federal government to pay the debts included in the tax transaction.
- It increased the limit of discounts that may be granted to taxpayers for debts included in a transaction from 50% to 65%.
- It increased the time limit of the payment terms to be granted to taxpayers for debts included in a transaction from 84 to 120 months.
- It extended the possibilities of guarantees to be offered by the taxpayer.

Moreover, at the beginning of 2023, the Ministry of Finance issued Ordinance No 1/2023, which enacted the Tax Litigation Reduction Programme (PRLF). Under the PRLF, the new federal administration opened the possibility of taxpayers adhering to a special and temporary form of tax transaction.

In this sense, Ordinance 1/2023 states that taxpayers may opt to settle their tax debts discussed in the administrative or judicial courts, with the possibility of enjoying the following benefits (in addition to the ones described above):

- using TLCFs for the settlement of apportion of any tax debts, regardless of the rating assigned by PGFN and the RFB;
- discounts of up to 100% of the fine and interest charged on the debts included in the transaction, progressively scaled according to the rating assigned by the PGFN and the RFB.

New Transfer Pricing Rules
On 29 December 2022, the federal government published Provisional Measure No 1,152 (MP 1,152), which introduced important changes to Brazilian transfer pricing (TP) rules. MP 1,152 repealed the Brazilian TP rules, which had been in existence since 1996, and introduced a new set of rules with a methodology based on OECD standards. The MP is the result of a joint effort of the RFB and the OECD with the purpose of moving Brazilian TP rules closer to those outlined by the OECD.

Below are some of the most relevant changes introduced by MP 1,152:

- Repeal of the current system of pre-fixed margins and introduction of the arm’s length principle in the Brazilian tax legislation.
- Introduction of new criteria for identifying related parties. As a rule, all related-party transactions may be subject to TP adjustments if they do not meet the arm’s length principle. Further regulation under MP 1,152 may include safe harbours.
- New forms of adjustments to the CIT calculation base by virtue of the application of
transfer pricing rules, such as secondary and compensating adjustments.

• Countries with CIT rates lower than 17% are now considered as low tax jurisdictions and privileged tax regimes (the original rate was 20%).

• Possibility for taxpayers to negotiate advanced pricing agreements with tax authorities.

• Repeal of the specific rules limiting the deductibility of expenses related to the payment of royalties and technical services and submission of those transactions to transfer pricing rules. Current TP rules do not deal with deductibility of royalties, which are subject to a specific set of rules dating from the 1950s. The new rules applicable to the deduction of royalties are generally seen as a positive change for multinational companies operating in Brazil, as the tax treatment provided by the current Brazilian tax rules is very restrictive on the deductibility of royalties for CIT purposes.

With the changes promoted by MP 1,152, the Brazilian federal government hopes that there will be an alignment between the laws of both countries, so that US companies may again be able to deduct Brazilian WHT as a foreign tax credit.

MP 1,152 is one of a group of measures undertaken by the previous administration in an effort to become an OECD member country. It is unknown to which extent the current administration shares the same desire. Hence, it is not possible to ascertain whether the current administration will push for the approval of the changes promoted by MP 1,152.

MP 1,152 must be approved by the Congress and converted into law within 120 days of its issuance for its provisions to become effective in the Brazilian legal system. Notwithstanding that, MP 1,152 states that its provisions enter into force in 2024, unless taxpayers elect to submit themselves to the new rules in 2023 (the exercise of this option is irreversible).

Review of the Effects of the Res Judicata

In February 2023, Brazil’s Federal Supreme Court (STF) ruled that decisions issued by the STF in proceedings with erga omnes effects null final decisions issued in proceedings with only inter partes effects.

The ruling had as background the discussion of the constitutionality of the social contribution on net profit (CSLL), one of the taxes that comprise Brazilian CIT.

In 2007, the STF ruled in favour of CSLL’s constitutionality. The decision was issued upon judgement of the direct action for unconstitutionality No 15, a proceeding with erga omnes effects (ADI 15). Taxpayers claimed the res judicata
(final decisions not subject to any kind of appeal) should be respected, notwithstanding the fact that a subsequent divergent decision was issued with erga omnes effects. Hence, companies that had final decisions in procedures filed by them stating that CSLL was unconstitutional should not be affected by the ruling under ADI 15.

The 2023 Court, however, ruled that decisions issued in proceedings with inter partes effects should become void when there is a subsequent divergent decision with erga omnes effects dealing with the same subject matter.

