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The reform of Brazil's consumption tax system

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ABSTRACT

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Reforming Brazil's consumption tax system has long been acknowledged as a crucial policy priority, as the present fragmented system raises the costs of doing business, distorts production chains and obstructs inter-state trade. In late 2023, Brazil successfully passed and is currently implementing a major tax reform that will address the challenges related to the current complex system. Implementing a value added tax system in a federal country that shares the authority to levy VAT among the federal and subnational governments presents challenges. This paper analyses several aspects of these challenges and describes possible solutions, based on the policy experiences of other countries. It also discusses core design features of the new dual value added tax, its management and the transition towards the new regime.

Key words: Brazil, consumption tax, policy reforms, economics, business climate.

JEL Classification: D24, E62, H25, H71

RÉSUMÉ

La réforme du système fiscal brésilien sur la consommation

Une réforme du système brésilien de taxe sur la consommation est depuis longtemps reconnue comme une priorité politique cruciale, car le système fragmenté actuel augmente les coûts des entreprises, crée des distorsions dans les chaînes de production et entrave les échanges entre les différents états du Brésil. Fin 2023, le Brésil a adopté et met actuellement en œuvre une réforme fiscale majeure qui répondra aux défis liés à la complexité du système actuel. La mise en œuvre d'un système de taxe sur la valeur ajoutée dans un État fédéral où le pouvoir de perception de la TVA est partagé entre le gouvernement fédéral et les collectivités territoriales présente des défis. Cet article analyse plusieurs aspects de ces défis et décrit des solutions possibles, fondées sur l'expérience d'autres pays. Il aborde également les principales caractéristiques de la nouvelle taxe sur la valeur ajoutée duale, sa gestion et la transition vers ce nouveau régime.

Mots clé : Brésil, taxe de consommation, réformes, économie, climat des affaires.

Classification JEL: D24, E62, H25, H71

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The reform of Brazil's consumption tax system

A historic achievement

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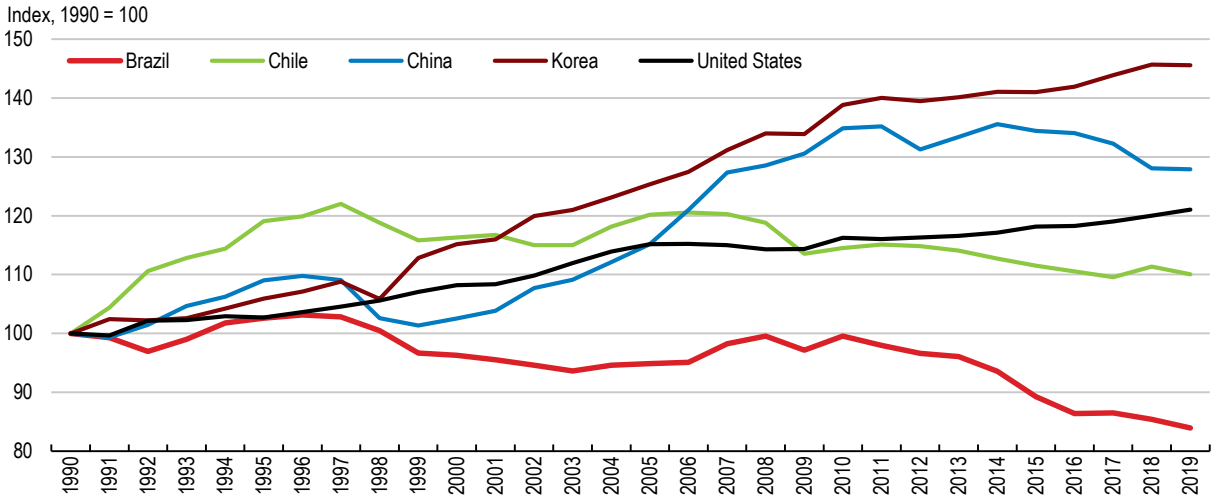
1. Introduction

Brazil has made remarkable economic progress over the last decades, but productivity growth has been stagnating or falling during most of that period (Figure 1). The likely reasons behind this weak productivity performance include longstanding structural policy challenges, one of which is a highly complex, fragmented and distortive system of consumption taxes.

Figure 1. Total factor productivity growth in Brazil lags behind other economies



Source: Penn World Table; and OECD calculations.

First, tax compliance costs are among the highest in the world, which is a result of the fragmented rules across different subnational jurisdictions[1]. Frequent litigation further adds to these costs. From a productivity perspective, costly compliance activities can be seen as a waste of economic resources, as they increase the implicit tax burden of individuals and businesses without increasing the revenues of the government.

Second, the incentives created by the current tax system distort economic decision-making and the allocation of resources. Finally, complex rules can provide tax planning opportunities for well-informed taxpayers, thus contributing to the persistence of income inequalities.

But taxes are also an area where Brazil has showcased its determination and ability to tackle structural challenges through reforms. On 20 December 2023, the Brazilian Congress adopted the long-awaited and much-needed reform of the country's notoriously complex consumption tax system. This historic reform seeks to modernise and fundamentally simplify the myriad of consumption taxes that are levied across three levels of Brazil's federal state, i.e. at the Federal level, 26 States, the Federal District and 5.570 Municipalities.

At the core of the reform is the introduction of an entirely new modern value added tax (VAT) system that will replace the five main consumption taxes that are currently applied at the Federal and sub-Federal levels. It will take the form of a dual VAT consisting of a Federal VAT (*Contribuição sobre Bens e Serviços* or CBS) and a State and Municipal VAT (*Imposto sobre Bens e Serviços* or IBS). They will be governed by common uniform rules. This unique reform carries great promise for a more competitive and investor-friendly economic environment in Brazil and for fairer and more transparent taxation of consumption.

Implementing a VAT system in a federal country that shares the authority to levy VAT among the federal and sub-federal (i.e. state and municipal) levels of government is known to be fraught with challenges. It requires reconciling the need for consistency and ease of compliance and administration, including in applying the VAT to economic activity that is carried out across sub-federal borders, with the authority for the various levels of the federal state to levy VAT as an autonomous revenue source while taking account of specific socio-economic needs and circumstances. This is a challenging task.

The examples of Canada[2] and India in particular have proven, however, that the successful introduction and operation of a federal VAT in a complex national context is possible. Both are federal states that share the authority to levy taxes on consumption between the federal and sub-federal levels – and both have successfully implemented a dual VAT model that applies at federal and sub-federal levels.

While the Canadian and Indian dual VAT models have undoubtedly served as a source of inspiration for the Brazilian dual VAT, the latter presents a number of unique and innovative features. This is also because in Brazil, unlike Canada and India, not only states but also municipalities have the jurisdiction to introduce a consumption tax, which means that during the reform process the needs of three different levels have to be reconciled rather than two.

This paper presents an overview of the core components of Brazil's consumption tax reform, focusing particularly on the design and future operation of the new dual VAT. It begins by recalling the main challenges for the introduction and the operation of a federal VAT that is intended to apply uniformly nationwide in a federal state where the right to levy VAT is shared across multiple levels of federal government (Section 2.). It then recalls the main drivers for Brazil's consumption tax reform and its main policy design features (Section 3). This section looks in particular at the policy design aspects that have

[1] World Bank (2021), *Subnational Doing Business in Brazil 2021: Comparing Business Regulation for Domestic Firms in 27 Brazilian Locations with 190 Other Economies*, World Bank, Washington, DC, USA, https://documents.worldbank.org/en/publication/documents-reports/documentdetail/149941636370484994, at p. 95.

[2] For the purposes of this paper, any reference to Canada's sales taxes as a dual VAT and its illustrative comparison with Brazil's dual VAT focuses exclusively on Canada's Goods and Services Tax/Harmonized Sales Tax (GST/HST) and the Quebec Sales Tax (QST), which have effectively been designed to operate as a dual VAT. It does not consider non-harmonized provincial sales taxes, unless stated otherwise.

been central to achieving consensus among all levels of federal government around a dual VAT that reconciles VAT-neutrality, consistency, simplicity and efficiency with each federal level's authority to levy VAT within its territory and to collect and administer it. This is followed by a closer look at the core technical design aspects of the dual VAT (Section 4) and the arrangements for the coordination of its management and administration (Section 5). These sections include short tables presenting a high-level comparison between the new Brazilian regime and the existing Canadian and Indian dual VATs, to illustrate the similarities and some of the unique features of Brazil's model. The final section (Section 6) presents the transitional rules for the introduction of Brazil's new regime.

2. The challenges of introducing a VAT in a federal state with shared VAT-jurisdiction

While this paper is not intended to present an in-depth analysis of the policy and design choices and challenges of a federal VAT, this section outlines some of the main aspects that need to be considered and addressed when introducing a VAT that is intended to apply uniformly and nationwide in a federal state that shares the right to tax consumption across multiple levels of federal government. This is intended only to serve as background for the description of Brazil's consumption tax reform in this paper, particularly where it looks at the features of the design and administration of Brazil's new dual VAT that have been adopted to address the challenges of achieving consensus on an efficient and effective system.

Political consensus. Introducing a VAT in a federal state that shares VAT jurisdiction among federal and sub-federal levels, generally requires political consensus across all levels of federal government on a broad range of aspects of VAT design and administration. Critical aspects include the allocation of the right to collect VAT on transactions that cross sub-federal boundaries; the right to define the tax base and rate(s); the granting of input-tax credits across federal levels and entities; the organization and authority to collect the tax and to administer it; the distribution of revenues, incl. compensation for the sub-federal entities that stand to lose revenue from the reform. These challenges can be exacerbated in federal states with uneven levels of social and economic development across different parts of the country, where policymakers may seek to use VAT policy to achieve equity objectives and/or to stimulate economic activity, with little or no incentive to consider a coordinated approach across federal state levels.

Allocating taxing rights in accordance with the destination principle. The principle of "taxation at destination" is the international standard for applying VAT to cross-border transactions: where a supplier and its customer are located in different jurisdictions, it is generally the jurisdiction where the customer is located that has the right to tax that supply (subject to exceptions). This core feature of VAT design gives this tax its desirable characteristic of neutrality in cross-border trade. No VAT is levied on exported products and imports are taxed at the same rate as domestic products in the importing jurisdiction. Exporting businesses are thus not disadvantaged by high rates in the jurisdiction where they are located - and there is no advantage for customers to buy from a supplier located in a low or no tax jurisdiction. In a federal state with VAT jurisdiction for sub-federal entities, the destination principle should in principle not only apply to international trade but also to transactions that cross internal federal borders. Levying VAT at the place of destination, rather than where their suppliers are located, prevents internal tax competition whereby sub-federal governments use preferential VAT regimes to protect domestic industries and investment, thus distorting production and investment decisions. Consensus around the destination-based application of the VAT is one of the main challenges for the adoption of a federal VAT, particularly where it replaces taxes on consumption and/or production that were levied on suppliers rather than consumers (i.e. that were origin-based and often cumulative). A shift to a destination-based VAT removes the possibility for sub-federal levels to use these taxes as a lever to protect or stimulate local economic activity – but also to use it as an instrument to pursue equity objectives. All this adds to the considerable revenue consequences that such a shift can have, as it moves taxing rights from production to consumption jurisdictions, explaining the complexity and challenging nature of this component of federal VAT design or reform.

