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Government reduces excise tax rate

Machado Associados | Corporate Tax - Brazil



GABRIEL
CALDIRON
REZENDE

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The government has significantly reduced the excise tax (IPI) rate in an effort to aid economic recovery after the covid-19 pandemic and mitigate the negative effects of inflation and the potential adverse impacts of the Ukraine-Russia war. Decree No. 10979, which was published in the 25 February 2022 edition of the *Official Gazette*, has provided for an immediate 25% reduction in the IPI rate for most manufactured and imported products. However, this has proven controversial and raised several practical issues.

IPI rate reduction

The IPI is a federal value-added tax that is levied on sales of products by manufacturers and other entities considered equal to manufacturers by law, as well as on imports and subsequent resale of imported products. IPI rates vary depending on how essential a product is; they may be as low as zero or reach higher rates, such as 35% for motorcycles, 42% for perfumes and even 300% for cigarettes. As an excise tax, aside from increasing tax revenues, the IPI is used to promoting or discouraging the consumption of certain products.

Decree No. 10709/2022 has cut IPI rates by 25% for most products, which were previously set out in a list approved by Decree No. 8950/2016. Exceptions apply to passenger transport vehicles, to which an 18.5% reduction was granted, and to tobacco products, for which the rates have remained unchanged.

Practical issues and controversies

It is expected that the IPI cutback will increase consumption of products in the Brazilian market and stimulate the economy. Although the reduction aims to foster the local industry, the IPI reduction also decreases the tax burden on imported products.

Despite potential positive effects for the economy, it seems that the IPI rates reduction was issued in a rush and that consideration was not given to the new IPI rates list previously approved by Decree No. 10923 by the end of 2021, which will enter into force on 1 April 2022. Considering that this new list was not revoked or amended, and that it establishes higher rates than the current ones set by Decree No. 10709/2022, in practical terms, the IPI rate reduction at issue would only apply from 25 February 2022 to 31 March 2022.

The Brazilian Federal Revenue Service has announced that it is preparing a new decree to ensure that the IPI reduction provided by Decree 10979/2022 continues after 1 April 2022. No actual measure has yet been taken.

In addition to the uncertainty regarding the period to which reduced rates would apply, the immediate effect of the reduction has brought practical problems to taxpayers who were not prepared to calculate IPI and issue tax invoices at lower rates. The calculation of the IPI at higher rates in the days following the issuance of Decree No. 10979/2022 raised questions on the appropriate measures to correct the relevant procedures.

Further, there is also a discussion on whether the IPI rates reduction would jeopardise the benefits applicable to manufacturers located in the Free Trade Zone of Manaus (ZFM). In brief, products manufactured within the ZFM are exempt from IPI, provided certain conditions are met. In this scenario, Decree No. 10979/2022 resulted in an increase in the IPI rates for companies located in ZFM, which led the State of Amazonas to challenge the decree before the Federal Supreme Court. Currently, an exception for companies within the ZFM is under negotiation.

Comment

At present, it is uncertain how practical issues and controversies surrounding the IPI rates reduction will be settled, but new developments are expected soon. It is, therefore, important to closely follow the issue as more information becomes available.

For further information on this topic please contact [Gabriel Caldiron Rezende](#) at Machado Associados by telephone (+55 11 3819 4855) or email (gcr@machadoassociados.com.br). The Machado Associados website can be accessed at www.machadoassociados.com.br.