Thank you for joining.

The webinar will begin shortly.
Before we start…

1. Stay on mute
2. Ask questions via the chat
3. This session will be recorded
4. The material will be shared after the session
Brazilian tax reform(s): current status and possible implications

Presentation by Prof. Dr. Romero Tavares, Dr. Pedro Schoueri

Moderation: Chris Winkelman
Agenda

1. Tax reform drivers
2. Indirect tax reform
3. Income tax reform
4. Tax treaties / TP
5. Discussions
1 Tax reform drivers
Tax reform drivers

Tax to GDP

Close to OECD average; higher than LAC average

Tax reform drivers

Tax mix

- Heavier weight to indirect taxation, highly regressive system
- High complexity, uncertainty, highly litigious environment
- Income taxes
  - OECD comparison: lighter on PIT, average on CIT
  - LAC comparison: average on PIT, lighter on CIT
- Goods and services
  - OECD comparison: higher levy of “other taxes”
  - LAC comparison: higher levy of VAT

Tax reform drivers

Time to comply 2018

- Highly technological, e-compliance, real-time e-reporting
- Structural challenges reinforced by high costs to comply

PwC's Paying Taxes data explorer (https://www.pwc.com/payingtaxesdatatool).
Indirect tax reform
Indirect/Transactional Taxes
Current system targeted by Tax Reform

- **PIS/COFINS**
  - Turnover tax; non-cumulative regime quasi-VAT allows limited input credits
  - Federal competence

- **IPI**
  - Highly selective quasi-excise/quasi-VAT, limited credits
  - Federal competence

- **ICMS**
  - Quasi-VAT on goods and certain services
  - State level competence

- **ISS**
  - Tax on service charges
  - Municipal level competence

- **Other**
  - IOF/CPMF
  - CIDE
Indirect tax reform
Proposals - 2019

PEC 45
- Intended as a true VAT/GST ("IBS"), replacing PIS/COFINS, IPI, ICMS and ISS
- 10-year transition for taxpayers
- Additional excise tax, not revenue-driven
- Destination based
- Original proposal: Single Federal Rate with Maximum Total Rate (States and Municipalities could reduce their apportionment); uniform across goods and services
- Legal discussion of infringement of the autonomy of States and Municipalities leading to “dual system” alternative (National and Subnational)

PEC 110
- Intended as a true VAT/GST ("IBS"), including PIS/COFINS, IPI, ICMS, ISS, IOF, CIDE-Combustiveis, salario-educacao
- 5-year transition for taxpayers
- Additional excise tax, partly revenue-driven
- Destination based
- Standard rate applicable nationally; may vary depending on the goods and services
- Legal discussion of infringement of the autonomy of States and Municipalities leading to “dual system” alternative

Government’s proposed approach
- Start with Federal VAT replacing PIS/COFINS, Contribution on goods and services ("CBS"), Project of Law submitted to Congress as the first of a 4-phase reform
- Destination based
- Federal level - single rate, potential revenue increase
- No discussion regarding autonomy of States and Municipalities (does not change ICMS and ISS)
- Intended as compatible with PECs 45 and 110
Income tax reform
The original proposal

Process
• Presented by the Government to Congress
• Not a “Provisional Measure” but a Project of Law
• Measures Highly Influenced by 2022 Elections
• Amended version approved by the House of Representatives

Stated purpose inconsistent with enacted law
• Foster investment, enhance progressiveness of PIT
• Overall collection neutrality
• Reduction of distortions and privileges

Object
• Base broadening
• Nominal rate increase: 5% reduction to CIT but with a 20% dividend withholding tax
The original proposal

- **Base broadening**
  - **INE**
    - Non-deductibility of the INE
  - **Goodwill amortization**
    - Elimination goodwill deductions for acquisitions of equity interests
  - **Equity based compensation**
    - Non-deductibility of equity-based compensation or profit-sharing payment plans
  - **Indirect capital gains**
    - Taxation of capital gains earned on indirect transfers abroad (even if not “artificial”) of assets located in Brazil
  - **Intangible amortization**
    - Fixed term for the amortization of intangible assets at 20 years in general
  - **Actual profit method**
    - Mandatory application of the actual profit method for entities deriving more than 50% of their gross revenue from royalties; certain real estate activity; copyrights
### Base broadening