Autonomy vs. uniformity. Sub-federal entities might wish to decide autonomously on core design components of the VAT that applies within their territory, incl. the tax base and rate(s), thresholds, exemptions and specific regimes – for instance to pursue equity objectives. They might also wish to remain in charge of collecting and administering their respective VATs. Efficiency and ease of compliance and administration, however, call for a broad-based VAT with limited rate differentiation that is applied uniformly or at least in a coordinated manner across the various federal levels. To reach political consensus on a workable solution that provides an acceptable balance between the conflicting aims of autonomy and uniformity, a high level of trust and cooperation between federal and sub-federal levels is required, not only when designing and implementing the federal VAT but also when administering it. The less harmonization and coordination, the greater the risk of economic distortion, inefficiency and administrative complexity – both for businesses and tax authorities.

Revenue sharing. As highlighted above, the revenue impact of the introduction of a federal VAT for the sub-federal levels can be significant. Managing this impact requires consensus around robust solutions for the collection and distribution of VAT revenues that are accepted as fair, efficient and transparent by all levels of federal government. This is likely to include mechanisms to compensate for revenue losses following a shift from origin- to destination-based taxation and/or to take account of disparities in social and economic development across regions.

Legal and constitutional issues. Where the division of taxing powers between federal and sub-federal levels of government is enshrined in the constitution, the implementation of a federal VAT in a federal state with shared VAT jurisdiction is likely to require constitutional change. Constitutional reform typically requires special procedures and supermajorities, calling for broad and deep consensus across the political spectrum, across economic and social interest groups and across society at large.

3. The path towards reform and its core components

3.1. The need for reform

Reforming the Brazilian consumption tax system has long been acknowledged as a crucial component of the country's development and economic agenda. While Brazil is among the world's largest economies,[3] its myriad of taxes on consumption and production that have been operating across three levels of federal government since the 1960s have been considered as among the most distortive in the world.[4] Brazil's consumption tax regime generates among the highest levels of compliance costs globally, and tax litigation in Brazil is substantial.[5] The poor and outdated design of the existing regime and its growing complexity and fragmentation were found to have a significant adverse impact on productivity, investment and competitiveness and thus to severely stifle Brazilian economic growth,[6] calling for reform towards a more

[3] World Bank (2022), *Gross domestic product 2022*, World Bank, Washington, DC, USA, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?most_recent_value_desc=true.

[4] According to the World Economic Forum (2019), *The Global Competitiveness Report 2019*, Geneva, Switzerland, https://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf, at p. 112, Brazil ranks 136th out of 141 countries in terms of distortive effect of taxes and subsidies on competition.

[5] World Bank (2021), *Subnational Doing Business in Brazil 2021: Comparing Business Regulation for Domestic Firms in 27 Brazilian Locations with 190 Other Economies*, World Bank, Washington, DC, USA, https://documents.worldbank.org/en/publication/documents-reports/documentdetail/149941636370484994, at p. 95.

[6] OECD (2023), *Redesigning Brazil's consumption taxes to strengthen growth and equity*, Policy Brief, OECD Publishing, Paris, https://search.oecd.org/economy/surveys/publicationsdocuments/policybriefs/ ; OECD (2023), *OECD Economic Surveys: Brazil 2023*, OECD Publishing, Paris, https://doi.org/10.1787/a2d6acac-en.

coherent, modern, efficient consumption tax regime that minimizes risks of economic distortion while enhancing fairness and transparency.

These inefficiencies of Brazil's consumption tax system essentially result from three main factors:

- the fragmentation of the consumption tax system as a consequence of fiscal federalism across three levels of federal government: Federal, States and Municipalities;
- the origin-based design of most of these taxes, including in inter-State and inter-Municipal trade, which leads to the use of sub-federal consumption taxes as a tool for sub-federal protectionism and tax competition;
- the "cumulative" design and/or operation of these taxes due to the absence, or complexity, of regimes for businesses to recover the consumption taxes incurred on their business inputs ("input-tax credits"). Combined with origin-based taxation, this leads to severe distortions of production and investment decisions, as businesses adjust their business structure to avoid irrecoverable taxes on their inputs, and to inefficiency and loss of competitiveness from irrecoverable taxes on business inputs cascading through the value chain and increasing the cost of domestic production.

The balance of this sub-section discusses these core drivers of the inefficiency of Brazil's consumption tax regime in some further detail.

Fragmented tax system. Brazil's current consumption tax system consists of four main distinct categories of taxes,[7] distributed across three levels of government:

Two at the Federal level:

- IPI: *(Imposto sobre Produtos Industrializados)*: a Federal tax on industrialized products levied at different rates depending on the type of product.
- PIS *(Programa de Integração Social)* and COFINS *(Contribuição para o Financiamento da Seguridade Social)*: Federal social contributions levied on companies' gross revenues that are subject to the same rules. They can be cumulative or non-cumulative, depending on the types of business and revenue.

One at the State level – 26 States + the Federal District:

- ICMS *(Imposto sobre Circulação de Mercadorias e Serviços)*: a State-level VAT on the sale of goods, electric power, interstate and intermunicipal transportation and communications. Each State has its own ICMS legislation with widely varying rates and rules.

One at the Municipal level – 5.570 Municipalities:

- ISS *(Imposto sobre Serviços de Qualquer Natureza)*: a Municipal service tax levied on a wide range of services. Each Municipality sets its own ISS rates[8] and regulations.

[7] The current Brazilian tax system encompasses various types of levies, which can be classified as follows: (i) taxes (*impostos*); (ii) user fees (*taxas*); (iii) public improvement contributions (*contribuições de melhoria*); (iv) compulsory loans (*empréstimos compulsórios*); (v) social contributions (*contribuições sociais*); (vi) market intervention contributions (*contribuições de intervenção sobre o domínio econômico); and (vii)* professional contributions (*contribuições de interesse de categorias profissionais*). While the first three types of levies can be instituted by all three levels of government (the federal government, states, and municipalities), the last four fall under the exclusive competence of the federal government, with certain exceptions. Articles 145-149 of the Brazilian Federal Constitution of 1988.

[8] Municipalities have the autonomy to set ISS rates within a minimum of 2% and a maximum of 5%.

Each of these taxes applies to different and often overlapping tax bases. For example, the sale of an industrialized product by a manufacturer can be subject to ICMS, IPI, PIS and Cofins, while the provision of a service can be subject to ISS, PIS and Cofins. These fragmented taxes are often cumulative, by design or as a consequence of ineffective input-tax credit mechanisms and governed by a multitude of distinct rules9 that are not harmonized across sub-federal jurisdictions.[10] Added to this is the multiplicity of rates, exemptions and special regimes notably to stimulate specific economic sectors. The result is an exceptionally complex regime that is highly distortive, with business structures and investment and production decisions being dictated by consumption tax consideration, notably to minimize the cost of irrecoverable taxes on their inputs, rather than by economic efficiency;[11] with intransparent and unpredictable tax burdens embedded in product prices depending on the structure of the production and distribution; and with exceptionally high costs of compliance, administration and legal uncertainty.

Origin-based taxation. Unlike modern VATs, which operate on the basis of taxation at destination,[12] Brazil's sub-federal consumption taxes apply a mixture of origin and destination principles to inter-State commerce and predominantly the origin principle to the inter-Municipal provision of services. The largely origin-based nature of these taxes has, unsurprisingly, led to their use as a tool for tax competition ("fiscal war") among States and Municipalities,[13] to protect and stimulate local activity and to attract investment including through the adoption of an extensive range of exemptions and special regimes. While this design feature of Brazil's consumption taxes is a core driver of the distortions outlined above, reforming it was also among the most contentious aspects of reform efforts, as the move towards a destination-based VAT would all but end States' and Municipalities' capacity to use the tax as a tool for tax competition and to generate consumption tax revenue from products that are produced in their territory but that are consumed elsewhere.

Cascading consumption taxes. While some of Brazil's consumption taxes are cumulatively levied throughout the production chain by design,[14] others were designed to be mostly non-cumulative.[15] In practice, the availability of input-tax credits under the supposedly non-cumulative regimes is frequently

[9] As highlighted by Pestana, M. (2023), "The Tax Reform: necessary change, its characteristics and the calibration of the standard rate", *Fiscal Follow-Up Report No. 79*, Independent Fiscal Institution, at p. 16: "A study carried out by the IBPT [Brazilian Institute of Planning and Taxation] in September 2022 showed that since the Federal Constitution was enacted in 1988, 466,561 tax rules have been enacted. There are 2.26 regulations per hour on working days issued by the various levels of government." *See* IBPT (2022), *Quantidade de Normas Editadas no Brasil: 34 Anos da Constituição Federal de 1988*, available at: https://ibpt.com.br/quantidade-de-normas-editadas-no-brasil-34-anos-da-constituicao-federal-de-1988/.

[10] For example, the regulations governing the ICMS are not uniform across the states, as the states possess the autonomy to establish their own tax code, tax rates, exemptions, and special regimes. As a result, companies operating nationwide are required to comply with 27 individual tax codes.

[11] As explained in OECD (2023), *Redesigning Brazil's consumption taxes to strengthen growth and equity*, Policy Brief, OECD Publishing, Paris, https://www.gov.br/fazenda/pt-br/acesso-a-informacao/acoes-e-programas/reforma-tributaria/estudos/brazil-tax-policy-brief-2023-final.pdf , at p. 3.

[12] OECD (2017), *International VAT/GST Guidelines*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264271401-en, at pp. 15-17.

[13] On the Brazilian fiscal war, *see* de Mello, L. (2007), "The Brazilian 'Tax War': The Case of Value-Added Tax Competition among the States", *OECD Economics Department Working Papers*, No. 544, OECD Publishing, Paris, https://doi.org/10.1787/286220576442. Also, Guardia, E. R. and D. Sonder (2004), "Fiscal Adjustment and Federalism in Brazil", *IMF/NIPFP Conference on Fiscal Policy in India*, IMF, at. pp. 12-14.

[14] As is the case with the ISS (entirely) and PIS and Cofins (partially, on certain activities or companies).

