Brazil's proposal to define the 'export of services'

December 10 2018

Brazil's Federal Revenue Services issued a Normative Opinion to define the "export of services" for tax exemption purposes.

One of the principles of public international law is the territorial (or territoriality) principle, a notion under which a state may exercise jurisdiction only within its territory. According to this principle, taxes can only be levied on economic facts carried out within the territorial jurisdiction of a sovereign tax authority or country.

When it comes to the cross-border sale of services, states usually adopt the destination-based taxation rule, which sees imports taxed on the destination, and where exports are exempt from being taxed at their origin. This is the Brazilian case, where tax legislation provides for the exemption of different taxes levied on services. In general, the service provision by a Brazilian company is subject to:

- Social security contributions (PIS/COFINS) on the relevant revenues at a combined rate of 9.25%;
- Municipal service tax (ISS) at rates varying from 2-5%, depending on the service and the municipality entitled to charge the tax; and
- A state Value Added Tax (VAT) levied on the sales and provision of interstate and inter-municipal transportation and communication services (ICMS), at a rate that may vary according to the state entitled to charge the tax and to the service provided (ranging from 4- 35%).

However, the provision of services to a foreign company or individual is exempt from the aforementioned taxes if the requirements set forth by the tax legislation – which characterises the transaction as an export of services – are complied with. With regards to the PIS/COFINS (levied on revenues), the following conditions must be met:

- The services must be engaged by and rendered to a party resident, or be domiciled abroad; and
- There must be an inflow of funds into Brazil or the funds have to be kept in a bank account abroad, whose holder must be the Brazilian company that rendered the services (subject to certain limits established by the National Monetary Council).

According to Article 2 of Supplementary Law 116/03, exports of services are not subject to the levy of ISS – except when the service is performed in Brazil and its outcome is verified in its territory – even if the payment for the service is made by a foreign party.

Regarding the ICMS, in Article 155, paragraph 2, item X of the Federal Constitution states that the services performed to a foreign receiver are exempt from the tax. There are no legal requirements for the characterisation of the export of service.

In addition to the taxes mentioned, there are other legal provisions regarding the exemption of taxes related to the export of services. These include:

- A zero tax rate on foreign currency exchange transactions (IOF-Exchange) levied on the exchange transactions related to the export of services; and
- A zero rate income withholding tax on interest and commissions on credits obtained abroad and destined to the financing of exports of services.

In this scenario, the Brazilian Federal Revenue Services (FRS) proposes a national definition for the export of services, stating that there is neither a consensus in the legal doctrine and case law nor a legal meaning of "export of service". Normative Opinion 1 was issued on October 2018, bringing forward a definition on the export of services for tax exemption purposes.

According to the FRS, the export of services is characterised as a situation whereby the provider operates from the domestic market with instruments in its national territory to meet a demand to be satisfied in a market abroad that is in favour of a receiver who acts in that other market. There are exceptions for the existence of a different legal definition applicable to the specific case, and in cases where the law states otherwise.

This definition is based on elements that must be linked to the foreign territory in order for the export to be recognised for tax exemption purposes. These elements chosen by the FRS – known as fiscal attachments – are the territory where: (i) the service provision begins, (ii) the service outcome is produced, (iii) the object of the rendering of the services is used, and (iv) the receiver acts.

Although the FRS's intention is praiseworthy, the proposed definition of 'export of services' is based on fiscal attachments that are not provided by in the tax legislation. Regardless of what Normative Opinion 01/18 states, there is an official and international definition of 'export of services', which is set forth by Article I of the General Agreement on Trade in Services (GATS), which considers the trade of services as 'the supply of a service':

- From the territory of one member to the territory of any other member;
- In the territory of one member to the service consumer of any other member;
- By a service supplier of one member, by means of commercial presence in the territory of any other member; and
- By a service supplier of one member, by means of presence of individuals of a member in the territory of any other member.

According to this agreement, the 'export of services' is characterised when there is a transposition of people or the service itself. There is no mention of objects related to the services or production outcome as the relevant fiscal attachment is to be considered for the characterisation of export of service.

The legislation regulating each tax provides the requirements for the characterisation of export of services and exemptions. The FRS is not entitled to propose a definition of 'export of services' for taxes such as ISS and ICMS, which are, respectively, under municipal and state jurisdiction.

Normative Opinion 01/18 could have solved some controversies related to the export of service by:

- Clarifying the meaning of service outcome mentioned in Article 2 of Supplementary Law 116/03: whether it is the conclusion of the service provi-

sion, or the benefit brought to and enjoyed by the engaging party; and
- Defining who is the receiver of the service, which could either mean the 'engaging party' or the 'beneficiary' of the service.

These doubts remain, and instead of solving them, the FRS has brought new requirements for the characterisation of 'export of services' that have no legal grounds, and that are ultimately different to and more complex than the definition provided by the GATS.

As a result, we can say that Normative Opinion 01/18 presents a purely academic definition of 'export of services', one that may not produce concrete effects in the application of the tax legislation to exempt the exports of services, mainly because the Brazilian legislation already provides specific definition for each tax.

This article was written by Carolina Romanini Miguel (cmiguel@machadoassociados.com.br) of Machado Associados.