<table>
<thead>
<tr>
<th>INE</th>
<th>Goodwill amortization</th>
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| - Non-deductibility of the INE  
- Extinction of the INE | - Elimination goodwill deductions for acquisitions of equity interests | - Non-deductibility of equity-based compensation or profit-sharing payment plans |

<table>
<thead>
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<td>- Taxation of capital gains earned on indirect transfers abroad (even if not “artificial”) of assets located in Brazil</td>
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<td>- Mandatory application of the actual-profit method for entities deriving more than 50% of their gross revenue from royalties; certain real estate activity; copyrights</td>
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Proposed CIT/WHT system

Since 1995 - unique integration model
• Taxation concentrated at the corporate level
• Exempt dividend WHT

Proposed shift to global standard
• Reduced corporate income taxation
• WHT on dividends

Unbalanced result
• Increase of tax burden on fully repatriated earnings
• Potential shift of capital structures

Lack of transition rule
• Profits taxed at 34% may be subject to WHT upon approval of the proposal

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<thead>
<tr>
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<th>Current system</th>
<th>Original proposal</th>
<th>Current proposal</th>
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<tbody>
<tr>
<td>WHT</td>
<td>0%</td>
<td>20%</td>
<td>15%</td>
</tr>
<tr>
<td>IRPJ/CSLL</td>
<td>25% + 9%</td>
<td>20% + 9%</td>
<td>18% + 8%</td>
</tr>
</tbody>
</table>
CIT system - original proposal

Rules on profit distribution

Disguised Distribution
- Strengthened rules on disguised distribution of profits

In-kind distribution
- In-kind distribution at FMV
- Positive difference to tax cost taxed as capital gain by the distributing entity

Profits of branches
- Profits of branches, offices, agencies or representations of non-resident entities will be deemed distributed on an yearly basis (and subject to 15% WHT)

Distributions to tax havens
- Increased rate of 30% for beneficiaries in “tax havens” or subject to a “privileged tax regime”

Economic double taxation I
- WHT levied on distributions received by an entity may be compensated against the WHT levied on that entity’s own distributions
CIT system - original current proposal

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**Economic double taxation I**
- WHT levied on distributions received by an entity may be compensated against the WHT levied on that entity’s own distributions

**Economic double taxation II**
- No WHT on distributions to entities resident in Brazil that (i) hold control or are under common control or (ii) hold at least 10% interest
CIT system - original proposal

Reorgs and capital transactions

Capitalization
- Profit capitalization: exempt and received at 0 cost
- Levy of WHT in case of capital reduction 5 years prior or after

Capital reduction
- Capital reductions at the highest between tax cost and FMV
- Difference between tax cost and FMV taxed as capital gains

Capital contribution to non-res
- Capital contributions to non-resident entities at FMV
- Difference between tax cost and FMV taxed as capital gains
## Reorgs and capital transactions

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### Domestic reorg
- Capital reductions at cost for reorganization within Brazilian groups
Tax treaties
TP
The structural changes of the proposed income tax reform would shift some of the treaty features that are most relevant for investors:

- Article 10: reduced rate may vary depending on the treaty - 15% or 10%
- Tax sparing clauses
- Taxation of services
- Relevance of non-discrimination clauses
  - Recent Volvo case

Renegotiations could include new considerations in the interplay between tax treaties and the Brazilian full inclusion system:

- Exemption clauses in certain tax treaties
- Substance requirement for treaty benefits leading to increased, protracted litigation
Transfer Pricing

OECD/RFB TP Project

Brazil’s proposed accession to the OECD requires the convergence of TP rules

- Arm’s length principle
- Treaty model 9(1) + 9(2), MAP
- TP for intangibles (including non-deductibility rules)
- Sectoral APAs vs. safe harbors
5 Discussions
What does this mean for your business?

**Timing and transition**
- Earliest possible effective date
- Transition considerations
  - Profits taxed at 34%
  - Financing structure and debt bias
  - Ability to reorganize internationally

**Challenges of the new system**
- Disguised distribution / in-kind distribution
- Reinvestment / lock-in
- Tax treaty and substance

**Outstanding challenges**
- CFC and TP rules in Brazil
Thank you for joining

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