[15] ICMS (entirely) and PIS and Cofins (partially, on certain activities or companies).

limited and subject to complex definitions and procedures that undermine their non-cumulative nature.[16] These limitations give rise to tax cascading, whereby not all the input taxes paid throughout the production and distribution process are effectively recovered by businesses, breaching the economically desirable feature of a well-designed VAT as a tax on final household consumption that does not impose a tax burden on businesses as collectors of the tax.[17] No input-tax credits can be claimed across these tax types, even where they are levied on the same transaction and may in certain instances be included in each other's tax base. Obtaining a tax credit for tax incurred on inter-State transactions is even more cumbersome than for taxes incurred on intra-State trade and businesses often face long delays or refusals. Added to the cost of irrecoverable taxes on economic activity are the considerable costs of compliance and excessive litigation. This ultimately raises the cost of production for Brazilian firms and consumers and a significant loss of competitiveness compared to imported products produced by foreign competitors that are not burdened by the cost of irrecoverable VAT on their exports to Brazil. The complexity of the system also discourages foreign investment.

These challenges were not unique to Brazil: other federal states with jurisdiction for sub-federal levels to levy consumption taxes, have faced very similar issues as is illustrated for Canada and India in the table below. Before the implementation of its Goods and Services Tax (GST) in 2017, India's consumption system was fragmented across numerous Central and State taxes, leading to similar difficulties from insufficient coordination as those outlined above. While Canada's tax system was not as fragmented as Brazil's, the differences in the design and operation of its federal Manufacturers' Sales Tax and the provincial sales taxes before the introduction of its Goods and Services Tax/Harmonized Sales Tax (GST/HST) notably created obstacles for inter-provincial and international trade. India's consumption taxes and the Manufacturers' Sales Tax in Canada were also primarily origin-based and often cumulative.[18] It comes as no surprise that both these countries' dual-VAT systems, which were introduced to replace all or some of the existing consumption taxes and to address the obstacles to trade and economic activity they caused, served as sources of inspiration for Brazil's consumption tax reform. While the Brazilian reform indeed resulted in the introduction of a dual VAT, with similarities to Canada's and India's systems, it also presents a number of unique and innovative features – not least since Brazil's dual-VAT will be levied not at two but at three levels of government: at Federal, State and at Municipal level.

Table 1. Consumption tax systems in Brazil, Canada and India prior to their reforms

Brazil	Canada	India
Five distinct consumption taxes, distributed across three levels of federal government and applied to varying tax bases.	Federally administered Manufacturers' Sales Tax and provincial sales taxes.	Multiple indirect taxes levied by the Central and State Governments, incl. services tax, value-added tax and excises.
Mainly origin-based taxation of inter-State and inter-Municipal trade.	Manufacturers' Sales Tax: origin based. Provincial Sales Taxes: Primarily destination based, but fragmented.	Origin-based taxation of inter-state trade.
Cumulative by design or in practice due to complexity of input-tax recovery for businesses.	Cumulative by design: no input-tax recovery for businesses.	Complex input-tax credit rules and absence of a right to input-tax recovery across some taxes. The right to input-tax credit (recovery) was restricted to the same taxes and was not transferrable to other taxes.

[16] OECD (2023), *OECD Economic Surveys: Brazil 2023*, OECD Publishing, Paris, https://doi.org/10.1787/a2d6acac-en, at p. 31.

[17] OECD (2017), *International VAT/GST Guidelines*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264271401-en, at p. 15

[18] The provincial sales taxes in Canada were (and are) destination-based but fragmented leading to undesired effects, as well.

3.2. The introduction of a dual-VAT levied at three federal levels

The structure and core design of Brazil's tax system is enshrined in its Federal Constitution. This includes general principles of taxation, the allocation of taxing powers among the three levels of federal government, rules governing the limitations to taxing powers, the respective scope of Federal, State,[19] and Municipal taxes and revenue allocation. The fundamental reform to remedy the ailments of Brazil's current consumption tax system therefore required a Constitutional Amendment, which was enacted on 20 December 2023.[20] This historic reform, adopted after many years of sustained policy discussions and negotiations, will replace the existing fragmented and distortive regime by a streamlined and efficient system for taxing consumption. It introduces a dual VAT as Brazil's main consumption tax, designed in accordance with international standards and with a view to ensure consistency and efficiency in its nationwide application while respecting the VAT-jurisdiction of the three levels of federal government.

At the center of the reform, as enacted in the Constitutional Amendment No. 132/23, is the consolidation of the existing five Federal, State and Municipal consumption taxes into a dual VAT that will be applied concurrently at the Federal level and at the two sub-federal levels (States and Municipalities), as follows:

- At Federal level, the new **Contribution on Goods and Services *(Contribuição sobre Bens e Serviços* or CBS)** will replace the main three existing federal consumption taxes, the Federal contribution for the financing of Social Security (COFINS); the Federal contribution for the financing of the private sector Social Integration Program (PIS); and the Federal tax on manufactured goods (IPI) – except for goods produced in the Manaus Free Trade Zone (see section 6).
- At sub-federal level, the new **Tax on Goods and Services (*Imposto sobre Bens e Serviços* or IBS)** will replace the State tax on goods and services (ICMS) and the Municipal tax on services (ISS). The IBS will thus consist of an IBS-State and an IBS-Municipal component.

The system is complemented by the **Selective Tax (*Imposto Seletivo* or IS)**, a federal excise tax designed to discourage the consumption of certain goods and services (see Box 1).

The Federal CBS is categorized as a "contribution", the revenues of which will be earmarked to finance Brazil's social security. The sub-federal IBS is categorized as a tax, which will be used to finance States and Municipalities. The CBS will be administered by the Federal Government. The IBS will be administered jointly by States and Municipalities, which is another unique feature of Brazil's dual VAT in addition to its three-layered structure.

The other salient aspects of Brazil's new dual VAT include the following:

- **Two separate but harmonized taxes**: the CBS and IBS will be implemented and regulated by the same Supplementary Legislation and be subject to uniform rules nationwide.
- **Destination-based taxation**: the CBS and IBS will be levied at destination on the basis of uniform rules for determining the place of taxation, at the combined rate of the Federal CBS and the sub-federal IBS.
- **Full non-cumulative nature**: businesses will have the right to recover the VAT incurred on their business inputs, subject to normal exceptions and limitations (e.g. purchases for personal use or consumption, exemptions, special regimes).

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[19] Including the Federal District. Article 145 of the Brazilian Federal Constitution of 1988. Fernandes, A. L. and P. Santana (2018), "Reforms of Fiscal Relations in Brazil: Main issues, challenges, and reforms", *Background paper 14th Annual Meeting of the Network on Fiscal Relations Across Levels of Government*, OECD, https://www.oecd.org/tax/federalism/reforms-of-fiscal-relations-in-brazil.pdf.

[20] Constitutional Amendment No. 132 of 20 December 2023, Official Gazette of the Federal Executive, 21 December 2023, pp. 1-7, available at: https://pesquisa.in.gov.br/imprensa/jsp/visualiza/index.jsp?jornal=515&pagina=1&data=21/12/2023&totalArquivos=363.

- **Common broad tax base**: the CBS and IBS will apply to all supplies of goods, including tangible and intangible (such as rights), and services. They will also be levied on imports while exports will be exempt with a right to input-tax credit for exporters.
- **Tax rates**: the Federal Government and each State and Municipality will have the authority to set their own CBS and IBS rates respectively, which will apply to all goods and services supplied within their territory unless a constitutional derogation applies. The Senate will set a reference rate for the CBS and IBS through a Senate Resolution, which will be used by the Federal Government and every State, Municipality and the Federal District unless they adopt their own rate.
- **Cashback for low-income households**: a cashback system will be introduced to compensate low-income households for the relatively high(er) cost of VAT as a share of their income.
- **Reduced number of tax benefits**: no incentives or special regimes are allowed, except where explicitly provided for by the Federal Constitution.
- **IBS Steering Committee**: a new independent body composed of representatives of States, Municipalities and the Federal District will be established to organize the joint management and administration of the sub-federal IBS.
- **Funds**: a number of compensation funds will be created, including the "National Fund for Regional Development"[21] to compensate States for the loss of their capacity to support local economic activity and to attract investment through preferential regimes, as well as the "Fund for the Compensation of Tax or Financial Benefits"[22] with a view to compensating, between 1 January 2029 and 31 December 2032, businesses benefiting from exemptions, incentives, and tax or financial benefits related to ICMS, granted for a fixed period and subject to conditions.
- **Transition period**: the transition to the new regime will be implemented gradually from 2026 to 2032, with full implementation in 2033.

Box 1. The Selective Tax (*Imposto Seletivo*; IS)

In addition to the new dual VAT, the reform of Brazil's consumption tax regime also introduces a new Selective Tax (*Imposto Seletivo* or IS), a federal excise tax designed to discourage the consumption of certain goods and services. It will be levied on the production, extraction, commercialization and importation of goods and services that are deemed harmful to health or the environment, as set out by Supplementary Law No. 214/2025.[23]

The IS will not be levied on electricity and telecommunications-related transactions nor on exports, except those linked to extractive activities (at a maximum tax rate of 1% of the product's market value).

The IS tax rates will be defined by Statutory Law, which can be specific per unit of measurement adopted (*ad quantum*) or *ad valorem*. It will be levied only once on a given good or service under a single-phase mechanism. Although not integrating its own tax base, it will form part of the tax bases of the CBS and the IBS (and of the States' ICMS and the Municipalities' ISS during the transition period).

Although it is a federal tax, 60% of the IS revenue will be shared with States and Municipalities. Of this, 57% will be allocated through revenue-sharing funds. The remaining 3% will specifically fund programs aimed at financing the productive sectors in the North, Northeast, and Centre-West regions.

Brazil's dual VAT has undoubtedly been inspired by the models adopted by Canada and India, two federal countries that also share the jurisdiction to tax consumption with sub-federal entities and that have both

[21] *Fundo Nacional de Desenvolvimento Regional*, see article 159-A of the Brazilian Federal Constitution.

[22] *Fundo de Compensação de Benefícios Fiscais ou Financeiro-Fiscais*, see article 12 of the Constitutional Amendment No. 132, of 20 December 2023.

[23] See article 409 and subsequent provisions.

implemented a dual VAT. While the three regimes share many common features, including their non-cumulative nature and their adherence to the destination principle, they each present distinct characteristics reflecting each country's specific needs and circumstances – as is illustrated in the table below. Among the main distinct, and unique, aspects of Brazil's dual VAT are its application across three layers of Federal government based on uniform rules; and the central role of the IBS Steering Committee in management and administration of the sub-federal IBS, including collecting it and in distributing its revenues, with a view to combine consistency and efficiency with transparency and respect for States' and Municipalities' VAT jurisdiction.

