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|----------------------------------|--------------------------------|--------------------------------|--------------------------------|
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| JULIA RODRIGUES ANDRADE | ISABELLA G. PEREIRA BARRETO | | |



SÃO PAULO
 AV. BRIGADEIRO FARIA LIMA, 1656
 11º ANDAR (01451-918)
 SÃO PAULO - SP - BRASIL
 T. + 55 11 3819 4855

BRASÍLIA
 COMPLEXO BRASIL XXI - BLOCO A
 SHS QUADRA 06 CONJ. 6 - SALA 808
 ASA SUL (70316-100)
 BRASÍLIA - DF - BRASIL
 T. + 55 61 3039 8081

RIO DE JANEIRO
 PRAÇA FLORIANO, 19 - 4º ANDAR
 CENTRO (20031-050)
 RIO DE JANEIRO - RJ - BRASIL
 T. + 55 21 3550-3000

CONSULTOR
 NELIO B. WEISS

www.machadoassociados.com.br

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RECENT CHANGES IN STATES' TAX BENEFITS RELATED TO THE ICMS IN BRAZIL ¹

Júlio M. de Oliveira and Rogério Gaspari Coelho²

Supplementary Law 160/2017, recently enacted, addresses the so-called tax war between the Brazilian states.

1. The Brazilian Constitution established that a supplementary law should define how state-VAT (ICMS) incentives would be granted, as Brazil has 26 states plus the federal district with competence to collect this state tax.
2. A supplementary law, in the Brazilian system, is a law reserved to minutely discipline certain issues set forth in the Constitution and must be approved by a 2/3 majority of both legislative houses – the Senate and the House of Representatives.
3. Therefore, Supplementary Law 24/1975 established that all tax exemptions, benefits, remissions, amnesties and tax/financial incentives should be approved by an organ called the National Council of Tax Policy (CONFAZ), composed of the 27 state treasury secretaries and the finance minister, representing the federal union.
4. The quorum for the CONFAZ meetings to take place is the majority of its members, and its decisions regarding tax favours must be taken unanimously. The CONFAZ decisions authorising states to grant benefits are, then, formalised by means of a covenant, which must be ratified by the respective state's legislative branch.
5. In spite of the provision establishing that tax favours granted without respecting this procedure should be deemed null and void, and that the relevant tax not collected is payable,

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² Júlio M. de Oliveira and Rogério Gaspari Coelho are members of the Indirect Tax and Customs area of **Machado Associados**

many states granted several tax incentives since the enactment of Supplementary Law 24/1975, without complying with its rules.

6. That was the beginning of the tax war between the states. Eager to attract companies and investments, the states have been granting illegal tax benefits for years. Moreover, given the competition between them, not only those unlawful tax benefits were conceded, but the states also started to deny the booking of credits related to the noncumulative taxation in interstate transactions whose previous transaction was favoured with tax incentives not approved by the CONFAZ. Furthermore, many states try to collect their share of the interstate rate using the total amount of the transaction as a taxable basis, disregarding tax benefits that did not respect the legal requirement of being approved by the CONFAZ.

7. Thus, neither the competition between the states was healthy for the overall economy, nor did taxpayers feel completely safe to perform their investments, given that, if the tax benefits that favoured them were deemed unconstitutional, they could have tax assessment notices drawn up against them aiming to collect the tax not paid while using the benefit unduly granted.

8. The Brazilian Federal Supreme Court (STF) has several precedent rulings that determined unilaterally granted tax benefits by states to be unconstitutional.

9. Supplementary Law 160/2017 was passed to overcome this scenario of uncertainty. Its main provisions are as follows:

- States should list all the normative acts granting tax benefits and register them with the CONFAZ;
- By means of a covenant executed at CONFAZ, as set forth by Supplementary Law 24/1975, the states and federal district can remit tax credits related to tax benefits unilaterally granted, and institute again such tax benefits;
- The approval of the covenant will require a reduced quorum: 2/3 of the states, being at least 1/3 of each region of the five regions of Brazil. That should happen until the beginning of February 2018;
- From then on, the term of each incentive may be extended by governors for up to 15 years for most economic activities, with reduced deadlines of eight, five, three and one year for other activities listed in the covenant;
- There is also the possibility for governors to grant incentives to other taxpayers located in their states, extending the existing ones and under the same terms;
- A state might also adhere to the same tax benefits granted by other states of the same Brazilian region;

- Supplementary Law 160/2017 gives retroactive effect to those provisions, forbidding the collection of past tax credits related to tax benefits and preventing liabilities connected to budgetary laws. Nevertheless, it does not grant a right to offset, to plea for a refund, or to book tax credits; and
- The granting of other tax benefits – that are not consistent with Supplementary Law 24/1975 – will subject the states to the penalties provided for in the Fiscal Responsibility Law, such as the prohibition of receiving voluntary transfers, as well as credit restrictions.

10. In conclusion, once the referred covenant is approved, past tax liabilities connected to the lawfulness of the tax benefits will be settled. If, on the one hand, the discrepancies between the states' tax incentives will linger for up to 15 years, on the other hand companies can be sure that past situations will not trigger tax assessment notices drawn up by different states, and can plan their future investments in the short and medium term, from a tax viewpoint.

São Paulo, September 2017