The decision was issued by the STF upon trial of the extraordinary appeals No 949,297 and 955,227 – both judged under the general repercussion regime. Although the discussion involved CSLL, the rationale above may expand to other taxes that are imposed on a continuous basis (ie, not imposed in specific and isolated situations).

Changes in Legislation Dealing With PIS/COFINS Credits

In 2021, the STF settled a discussion that had stretched for many years between taxpayers and the RFB, regarding the exclusion of state VAT (ICMS) from the tax basis of the social contributions imposed on gross revenues (PIS/COFINS). In the decision issued on extraordinary appeal 574,706 (RE 574,706), the Court ruled that the ICMS does not constitute taxable revenue for PIS/COFINS purposes.

On 12 January 2023, the Executive Power published Provisional Measure 1,159 (MP 1,159), which stated that, for purposes of the PIS/COFINS assessed under the non-cumulative regime, which allows the calculation of credits over certain costs and expenses, the ICMS should not be included in the acquisition cost for purposes of assessing the basis of such credits. Based on the understanding conveyed in RE 574.706, the executive power claimed that, if the ICMS highlighted in the sales invoice is not subject to the payment of PIS/COFINS, then it should not be included in the basis of the credits under the non-cumulative regime.

Another relevant change in the regulation dealing with PIS/COFINS credits occurred at the level of regulations issued by the RFB. As seen from normative instructions issued since 2002, the RFB historically understood that the tax on manufactured products (IPI) should be included in the acquisition cost for purposes of determining the basis of PIS/COFINS credits, whenever the IPI was not recoverable by the taxpayer (ie, the taxpayer did not make sales subject to the imposition of IPI that allowed the offset of the IPI imposed on acquired products with the IPI imposed on sales). Normative Instruction No 2,121/2022 (IN 2,121), published on 20 December 2022, changed that historical understanding, stating that the IPI should not be included in the basis of PIS/COFINS credits.

Taxpayers understand that, despite the changes described above, there are still arguments supporting the right to include the ICMS and the IPI (recoverable or not) in the basis of PIS/COFINS credits. One should monitor the discussions that may arise in Brazilian tax courts in view of the changes above.

Discussions on the Existence of a General Anti-Avoidance Rule (GAAR) in the Brazilian Legal Framework

In April 2022, the STF settled a discussion that had stretched for many years on whether there is a GAAR in the Brazilian tax framework. The STF judged the Direct Action of Unconstitutionality No 2,446 (ADI 2446), which challenged the
constitutionality of the sole paragraph of Section 116 of the National Tax Code (CTN). The sole paragraph of Section 116 was included by Complimentary Law No 104/2001 and stated that “The administrative authority is authorised to disregard legal acts or businesses carried out with the purpose of dissembling the occurrence of the taxable event or the nature of the elements constituting the tax obligation, subject to the procedures to be ruled by an ordinary law”.

Although the STF recognised that the sole paragraph of Section 116 is constitutional, the understanding that prevailed in the Court was that such a provision is of limited effectiveness, lacking the power to produce effects in the Brazilian legal system. Pursuant to the opinion of Justice Cármem Lúcia, the reporting judge of the trial, the effectiveness of the sole paragraph depends on the enactment of a law that establishes the procedures tax authorities must adopt to disregard taxpayers’ transactions; however, such a piece of regulatory legislation has not yet been published.

Hence, one can say that, until said law is published, the Brazilian tax system does not provide for any provision that conditions the validity of legal transactions executed by taxpayers upon the existence of elements such as business purpose or economic substance. In this sense, Justice Cármem Lúcia, in her reporting vote, expressly recognised the right of taxpayers to structure their operations in the most efficient manner from a tax point of view.

What can be seen from the judgment above is that the STF generally recognised the right of taxpayers to organise their businesses at their own discretion, including through the adoption of structures that result in the optimisation of profits and that are less costly from a fiscal point of view, provided that the applicable legal provisions are observed. This reinforces the understanding that there is no GAAR or any other rule on which tax authorities could support a disregarding approach based on lack of business purpose or economic substance; at least not until the sole paragraph of Section 116 of the CTN is regulated by Congress.

Meanwhile, tax authorities can only adopt a disregarding approach if the specific situations covered by Section 149, VII, of the CTN are identified – ie, in cases where tax authorities can prove that the taxpayer acted with intent, fraud, or simulation.
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