Table 2. The core features of Brazil's dual VAT compared to the dual VATs in Canada and India

Brazil	Canada	India
Reform 2023 Introduction of a dual VAT to replace the five main consumption taxes levied by the Federal, State and Municipality Level. The dual VAT consists of a Federal Contribution on Goods and Services (CBS) levied by the Federal Government and a Sub-Federal Tax on Goods and Services (IBS-State) levied by the States and Municipalities (IBS-Municipal). .	**Iterative reforms since 1991** Introduction of the federal Goods and Services Tax (GST) in 1991 to replace the Manufacturers' Sales Tax. Since 1997, five out of ten provinces have entered into Comprehensive Integrated Tax Coordination Agreements (CITCAs) with the federal government to harmonize their provincial sales taxes with the GST to form the Harmonized Sales Tax (HST). The HST is a single tax administered by the federal government that includes a federal component (i.e., the GST) and a provincial component set by the province. The HST is levied under the same federal legislation as the GST and generally applies to the same base of property and services as the GST. Provincial revenues under the HST are collected by the federal government and paid to HST participating provinces. The Quebec Sales Tax (QST) applies in the Province of Quebec, concurrently with the federal GST. The QST is largely harmonized with the federal GST under a CITCA between the federal government and the Province of Quebec. The other provinces charge provincial sales taxes (PST) separately from the federal GST, except for the Province of Alberta and the three territories where only federal GST is charged.[24]	Reform 2017 Introduction of a dual GST to replace multiple indirect taxes levied by the Central and State Governments. The new Goods and Services Tax (GST) operates under a dual structure comprising the Central GST (CGST) levied by the Central Government and the State GST (SGST)[25] levied by the State Governments. The CGST and SGST apply concurrently to intra-State supply of goods and services. The Integrated GST (IGST) applies to inter-State supplies of goods and services and imports. It is levied by the Central Government and apportioned to the respective (destination) States.
Full harmonization of tax bases and scope of reduced rates, with autonomy for the federal and sub-federal levels to set the standard tax rate applicable within their respective jurisdictions.	Close to full harmonization of tax bases within the HST-provinces and Quebec, with limited exceptions and autonomy for the federal and provincial governments to set rates applicable within their respective jurisdictions.	Full harmonization of tax bases and tax rates.
Adherence to the destination principle.	Adherence to the destination principle.	Adherence to the destination principle.
A broad input-tax credit system to ensure neutrality of the tax for businesses.	A broad input-tax credit system to ensure neutrality of the GST/HST and QST for businesses.	A broad input-tax credit system to ensure neutrality of the tax for businesses.

[24] These unharmonized provincial sales taxes (PST) are not discussed in detail in this paper.

[25] For the purposes of this report, reference to SGST also includes Union Territory Goods and Services Tax (UTGST).

3.3. The pivotal role of the IBS Steering Committee

The Brazilian consumption tax reform faced the unique challenge of requiring coordination across three levels of government – i.e. Federal, States and Municipalities – while respecting the sub-federal levels' jurisdiction to levy a tax on consumption within their respective territories and to administer and collect it as a core revenue source to fund their respective government programs. Concerns that needed to be addressed included the potential loss of autonomy for States and Municipalities in managing their consumption taxes; potential increases in the overall tax burden; the impact of the reform on the distribution of revenues across levels of government; the impact on the relative competitiveness of States and Municipalities.

The design of the dual VAT has been central in achieving consensus around a solution that ensures legal consistency, by adopting uniform rules for both components of the dual VAT, while safeguarding a level of sub-federal autonomy that was considered appropriate, by adopting a three-layered application of the dual VAT and granting States and Municipalities the right to set the rates that will apply within their territory.

An equally critical component of the consensus has been the creation of the IBS Steering Committee as a unique solution to safeguard the States' and Municipalities' authority to administer and collect their respective shares of the dual VAT, including on inter-State and inter-Municipal transactions. The IBS Steering Committee has been introduced into the Federal Constitution by the Constitutional Amendment as a separate and independent entity to administer both layers of IBS, i.e. the IBS-State and the IBS-Municipal. It will be composed of representatives of States, Municipalities and the Federal District.[26]

The IBS Steering Committee will be responsible for the centralized collection of the IBS as well as for its regulation and administration and for the distribution of IBS revenues. It will distribute the net revenues from the IBS collected on business-to-consumer (B2C) supplies to the sub-federal jurisdictions where consumption is deemed to occur, in accordance with the destination principle. These revenues will be distributed to the States and Municipalities after deduction of IBS input-tax credits (see sub-section 5.2) and cashbacks to low-income households (see sub-section 4.4). The Committee will not distribute IBS collected on business-to-business (B2B) supplies, as these do not involve final consumption in principle and thus do not generate net VAT revenues. The distribution of net IBS revenues to the States and Municipalities of destination, on the basis of the same rules that will apply for determining the place of taxation, presents a promising solution not only for an efficient and transparent destination-based IBS revenue allocation but also for significantly enhanced VAT-neutrality for businesses by centralizing the input-tax recovery and refund process.

The Committee will further enhance the consistent IBS application by centralizing IBS compliance for businesses; by issuing a single set of rules and administrative guidance for the IBS; by harmonizing the interpretation and rulings; centralizing administrative dispute management; and by coordinating the sub-federal tax administration's audits and enforcement activities.

The IBS Steering Committee will thus not only install the necessary level of confidence in the proper and fair operation of the sub-federal IBS across all levels of federal government. It will also lead to greater efficiency and consistency in IBS application and administration while significantly enhancing IBS

[26] States (including the Federal District) and municipalities will be represented at the highest decision-making body of the Committee on an equal basis, consisting of 27 members representing states and the Federal District, and 27 members representing municipalities and the Federal District. Among the municipality representatives, 14 will be elected based on votes of each municipality with equal value, and 13 based on votes of each municipality weighted according to their respective populations. Resolutions will be approved within the Committee's scope if they receive an absolute majority of the votes from municipalities and from the states and Federal District (provided they represent at least 50% of the country's population). The IBS Steering Committee will be financed by a percentage of the proceeds from the IBS collection allocated to each subnational level. Its external control will be exercised by the states and municipalities, with no involvement from the federal government.

compliance for businesses. It will operate as a single-point-of-contact for businesses to register and remit the IBS on all their supplies as well as to claim IBS input-tax credits and refunds, rather than having to engage with all states and municipalities in which they operate. As a next step, the reform envisages further integration for the combined collection of CBS and IBS, at which point businesses will have to deal with one point of contact only for their VAT-compliance in Brazil.

The creation of a coordinating body to streamline the operation of the dual VAT is not unique to Brazil: similar bodies have also been created in Canada and India, as the table below illustrates. Among the main distinguishing features of Brazil's IBS Steering Committee is its critical function as the IBS collection and revenue distribution agent for the States and Municipalities. In Canada and India, the Federal Government plays a central role in collecting VAT on interstate supplies – i.e. in Canada the federal government collects the federal GST as well as the HST in participating provinces,[27] and India has a specific Federal tax (IGST) collected on interstate supplies by the Federal Government. In contrast, Brazil's Federal Government will not be responsible for collecting the IBS on interstate supplies; this responsibility will fall to the IBS Steering Committee, which was created to ensure the autonomy and independence of States and Municipalities from the Federal Government.

Moreover, the IBS Steering Committee will act as a single point of contact for businesses to comply with their IBS obligations. Its task to centralize the input-tax credit and refund mechanism for the IBS across all sub-federal levels as part of its collection and revenue distribution mandate adds to its pivotal role in enhancing simplicity, efficiency, transparency and economic neutrality of the new regime.

Table 3.: The IBS Steering Committee compared to the dual-VAT coordinating bodies in Canada and India

Brazil	Canada	India
The IBS Steering Committee has been introduced into the Federal Constitution as an independent entity composed of representatives of the States, Municipalities and the Federal District. Its main responsibilities will be to regulate, administer and collect the IBS and to distribute the IBS revenues to States and Municipalities	The Federal-Provincial Tax Policy Review Committee (TPRC) was established under the CITCAs between the federal government and the HST provinces. It consists of representatives from the federal government and the five HST provinces. The Committee's role is to review issues related to the legislation governing the harmonized sales taxes, including the common tax base, tax rates and common tax structure. A Revenue Allocation Sub-Committee (RASC), reporting to the TPRC, is responsible for monitoring the ongoing application of the revenue allocation mechanism (i.e., which distributes HST revenues to the HST provinces). The Committee is not responsible for collecting GST/HST. In the case of Quebec, the Tax Harmonization Committee has been created to consider issues related to the GST/HST and the QST, including the harmonized tax base and associated administrative, definitional, and structural parameters.	The GST Council was created as a constitutional body responsible for making recommendations on issues related to the implementation of India's GST. The GST Council is chaired by the Union Finance Minister and consists of the Union Minister of State in charge of finance and Ministers of Finance or Taxation (or any other Minister) nominated by each State Government. The GST Council is responsible for issuing recommendations to the Union and the States on important issues related to GST, incl. the goods and services that may be subjected to or exempted from GST, GST model laws, place of taxation rules, thresholds, GST rates and administrative procedures. The GST Council is not responsible for tax collection.

[27] Except for the GST/HST due by businesses registered in Quebec. The Province of Quebec collects all GST/HST due by businesses registered in Quebec as well as the QST. See Table 9.

3.4. Compensation funds

Another corner stone of the path towards achieving consensus on the reform has been the adoption of compensation funds, in particular to compensate States for the consequences of no longer being able to use their consumption tax regimes for economic competition and to pursue specific equity and welfare objectives; and to compensate businesses that are currently benefiting from sub-federal incentives that will be phased out as the reform is fully implemented.

A National Regional Development Fund will be created to allocate resources from the Federal Government to the States (including the Federal District), based on specific criteria, to address regional and social inequalities. These resources will be earmarked for investments in infrastructure, activities that generate employment and income, as well as scientific, technological, and innovative development. The distribution is scheduled to commence in 2029 starting with an initial amount of BRL 8 billion (adjusted to inflation), and this figure will progressively increase each year until 2043, reaching BRL 60 billion annually (adjusted to inflation). The creation of this fund is motivated by the intention to compensate States for the consequences of no longer being able to use their consumption tax regimes for economic competition and to pursue specific equity and welfare objectives.

Compensation Fund for Tax Benefits of ICMS. This fund will be created to compensate individuals or legal entities that were granted ICMS tax incentives and benefits prior to May 31, 2023. This compensation will take place between 2029 and 2032 to coincide with the reduction of ICMS tax incentives. The resources for the fund will be provided by the Federal Government from 2025 to 2032, corresponding to predetermined amounts.

