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NEWSLETTER / MARCH 2016

BRAZIL: CONTROVERSIES RELATED TO THE NEW PAYMENT METHOD FOR TAX ON INTER-STATE SALES TO END CONSUMERS ¹

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Júlio de Oliveira and Fernando Telles da Silva of Machado Associados examine the controversies arising from the implementation of Constitutional Amendment 87/15 (CA 87/15), the new ICMS payment method on inter-state sales to end consumers.

1. As described in an article dated July 1 2015, CA 87/15 introduced new collection rules on inter-state sales to end consumers, non-taxpayers of the state-level VAT (ICMS).
2. The new rule sets forth that, when inter-state sales are intended for an end consumer that is a non-taxpayer of ICMS, the ICMS due on the transaction will be paid to both states involved in the transaction – the states of origin and destination. Before CA 87/15, when the inter-state sales were intended for an end consumer (non-taxpayer), the ICMS was paid in full to the origin state.
3. Considering the new rule, such inter-state sales will be subject to an inter-state ICMS tax rate (4%, 7% or 12%, depending on the nature of the transaction) plus the differential tax rate between the ICMS tax rate of the destination state and the inter-state rate (the DIFAL). While the ICMS derived from the interstate rate is paid to the state of origin, the DIFAL is due to the state of destination (CA 87/15 establishes that the DIFAL will be divided between the states of origin and destination, up to 2018; from 2019 henceforth, the DIFAL will be due in full to the state of destination).
4. The new payment rule aims to balance the division of ICMS revenues between Brazilian states. Its original purpose was to allow all states to obtain a portion of the ICMS generated from e-commerce, because most of the ICMS derived from these transactions was bound predominantly for São Paulo and Rio de Janeiro, where most online businesses are established. Nevertheless, CA 87/15 did not distinguish between regular or e-commerce sales, enforcing the new rules regardless of the nature of the sales process.

¹ This article was first published by **International Tax Review** in March 2016 on www.internationaltaxreview.com

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5. In view of the above, the practical application of CA 87/15 has brought some controversial issues, such as:

- **The difficulty to define the concept of intra-state transaction**, or, in other words, what should be the criterion to define which sales will be characterised as performed within the state and thus not subject to the CA 87/15 rule.

6. São Paulo and Rio de Janeiro already signalled that, if the sale and delivery of the goods (act of *traditio*) occurs within the state, the transaction is deemed an intra-state transaction, regardless of the fact that the end consumer is domiciled in another state. Conversely, the Federal District (jurisdiction equivalent to a state) has defined that a sale should be deemed an inter-state sale solely based on the domicile of the end consumer, irrespective of the place where the transfer of property has occurred.

7. Therefore, if a consensus criterion is not reached between states or defined at the federal level, we foresee a new chapter in the ‘tax war’ between Brazilian states, whereby each state may try to impose its concept by using physical cross-state tax barriers.

- **The possibility of companies accumulating ICMS credits on inter-state sales to non-taxpayer end consumer**, as the ICMS credits generated by the inbound shipments can only be offset with the ICMS debits determined by the inter-state tax rate, as set forth in Clause 3 of ICMS Agreement 93/15.

8. Before ICMS Agreement 93/15 was enacted, the shipping companies were entitled to offset the ICMS credits with the full amount of ICMS debit on inter-state sales to a non-taxpayer end consumer. Based on the restriction imposed by Clause 3 of ICMS Agreement 93/15, companies may, in practice, face an accumulation of ICMS credits.

9. The accumulation of ICMS credits may be an issue, as each state has its own rules to allow its use. In general, companies face time-consuming procedures to recover said credits, leading to a balance sheet with considerable pending long-term assets (recoverable ICMS).

10. In conclusion, although the implementation of CA 87/15 should be neutral to the taxpayers (as its purpose was to solely redirect ICMS revenues to the consumer states), in practice, it tends to lead to further discussions between states, and maltreats the real-economy actors, which are the taxpayers.

São Paulo, March 2016



MACHADO ASSOCIADOS INFORMS:

- Machado Associados has advised CCR S.A. regarding the sale of its ownership at STP, operator of automated toll and parking collection system in Brazil and holder of trademark Sem Parar, to North-American company FleetCor. The total transactions amount is approximately R\$ 4 billion.
- For the fifth consecutive year, Machado Associados is recognized as a Leading Transactional Firm in Brazil by International Tax Review, included in the ranking's first tier of the respected British publication, of the Euromoney Group. The search to define the ranking is conducted with executives and lawyers of multinational companies in approximately 50 countries; the major firms operating in corporate transactions were chosen.
- With a focus on legal issues in Latin America, Latin Lawyer released its Latin Lawyer 250 directory (2016), which brings Machado Associados once more as one of the most recognized law firms in the region, according to a survey conducted and the feedback received from clients. The Tax Litigation area received special mention due to its high success rate in trials.
- *Fabio Medeiros*, partner of the Labor and Labor Taxation area, has endorsed a manifesto together with labor relations specialists in defense of social protection with economic development. The manifesto was released after an interview by Minister Ives Gandra da Silva Martins, new President of the Superior Labor Court (TST), to newspaper O Globo, according to whom the "Labor Justice remains very patronizing".

This legal letter contains information and general comments on the matter. In specific cases, it is advisable to rely on proper legal assistance before adopting any concrete actions relating to the matters dealt with herein.