

# Withholding of municipal service tax controversy settled by Brazilian Supreme Court



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*Mauri Bornia and Gabriel Caldiron Rezende of Machado Associados discuss the decision of the Brazilian Federal Supreme Court, which deemed the withholding of the municipal service tax unconstitutional in certain cases.*

The municipal service tax (ISS) has always been the subject of severe controversies related to the municipality to where it should be paid.

This is because, as a rule, the ISS is payable to the municipality where the establishment providing the service is located, regardless of where the service receiver is located. Based on this, several municipalities granted ISS tax benefits, which resulted in a lower tax burden, to attract service providers.

Seeking tax reduction, but without setting up a new establishment, it became common for malicious companies to simulate their existence in municipalities with lower ISS, giving rise to several controversies when a party engaged a service provider located in another municipality.

Although the law in force provides for severe measures against the granting of ISS tax benefits, aimed at maintaining a national ISS tax burden between 2% and 5%, municipalities still view service providers from other municipalities with some scepticism, especially regarding their actual existence in another municipalities.

To avoid tax frauds, the municipality of São Paulo created the registration of service providers from other municipalities (CPOM), which required service providers of certain services established in other municipalities to enroll in such registry.

If these providers failed to register, the law established that the service receiver in São Paulo should withhold and pay the ISS in favour of the city of São Paulo, even if the tax was due originally to the municipalities where the providers were established. Failure to withhold and pay the ISS would subject the service receiver to penalties.

As a result, several service providers ended up suffering double ISS taxation – one from the municipality where they were established, and again by São Paulo, where the service receiver was located.

Inspired by São Paulo, several other municipalities established similar obligations, and the failure to comply with this rule would subject the company to withhold the ISS.

This obligation was taken to the courts and, after several years of discussion, the Brazilian Federal Supreme Court (STF) decided in Extraordinary Appeal 1167509 that it is unconstitutional for a legal rule to establish that a service provider not established in that municipality must register before a municipal administration body, and impose on the service receiver the withholding of the ISS when such ancillary obligation is not complied with.

Although the decision evaluated the obligation imposed by the city of São Paulo, its range is broad and applies to any municipal law that imposes the registration of the same type and ISS withholding.

Despite this decision, on March 23 2021, the Brazilian Association of Capital Cities' Finance Departments (ABRASF) filed a motion for clarification aiming at discussing, among other matters, when the effects of the decision will become enforceable.

ABRASF intends that the decision becomes enforceable only for future events, as of the publication of the decision, which, for practical effects, would legitimise ISS charges made in the past, making the withholding unconstitutional only for future facts.

On April 30 2021, the STF concluded the judgment of the case, denying the motion for clarification. Based on this, service providers could take measures to recover undue withholdings and service receivers may challenge ISS withholdings charges.

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