4. Zooming in on the core design features of Brazil's new dual VAT: a broad-based, simpler, and neutral VAT

The Constitutional Amendment that was enacted on 20 December 2023 introduced the core design features of the new dual VAT into Brazil's Federal Constitution. The actual entry into force of the new system is set for 2033, following a transition period that will begin in 2026, and required the adoption of implementing legislation by Congress. Most of the core aspects of the dual VAT are subject to Supplementary Legislation (*Lei Complementar*), which needs an absolute majority vote among all members in both the House and the Senate. Supplementary Law No. 214, enacted in January 2025,[28] notably establishes rules for determining the place of taxation in accordance with the destination principle, the input-tax credit and refund regime, discounted rates, the cashback for low-income households, the treatment of non-resident suppliers (incl. digital platforms), the potential introduction of a split-payment mechanism. Moreover, Supplementary legislation[29] will also establish the IBS Steering Committee and the rules for the administration of the IBS and the distribution of IBS revenues. This Section 4 explores the core technical design features of the dual VAT that have been introduced in Brazil's Federal Constitution by the 2023 Constitutional Amendment. Section 5 looks at the new constitutional provisions for the administration of Brazil's dual VAT, focusing in particular on the arrangements for a well-coordinated, efficient and transparent management of the IBS across Brazil's 27 States and 5.570 Municipalities.

[28] Available at https://www.planalto.gov.br/ccivil_03/leis/lcp/lcp214.htm

[29] See Draft Bill PLP 108/2024

4.1. Broad and uniform tax base

The overarching purpose of a VAT is to impose a broad-based tax on consumption.[30] One of the key challenges for VAT design in a federal country that shares VAT jurisdiction with sub-federal levels is to ensure consistency of the tax bases across the federal and sub-federal VAT regimes. This is needed to minimize risks of economic distortion and undue complexity of compliance and administration.

The Brazilian VAT reform has been successful in achieving this objective in that the CBS and IBS will be governed by a single and uniform legislation applicable nationwide. Both components of the dual VAT will be subject to the same rules concerning the definition of taxable persons, taxable transactions and chargeable events, taxable amount, exemptions and instances of non-taxation, input-tax credits, and specific and favoured regimes. The rates of the IBS are the only exception, although a framework has been agreed to maintain a certain level of uniformity of rate structures and levels across sub-federal entities (see sub-section 4.3 below). IBS rates can differ across territories (States and Municipalities) but not across goods and services, except for the reduced rates and specific regimes already provided for in the Constitution.

The Constitutional Amendment ensures that the CBS and IBS will be levied on a common broad tax base that encompasses all transactions involving tangible and intangible goods, including associated rights, as well as services, both locally supplied and imported. Additionally, unlike other countries with newly introduced VAT systems, Brazil is set to become a pioneer by taxing spread-based financial services under the CBS and IBS. This includes services involving the raising, transferring, intermediation, management, or administration of financial resources. Also supplies of real property will become subject to taxation under the CBS and IBS, including sales and rental of residential property.

The Federal and sub-federal VATs will share the same tax base and neither the Federal Government nor the States and Municipalities will have the autonomy to alter or adopt a different base. This has the potential to significantly reduce the complexity of the current fragmented system and to remove many of the distortions associated with it. The importance of uniform tax base determination for the efficient operation of a dual VAT is also reflected in the design of Canada's and India's dual VAT regimes as illustrated in Table 4 below.

Table 4.: Achieving uniformity of the tax base under the dual VATs in Brazil, Canada and India

Brazil	Canada	India
The CBS and IBS will be levied on a uniform tax base enshrined in the Brazilian Federal Constitution and defined in further detail in common and uniform implementing legislation.	The tax base of the GST/HST is legislated by the federal government and coordinated with HST provinces through CITCAs with those provinces. In the Province of Quebec, the QST tax base is legislated by the provincial government. It is aligned with the federal tax base in accordance with the CITCA between the province and the federal government. The tax bases are largely harmonized, with only limited exceptions as the CITCAs grant the provinces some elements of tax policy flexibility, such as the right to implement rebates of the provincial component of the HST, in the case of HST provinces, or to remove a property or service from the QST base, in the case of Quebec.	The GST Council issues recommendations including on the GST tax base. Although all recommendations of the GST Council are not automatically binding, in practice, these recommendations are implemented by the Central and State Governments in separate but identical laws.

[30] OECD (2017), *International VAT/GST Guidelines*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264271401-en, at para. 1.2.

4.2. The fundamental shift from origin- to destination-based taxation

As discussed earlier, destination-based taxation is the internationally agreed standard for achieving VAT neutrality in cross-border trade. Exports are free of VAT with a full right to input-tax recovery for the exporter, while imported goods and inbound services are subject to the same VAT rate as domestic supplies. The destination principle in VAT ensures neutrality in cross-border trade: by treating domestic and imported goods and services equally there is in principle no VAT benefit from purchasing goods or services from suppliers that are located in a low(er) VAT jurisdiction. It was the application of origin-based taxation to inter-State and inter-Municipal trade under Brazil's existing consumption tax regime, which did provide incentives to suppliers to establish themselves in a no- or low-tax jurisdiction, that was among the main causes of "fiscal wars" and the fragmentation and economic distortions across sub-federal levels. It was thus critical for the success of Brazil's VAT reform to include a shift from the origin to the destination principle in inter-State and inter-Municipal transactions, in addition to international trade.

The considerable challenges of reaching agreement on a shift from origin- to destination-based taxation of sub-federal trade in a federal country with shared VAT jurisdiction have been discussed earlier (see (sub-)sections 2 and 3.1 above). It is likely to have a fundamental impact on the sub-federal levels' tax revenues and their capacity to use these taxes as a socio-economic policy tool. Achieving consensus on such a fundamental change in the allocation of taxing rights between federal entities requires a difficult balance. On the one hand, it needs to safeguard the sub-federal levels' revenue raising capacity and a certain degree of policy autonomy to address specific needs and circumstances. On the other hand, it requires clear and uniform rules to allocate taxing rights across federal entities on the basis of the destination of transactions that are relatively simple to administer and to comply with. This needs to be complemented with measures to compensate for any revenue losses of sub-federal entities and for the loss of their capacity to use the tax as an economic incentive (see further detail in sub-section 3.4 on compensation funds and sub-section 5.2 on the transitional revenue-sharing regime).

Brazil has managed to cross this hugely complex and difficult hurdle successfully, by building the necessary checks and balances into the reform and including the necessary guarantees for transparency, trust and revenue neutrality in the design and the operation of its new VAT regime. These has been achieved in particular through the design of the dual VAT as such, with its unique feature of safeguarding the VAT jurisdiction of three layers of the federal state - and through the introduction of the IBS Steering Committee, which safeguards the sub-federal levels' authority to collect and administer the IBS and to oversee its revenue distribution.

Brazil's new VAT regime will thus operate the destination principle as the standard for determining the place of taxation, both for inter-State and inter-Municipal transactions and for international trade. The detailed rules are set out by Supplementary Law No. 214/2025. They will apply uniformly to both the CBS and the IBS across all federal levels. The Constitutional Amendment does present the potential criteria for determining the place of taxation in accordance with the destination principle, in particular: the location where the goods are delivered, made available or located; the place where services are provided or made available; or the domicile or location of the purchaser or recipient of the goods or services. Differentiations will be permitted based on the characteristics of the transaction.

Exports will be free of VAT, with a full right to input-tax credits for exporters, and imports will be taxed on the same basis and at the same rates as domestic supplies. These principles are in accordance with the recommendations set out in the OECD International VAT/GST Guidelines.

Like Brazil, Canada and India have also embraced the destination principle for the application of their respective dual VATs – both in international and sub-federal trade as outlined in the table below. While the place of taxation rules in accordance with the destination principle are also used for revenue distribution of the sub-federal component of the dual VAT in Brazil and India. In Canada, GST/HST revenues are

collected by the federal government and provincial revenues are distributed to the HST participating provinces in accordance with a revenue allocation formula[31].

Table 5.: Destination-based taxation of sub-federal trade under the dual VATs in Brazil, Canada and India

Brazil	Canada	India
Destination-based application of the sub-federal IBS to inter-State and inter-Municipal supplies. Place of taxation rules in accordance with the destination principle are defined in Supplementary Law. These rules are needed for businesses to determine the applicable IBS tax rate (i.e. that of the State and Municipality of destination) and for distribution of IBS-revenue to the States and Municipalities of destination.	The GST/HST (and the QST in Quebec) are levied in accordance with the destination principle. Place of taxation rules in accordance with the destination principle apply to determine the location of consumption and the applicable tax rate. GST/HST revenues are collected by the federal government and provincial revenues are distributed to the HST participating provinces in accordance with a revenue allocation formula – see table 10 below. QST revenues are collected by the Province of Quebec on the taxable supplies made within its territory.	The IGST that applies to inter-state trade operates in accordance with the destination principle. Place of taxation rules have been defined to determine whether a supply qualifies as intra-State (and thus subject to SGST/CGST) or inter-State (and thus subject to IGST) and for revenue distribution of the State component of the IGST. As the tax rates are uniform throughout the whole country, place of taxation rules do not play a role for rate determination by businesses.

4.3. Tax rates: a mix of uniformity and autonomy

The tax rate structure of Brazil's new dual VAT has been the subject of intense discussion and negotiation. An approach was ultimately agreed that preserves the autonomy of the three levels of federal government to set their own standard rates - combined with a set of pre-defined rate discounts that can be applied to pre-defined categories of supplies, aimed at preserving consistency in the levels and scope of reduced rates across the three layers of the dual VAT.

Under this arrangement, each federal unit has the autonomy to decide on its standard rate in a separate law: the Federal level sets the standard rate for the CBS, while States and Municipalities set the standard rate for their respective components of the IBS. The CBS/IBS rate will be the sum of the CBS standard rate and the applicable IBS standard rate. The IBS standard rate will be a compound rate representing the sum of the rates of the State and Municipality of destination of a given transaction.

The Federal Senate will establish reference rates for each federal unit, which will serve as a basis for setting their standard rates. These reference rates, determined by Federal Senate Resolution, will be the default rates for the CBS and IBS unless the respective federal unit adopts a standard rate that deviates from the reference rate, either above or below. Once set by the federal unit, the tax rates for the CBS and IBS will be uniform across all goods and services, except where constitutional exceptions apply.

Since a key objective of the reform was to not increase the overall tax burden, the CBS/IBS reference rates will be designed to be "revenue neutral", i.e. to raise the same amount of revenue as was raised from the existing taxes prior to the tax reform.[32]

[31] In Quebec, Revenu Québec collects the GST/HST on behalf of the Government of Canada by way of an agreement between the Canada Revenue Agency and Revenu Québec.

[32] A mechanism will be introduced to limit any increase of the tax burden by establishing a revenue reference ceiling (*teto de referência de arrecadação*). This reference ceiling will be calculated based on the average revenue generated by the taxes that will be replaced by the dual VAT and the IS (IPI, PIS, Cofins, ICMS, ISS) as a share of GDP between 2012 and 2021. If the revenues from CBS, IS and IBS exceed the reference ceiling, the reference rates will be reduced in the years 2030 (for CBS in relation to average revenues from 2027 and 2028) and 2035 (for CBS and IBS in relation to the average of revenues between 2029 and 2033).

Temporary reference rates for the CBS and IBS will apply during a transition period to ease the shift from the existing taxes to the CBS and IBS before their full implementation (see section 6. below). They will be set by the Federal Senate at a level to collect the necessary revenue to compensate for the gradual reduction of revenues from the taxes that the CBS and IBS will replace.

Additionally, the Constitutional Amendment provides the option to adopt discounted rates for supplies of specifically listed goods and services. Supplementary Law No. 214/2025 specifies the categories of supplies benefiting from a 30%, 60% or 100% reduction from the standard rate. These discounted rates will apply uniformly to the CBS and IBS. The sub-federal levels will not be authorized to grant any additional reductions beyond those stipulated by the Supplementary Law. As rate reductions will be applied uniformly, they will not affect the ratio between the revenue shares of the Federal government, the States, and Municipalities.

Reductions to the CBS/IBS standard rate are broadly defined by the Constitutional Amendment and are regulated by Supplementary Law for the following broad categories of supplies:[33]

- 30% reduction for services relating to intellectual professions and of a scientific, literary, or artistic nature that are subject to supervision by a professional council.
- 60% reduction for services relating to education, healthcare, public urban, semi-urban and metropolitan passenger transportation services (with potential exemption), food, personal hygiene and cleaning products, agricultural products and inputs, national artistic and cultural productions, sports, among others.
- 60% or 100% reduction for medical and accessibility devices and medication (as determined by the Supplementary Law).
- 100% reduction for fruits, vegetables and eggs, services provided by non-profit Scientific, Technological and Innovation Institutions (ICT), automobiles purchased by people with disabilities or to be used as taxis, higher education services under the 'University for All Programme' (Prouni – to CBS only), basic menstrual healthcare products, among others.

These reductions will be subject to a cost-benefit assessment every five years, including the analysis of their impact on the promotion of gender equality.

In addition, a zero rate will apply to the products of the National Staple Food Basket (*Cesta Básica Nacional*) as defined by Supplementary Law, to guarantee a healthy and nutritionally adequate diet.[34]

The adoption of a limited number of rate reductions and the stipulation that these reductions must be uniform across the entire national territory reflect Brazil's overarching goals of consistency, simplicity, ease of compliance and of minimizing risks of continued "fiscal wars" – while safeguarding the opportunity to address for specific socio-economic needs and welfare concerns.

The autonomy for the sub-federal levels to determine the standard rate of the sub-federal components of the dual VAT in Brazil shows some similarities to Canada's HST. It differs, however, from the Indian model that applies uniform rates at all federal levels nationwide. Then again, Brazil's Constitutional Amendment includes a unique approach to streamline rate differentiation under its dual VAT by providing the option to implement reductions to the CBS/IBS standard rate at a limited number of pre-determined discount rates for specifically listed goods and services - thereby ensuring that the relative shares of the federal and sub-federal components in the total tax burden remain stable. The table below presents a comparative overview.

[33] See in particular articles 126 to 156 of Supplementary Law No. 214/2025.

[34] See article 125 and Annex I to Supplementary Law No. 214/2025

Table 6. Setting the rates of the dual VAT in Brazil, Canada and India

	Brazil	Canada	India
Standard rate	The Federal Senate will determine a reference rate for the CBS, the IBS-State and the IBS-Municipal, which will apply by default for the application of the CBS by the Federal Government and the IBS by States and Municipalities. Each level (Federal Government, State and Municipalities) will have the option to set its own standard rate for the application of the CBS or IBS within its territory at a level above or below the reference rate.	The federal GST rate is determined by the federal government. The rate of the provincial component of the HST in a particular province and the rate of the QST in Quebec are determined respectively by the HST province and by the Province of Quebec.	The same rate of CGST, SGST and IGST applies across the country, including at Central as well as State level, following the recommendations of the GST Council.
Reduced rates	The Constitutional Amendment provides the option to adopt discounted rates for supplies of specifically listed goods and services. Depending on the category of supplies, the standard rate will be reduced by 30%, 60% or 100%. A zero rate will apply to the products of the National Staple Food Basket. The adoption of these discounted rates requires a Supplementary Law that will apply uniformly to the CBS and IBS. Within the limits set by the Constitutional Amendment, Supplementary Legislation specifies and defines the goods and services benefiting from a reduction.	No reduced rates apply. A zero rate applies to certain supplies, such as, basic groceries, prescription drugs and certain medical devices.	The same rate of CGST, SGST and IGST applies across the country, including at Central as well as State level, following the recommendations of the GST Council.

4.4. Specific and favoured regimes to address specific needs and circumstances

The discussions on the design of Brazil's new dual VAT reform have been influenced significantly by the country's socio-economic diversity as well as by the pressure from certain sectors that benefited from low tax rates under the existing system. While the diversity of Brazil's27 States (incl. the Federal District) and 5.570 Municipalities has contributed to the complexity and fragmentation of the current regime, the need to accommodate sectoral interests has been a significant factor in the adoption and maintenance of certain favored regimes. These regimes, alongside the framework for rate reductions, were essential to achieving consensus on the new dual VAT. It is important to note, however, that these specific and favoured regimes will have to be uniformly applied nationwide under both the CBS and IBS. This means that neither the Federal Government nor the States or Municipalities will have the autonomy to modify or introduce regimes beyond those established by the Federal Constitution and detailed by the implementing Supplementary Legislation. An important trade-off has thus been achieved between the need for nationwide consistency and efficiency, and the desire to address specific socio-economic and sectoral needs and welfare concerns.

The Constitutional Amendment notably provides for the adoption of specific regimes for sectors and activities with unique characteristics that pose challenges for the normal staged collection process of VAT, such as activities related to fuels and lubricants, financial services and real estate transactions. These specific regimes will introduce an alternative approach for VAT application to take account of sectoral specifics, essentially with a view to ensure efficiency and effectiveness in VAT administration and compliance rather than seeking to achieve a preferential treatment (i.e. a lower tax burden on final consumption). Nonetheless, the Constitutional Amendment also incorporates specific regimes that were adopted primarily to achieve the necessary political consensus.

A limited number of favored regimes will be maintained or introduced, including the simplified regime for small businesses, an innovative cashback regime for low-income households, and fictitious tax credits for purchases from non-taxpayers:

- *Simples Nacional* (SIMPLES) offers a unique simplified regime at a low rate with simplified compliance obligations and without input-tax credits. Under the new system, businesses that qualify for SIMPLES will have the option to choose between the standard non-cumulative CBS and IBS regime or to continue operating under SIMPLES. The new regime will allow business customers to claim input tax credits for the consumption tax collected under SIMPLES that is embedded in the price of the purchases from SIMPLES suppliers.
- A cashback system will be introduced to refund CBS and IBS paid by lower-income consumers, aimed at reducing income inequalities. The Constitutional Amendment mandates cashback refunds for CBS and IBS on purchases of electricity and liquefied petroleum gas to low-income consumers. The exact scope and operation of the cashback regime are set in Supplementary Law 214/2025.[35] The cashback regime holds great potential as a more targeted and efficient approach than reduced rates or exemptions to compensate low-income households for the relatively higher average impact of the VAT on their purchases as a share of their income. It can be compared to Canada's GST/HST credit, which is administered through the federal personal income tax system. The GST/HST credit is a tax-free quarterly payment that help individuals and families with low and modest incomes to offset the GST/HST that they pay. It is not linked to individual purchases but based on income level and family composition (e.g. single, couple, number of children).
- To offset the lack of input tax credits, fictitious input credits will be granted to taxable business on certain transactions with entities that are not IBS/CBS taxpayers, such as purchases from small rural producers, services from individual truck drivers, purchases of waste and other recyclable materials and of second-hand movable assets (such as automobiles) from individuals.

A preferential treatment will continue to apply to the Manaus Free Trade Zone (ZFM) and Free Trade Zones (FTZ). Special tax rules will further apply also for biofuels and green hydrogen, capital goods, export processing zones, and special customs regimes. Free radio broadcasting and free TV will both be exempt from the IBS for their activities, including income from advertising materials.

Although it must be acknowledged that the Brazilian reform reduced the number of rate reductions and preferential tax regimes, it is essential to assess whether the remaining rate reductions and specific regimes are necessary and effective in achieving their specific social and economic objectives. Studies based on other countries suggest that reduced VAT rates are often an inefficient means of accomplishing these goals and can, in some cases, be regressive.[36] Moreover, preferential regimes tend to increase administrative and compliance costs and may introduce economic distortions, thereby undermining the efficiency and neutrality of the tax system.[37]

While specific and/or preferential regimes to meet specific needs and circumstances have also been implemented to varying degrees in Canada's and India's dual VATs, the three regimes have sought to safeguard maximum uniformity across federal and sub-federal levels, as illustrated in the table below.

[35] See article 112 and subsequent provisions.

[36] OECD/Korea Institute of Public Finance (2014), *The Distributional Effects of Consumption Taxes in OECD Countries*, OECD Tax Policy Studies, No. 22, OECD Publishing. http://dx.doi.org/10.1787/9789264224520-en at pp 68 et seq.

[37] OECD (2022), *Consumption Tax Trends 2022: VAT/GST and Excise, Core Design Features and Trends*, OECD Publishing, Paris. *https://doi.org/10.1787/6525a942-en* at pp 36 et seq.

Table 7. Specific and/or preferential regimes

Brazil	Canada	India
The same specific and favoured regimes will apply uniformly to both the CBS and IBS, as established by the Brazilian Federal Constitution and in accordance with the provisions set forth by Supplementary Law.	A range of specific regimes apply uniformly across the GST/HST, such as a zero rate for certain purchases (e.g., basic groceries, prescription drugs, certain medical devices) exemptions (e.g. residential accommodation, health care, financial services), optional registration for small businesses, and specific measures for digital economy businesses. The GST/HST credit is a tax-free quarterly payment that helps individuals and families with low and modest incomes offset the GST/HST that they pay. It is not linked to individual purchases but based on income level and family composition (e.g. single, couple, number of children). Provincial sales tax credits may also be delivered with the GST/HST credit. The CITCAs grant the provinces some elements of tax policy flexibility, such as the right to implement rebates of the provincial part of the HST, in the case of HST provinces, or to remove a property or services from the QST base, in the case of Quebec.	The different provisions under GST are applicable uniformly at Central as well as State levels, following the recommendations of the GST Council.

4.5. Shift to VAT-neutrality, away from a cumulative regime

The neutrality principle is central to the design and operation of a modern VAT. VAT-neutrality is ensured by granting businesses the full right to deduct input tax through the supply chain, "whatever the nature of the product, the structure of the distribution chain, and the means used for its delivery (e.g. retail stores, physical delivery, Internet downloads)".[38] By granting this full right to deduct input tax, the VAT system remains neutral in its treatment of different economic activities and transactions, ensuring that the burden of the tax does not rest on businesses and thus avoiding that the incidence of irrecoverable VAT on business inputs distorts production decisions and investment choices.[39]

Brazil's existing consumption taxes, by contrast, are cumulative – either by design or in practice. The resulting accumulation of taxes throughout the production and distribution chain, whereby domestic products are taxed multiple times and taxes are levied on taxes incurred by businesses in the previous stages of the value chain, are among the main drivers of the economic distortions caused by this regime.

To address these distortions, the Constitutional Amendment introduces the neutrality principle for both CBS and IBS, making these taxes fully "non-cumulative". Also this critical aspect of Brazil's reform has been challenging to achieve, not only because of its revenue impact but also due to the complexity of coordinating the recovery of input-taxes incurred by businesses across the three levels of federal government. This complexity arises especially in respect of the IBS, which will be levied across 27 States and 5.570 Municipalities. How can one efficiently administer the offsetting of IBS

[38] OECD (2017), *International VAT/GST Guidelines*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264271401-en, at p. 15.

[39] It is to be noted that even non-cumulative taxes may place a tax burden upon businesses in certain circumstances, such as exempt transactions, to secure effective taxation of final consumption (e.g. non-business use) or when input tax deduction is disallowed due to non-compliance with explicit administrative obligations.

input-taxes incurred in one State/Municipality against IBS liabilities in other States/Municipalities? The creation of the IBS Steering Committee has played a central role in achieving consensus on an efficient non-cumulative design of the IBS by giving it the central authority to manage the IBS input-tax credit process. In short, the IBS Steering Committee will deduct IBS input-tax credits from IBS revenues before distributing the net IBS revenue collected on B2C supplies to the States and Municipalities of destination (see sub-section 5.2 below). This will not only enhance the efficiency of IBS administration and compliance, as businesses will have one single point of contact to claim all IBS input-tax credits, but also avoid the significant complexity of having to manage and coordinate input-tax credit processes at the level of sub-federal entities. Finally, the distribution of IBS revenues managed by the IBS Steering Committee will also include mechanisms to soften the revenue impact from the transition for States and Municipalities.

Accordingly, taxable businesses will have a full right to input-tax credit for the CBS and the IBS incurred on their business inputs, subject to normal exceptions and limitations (e.g. input-tax incurred on purchases intended for personal use or consumption, input-tax linked to exempt or "immune" activities, etc.). Exporters will have the right to recover the input-tax related to their export activities, which are deemed "immune" of IBS/CBS, indicating that the tax shall have no incidence on these activities.

The input-tax credit mechanism will be operated separately for the federal CBS and the sub-federal IBS. No offsetting of input- and output-tax between the federal (CBS) and sub-federal VAT (IBS) will be possible. The CBS input-tax credit mechanism will be administered by the Federal tax authorities while the IBS Steering Committee will centralize the administration of input-tax credits for the IBS. As the IBS will be applied as if it were a "single national tax", businesses will be able to offset the IBS incurred in any state or municipality against any IBS liability due in any state or municipality. Business will be able to claim refunds of excess input-tax credits, subject to the rules and conditions set out by Supplementary Law No. 214/2025.[40]

Input-tax credits may be made contingent upon the confirmation of tax collection in the previous stage. According to the Constitutional Amendment the condition of actual remittance for input-tax credit may however only be applied in combination with either a split-payment mechanism or similar mechanism whereby the purchaser is able to remit the tax directly to the tax authorities rather than paying it to their suppliers. The intended introduction of the split-payment system marks a significant step forward in the modernization of Brazil's tax system. By directly channeling the tax portion of transactions to the government, the split-payment system has the potential to narrow the tax compliance gap, which could also allow for a reduction in the CBS/IBS reference rates.

Additionally, the system offers clear advantages, such as safeguarding the purchaser's ability to claim tax credits and potentially lowering business compliance costs by easing the burden of procedural obligations, including by pre-filling tax returns. However, realizing these advantages depends on the successful implementation of a robust technological infrastructure.

All three dual-VAT regimes in Brazil, Canada and India have respectively been designed on the basis of the core principle of VAT neutrality as outlined in the table below. Unlike the Brazilian regime, India's system provides for cross-utilization of input-tax credits between the federal and sub-federal components of their dual VAT. In Canada, the GST/HST is levied as a single tax under federal legislation and input tax credits apply automatically in respect of both the federal and provincial components of the HST.

[40] See, in particular, articles 39 and 40.

Table 8.: Ensuring VAT-neutrality

Brazil	Canada	India
A right to input-tax recovery applies for both the CBS and IBS, subject to normal conditions and limitations. As the IBS is designed and will be applied as one single tax, business will be able to offset IBS credits against any IBS liability they have. Cross-utilization of credits and debits between CBS and IBS will not be possible.	A right to input-tax recovery applies for the GST/HST and QST, subject to normal conditions and limitations. As the GST/HST is levied as a single tax under federal legislation, input tax credits apply automatically in respect of both the federal and provincial components of the HST. Cross-utilization of credits and debits between the GST/HST and the QST as they are levied under separate legislation.	A right to input-tax recovery applies for CGST, SGST and IGST, subject to normal conditions and limitations. Cross-utilization of credits and debits between components of the dual GST is possible, as follows: IGST credit can be utilized first towards IGST liabilities and the balance (if any) towards CGST and SGST/UTGST liabilities; CGST credit can be utilized first towards CGST liabilities and the remaining (if any) towards IGST liabilities (and not towards SGST/UTGST); SGST credit can be utilized first towards SGST liabilities and the remaining (if any) towards IGST liabilities (and not towards CGST).

5. Management of Brazil's dual VAT

The previous section discussed the core design features of Brazil's new dual VAT that were introduced in the Federal Constitution to address the inefficiency and the distortions of the current regime while safeguarding States' and Municipalities' authority to raise revenues from these taxes to meet their finance needs.

This section looks in some further detail at the agreed rules and mechanisms for administering the dual VAT, focusing in particular on the sensitive issue of the collection and the revenue distribution of the sub-federal component of the tax as well as on the various core aspects of its administration, particularly the issuance of guidance and ruling, the organization and coordination of audits and litigation.

5.1. Collection of the dual VAT

Brazil's reform has achieved consensus around a tax collection model that safeguards the authority of States and Municipalities to manage and oversee the collection and distribution of the IBS, which is the component of the dual VAT over which they have jurisdiction, without jeopardizing the overall consistency and efficient operation and administration of the tax. The creation of the IBS Steering Committee has played a critical role in achieving this positive outcome.

The IBS Steering Committee will be the collection agent of the IBS for the States and Municipalities – and the distributor of IBS revenues to the States and Municipalities where that tax is due according to the place of taxation rules outlined above (see sub-section 4.2). The CBS will be collected and administered by the Federal tax administration.

The centralized collection of the IBS by the IBS Steering Committee holds great promise for the efficient and transparent administration of the tax and for enhanced ease of compliance. The IBS Steering Committee will effectively operate as a single point of contact for businesses, which is expected to lead to a significant reduction in compliance burden and reduced risks of uncertainty and disputes from inconsistent application of the IBS across sub-federal levels. The centralized administration of IBS input-tax credits that will complement the IBS Steering Committee's IBS collection role, will be critical in ensuring the effective neutrality of the tax for businesses (see next sub-section)

In contrast to Brazil's regime, in India, the CGST, SGST and IGST are collected both by the Central Government as well as the State Governments within their allocated tax base - see the table below. In Brazil, the authority to collect the sub-federal IBS on inter-State and inter-Municipal trade has remained with States and Municipalities. Both Brazil and India have introduced mechanisms to centralize and streamline the collection of the sub-federal tax components, respectively through the creation of the IBS Steering Committee in Brazil and the introduction of the GST Network (GSTN) in India that operates as a central digital platform for taxpayers to comply with their obligations under all three components of the GST. In Canada, the GST/HST is administered by the federal government. Businesses engaged in a commercial activity in Canada are generally required to register, collect and remit tax to the Canada Revenue Agency. Under an agreement between the federal and Quebec governments, Revenu Québec administers the GST/HST in Quebec on behalf of the federal government. Businesses carrying on commercial activities in Quebec are required to register, collect and remit tax to Revenu Québec. The QST is also administered by Revenu Québec.

Table 9.: Varying approaches to the collection of the dual VAT in Brazil, Canada and India

Brazil	Canada	India
The federal government will collect the federal CBS. The IBS Steering Committee will centralize the collection of the IBS for States and Municipalities.	The federal government collects the federal GST as well as the HST in participating provinces (except for the GST/HST due by businesses registered in Quebec). The Province of Quebec collects all GST/HST due by businesses registered in Quebec as well as the QST.	CGST and IGST are levied by the Central Government. SGST is levied by the respective State Governments. India has introduced a unique digital platform, called the GST Network (GSTN), which centralizes compliance for taxpayers with their obligations for these three taxes including registration, filing and payment/collection.

5.2. Distribution of revenues

The central role of the IBS Steering Committee in (re)distributing the IBS revenues among States and Municipalities has been the necessary complement to its role as the central IBS collection agent in achieving consensus on the sub-federal component of the dual VAT. This role does not only safeguard States' and Municipalities' collective authority over the distribution of IBS revenues - it also allows them to manage a 50-year transitional period of IBS revenue redistribution to absorb the tax revenue shocks for States and Municipalities as they transition from a system of origin-based cumulative consumption taxes to a destination-based non-cumulative IBS.

The revenue from the federal CBS will not be shared with States and Municipalities. This is because the Brazilian tax system classifies the CBS as a "social contribution". These are not subject to revenue-sharing arrangements with subnational levels according to the Constitution.[41] The revenues from the CBS will be earmarked for specific federal expenditure programs concerning health care, social assistance benefits and social security.[42]

The IBS Steering Committee will distribute the net proceeds of the IBS that it collects to the State and Municipalities where that IBS was due in accordance with the destination principle. These States and Municipalities of destination will be identified at transactional level based on the rules for determining the place of taxation outlined above (see sub-section 4.2). The net IBS proceeds distributed by the IBS Steering Committee will consist of all IBS revenues collected on business-to-consumer (B2C) transactions

[41] Articles 157-162 of the Brazilian Federal Constitution of 1988.

[42] Article 194 of the Brazilian Federal Constitution of 1988.

as well as business-to-business (B2B) transactions where the business customer is not entitled to a deduction based on the applicable legislation. The only two deduction items (prior to distribution) are accumulated input-tax credits (e.g. in the case of exporters) and cashbacks to low-income households, which will remain with the IBS Steering Committee. This central administration of IBS input-tax deduction has been agreed to avoid the complexity of a decentralized cross-utilization of IBS input-tax credits against IBS-liabilities across States and Municipalities - and to provide efficient access to IBS input-tax credits to businesses. The IBS collected on business-to-businesses (B2B) transactions, where the customer is entitled to input tax credit, will not be shared with States and Municipalities as these transactions do, in principle, not generate any net revenues.

This centralized administration of the IBS input-tax credit mechanism that will complement the IBS Steering Committee's role as an IBS collection agent, will be critical to ensure the proper implementation of the non-cumulative design of the IBS as a tax on consumption that is neutral for the businesses that collect the tax, including by minimizing their cash-flow costs.

The revenues from the IBS-Municipal will be distributed entirely to the relevant Municipalities of destination. The revenues from the IBS-State will be shared between the State of destination, which will receive 75%, and all Municipalities in that state, which will collectively receive 25% of their State's IBS revenue.[43]

A 50-year transitional period will apply from 2029 to 2077 to smoothen the revenue impact of the transition from a cumulative origin-based system to a non-cumulative destination-based regime. During this period, the IBS Steering Committee will withhold a percentage of IBS revenues for distribution to the States and Municipalities essentially based on their respective current tax revenue shares. The percentages of IBS revenue that will be withheld have been set at 80% from 2029 to 2032, increasing to 90% in 2033, followed by a gradual reduction at a rate of 1/45 per year from 2034 to 2077. During this transition period, the share of IBS revenues distributed to the States and Municipalities of destination according to the new place of taxation rules, will gradually increase.

Additionally, from 2029 to 2077, 5% of the amount that was not withheld by the IBS Steering Committee as outlined in the previous paragraph, will be withheld to be redistributed to those with the lowest ratio of IBS revenue (calculated at the reference rate) to the average revenue from ICMS and ISS across all States and Municipalities (capped at three times the national per capita average). From 2078 to 2097, that percentage of 5% will be reduced in a linear manner.

The centralized collection and IBS revenue distribution by the IBS Steering Committee will require a highly integrated process, supported by technology and including close collaboration between the IBS Steering Committee and the Federal tax administration. Brazil's sophisticated electronic invoicing system, consisting of the *Nota Fiscal Eletrônica* or NF-e and the *Nota Fiscal de Serviço Eletrônica* or NFS-e, is expected to play a central role in the centralized IBS-collection and subsequent revenue distribution process. It requires suppliers to submit e-invoices to the tax authority for clearance before issuing them to clients. This has been complemented with a digital bookkeeping system (*Sistema Público de Escrituração Digital* or SPED), which serves as an e-compliance system, consolidating the receipt, validation, storage, and authentication of books and documents integral to the accounting and tax records of taxpayers, through a unified electronic flow of information. It is accessible by the taxpayer and tax authorities. Together, these systems provide detailed information to the tax authorities on production and distribution

[43] This 25% will be shared among the Municipalities, according to the following criteria:

- 80% in proportion to the size of the population;
- 10%, calculated on the basis of indicators of improved educational performance and increased equity, taking into account the socio-economic level of the students;
- 5% based on environmental preservation indicators, in accordance with State law; and
- 5% in equal amounts for all Municipalities in the State.

chains, including at transactional level, which is notably expected to facilitate a transparent and automated collection and revenue distribution of the IBS to the relevant States and Municipalities.

While the allocation and distribution of revenues from the dual VATs in Brazil, Canada and India have several distinct and unique features, reflecting design variations and differing requirements to ensure political consensus, they share the common principle of destination-based allocation of revenues. This applies in particular to the allocation of revenues from the sub-federal component(s) of these countries' dual VAT on domestic sub-federal trade (inter-states, inter-municipalities, inter-provinces). Particularly unique is Brazil's system of distributing net revenues through the IBS Steering Committee. This approach safeguards transparency and fiscal autonomy for the States and Municipalities to collect and administer these taxes while it simplifies compliance and administration by centralizing the offsetting of input-tax credits and cashbacks to low-income households against gross IBS revenues. The table below presents a further high-level comparison of the three regimes.

Table 10. Varying approaches to the allocation and distribution of revenues from the dual VAT

Brazil	Canada	India
Revenues from the federal CBS are not subject to revenue-sharing. Net revenues of the sub-federal IBS are distributed to States (IBS-State) and Municipalities (IBS-Municipal) in accordance with the destination principle. This requires tracking of the place of taxation of inter-State and inter-Municipal trade at transactional level. IBS revenue from B2B transactions where the customer is entitled to an input tax credit is not distributed, but remains with the IBS Steering Committee, which manages the deduction. In addition, Municipalities will receive a share of the IBS-State revenue of the State where they are located.	GST/HST revenues are distributed to the HST provinces and the federal government on the basis of a revenue allocation formula and data from the System of National Accounts and administrative data. The allocation mechanism is overseen by the Revenue Allocation Sub-Committee (RASC) of the Federal-Provincial Tax Policy Review Committee (TPRC).[44] The QST is collected by the Province of Quebec and requires no further distribution. The GST/HST collected by the Province of Quebec from businesses established in Quebec is transferred to the federal government.	The CGST and SGST are each levied at identical rates on intra-State supplies, which results in a 50:50 sharing of the revenues from taxing these supplies between the Centre (CGST) and the respective States (SGST). The revenue from the CGST is allocated to the Central Government. The revenue from the SGST is allocated to the respective State Government. The revenue collected from inter-State supplies (IGST), is shared between the Centre and destination States.[45] This requires tracking the place of taxation of inter-State trade at transactional level. Not only IGST revenues from B2C, but also from B2B inter-State supplies are shared with the destination States. The possibility to claim input-tax credits across federal and sub-federal GST components necessitates regular settlement and leads to regular transfers of funds between the States and the Centre.[46]

[44] This approach of relying on a formula avoids the need to track HST revenues for each transaction but requires agreement on the formula.

[45] The IGST collected by the Centre is apportioned between the Centre and the State(s). A portion equal by legal fiction similar to CGST is apportioned to the Centre. The remaining is apportioned to each destination State(s).

[46] Accounts would be settled periodically between the Centre and the States to ensure that the credit of SGST used for payment of IGST is transferred by the exporting State to the Centre. Similarly, IGST used for payment of SGST would be transferred by the Centre to the importing State. Further, the State portion of IGST collected on B2C supplies would also be transferred by the Centre to the destination State. The transfer of funds would be carried out on the basis of information contained in the returns filed by the taxpayers (*see* https://gstcouncil.gov.in/brief-history-gst, accessed on 16 February 2024); in more detail Sethuraman K. (2020), *Procedure for the Apportionment of Integrated Goods and Services Tax,* Indian Law Institute New Delhi, https://dx.doi.org/10.2139/ssrn.3937347.

5.3. The issuance of administrative guidance

It will be critical for the success of Brazil's reform to ensure consistency in the interpretation of the common rules applicable to the CBS and IBS. Allowing each of the 27 States and 5,570 Municipalities to issue individual regulations and interpretations would undermine the objective of the reform. The IBS Steering Committee will therefore be empowered with the authority to issue common implementing regulations and administrative guidance and to ensure the consistent interpretation and application of the IBS across States and Municipalities. This will include close collaboration with the Federal tax administration to also ensure consistency between the application and interpretation of the CBS and IBS, as both are governed by the same common rules.

In India, even though the Central Board of Indirect Taxes and Customs (CBIC) has the power to issue orders, instructions, and directions for the uniform implementation of the CGST and IGST and similar powers lie with the Commissioners of SGST in states and union territories for the SGSTs, rules and regulations are applied uniformly based on the recommendations of the GST Council. In Canada, the federal government publishes comprehensive guidance on the GST/HST. The Province of Quebec also issues guidelines for the application of GST/HST by businesses registered in Quebec. This two-track approach is coordinated in practice. Guidelines on the QST are only issued by the Province of Quebec.

Table 11.: Issuance of administrative guidelines

Brazil	Canada	India
The IBS Steering Committee will be empowered with the authority to issue common implementing regulations and administrative guidance and to ensure the consistent interpretation and application of the IBS across States and Municipalities. Collaboration between the IBS Steering Committee and the Federal tax administration to also ensure consistency between the application and interpretation of the CBS and IBS is yet to be determined.	Guidance for the GST/HST is issued by the federal government and by the Province of Quebec for businesses registered in Quebec. Coordination between these authorities is ensured in practice. Guidance for the QST is issued only by the Province of Quebec.	Circulars and guidelines are issued at Central level by the Central Board of Indirect Taxes and Customs for CGST/IGST. They are issued at the State level by State Commissioners of SGST. The recommendations of the GST Council enhance uniformity in practice.

5.4. Audits

Under a federal VAT governed by common rules but levied at multiple levels of the federal state, the authority for each federal level to carry out VAT audits for activities that occur within their territory can lead to divergent outcomes for similar issues. Disparities in audit findings may emerge due to variations in audit procedures and interpretation of the law, resulting in inconsistencies in tax assessments, compliance requirements, and enforcement actions across tax administrations. These differences may arise not only across different levels of government (e.g. federal government vs. states in relation to their respective regimes), but also within the same level (e.g. among states in relation to the common VAT). This is likely to lead to undue complexity, compliance burden and legal uncertainty for businesses operating across sub-federal borders.

Ensuring consistency of audit procedures and outcomes will thus be another important requirement to safeguard the consistent and efficient operation of Brazil's dual VAT across the three levels of the federal state. In practice, this will mean reconciling the States' and Municipalities' sub-federal tax audit and enforcement autonomy with the need for the uniform application of the CBS and IBS that will be governed by common rules. The agreed approach is to assign the authority to audit and assess the IBS to the tax administrations of the States and Municipalities within their respective jurisdictions, and to give a coordinating responsibility to the IBS Steering Committee to promote consistency and cooperation across

the sub-federal levels. The need to coordinate audit activity and outcomes also between the CBS and the IBS has been recognized. The approach to such coordination is yet to be determined.

A proper coordination of audit practices and outcomes will be needed to ensure that Brazil's dual VAT can fully deliver on its promise of an efficient, fair and neutral system. Divergences in audit and assessment practice could significantly reduce the benefits of the reform if those increase legal uncertainty, risks of litigation and of a *de facto* uneven playing field for businesses operating across sub-federal levels. The efficient administrative cooperation across Federal, State and Municipal administrations will in any case be required notably in light of the destination-based taxation of inter-State and inter-Municipal trade. The tax administration that administers and audits a supplier, at the location where that supplier is established, will indeed often be another one than the administration that has authority over the jurisdiction where the tax will be due, i.e. the State/Municipality of destination.

In India, the power to audits and other examinations of India's dual GST in domestic trade (CGST and SGST) and interstate trade subject to IGST are governed by a "cross-empowerment" arrangement (i.e. the officers of Central and State administrations are cross-empowered to issue orders based on provisions of the CGST Act, SGST Act and IGST Act). For seamless administrative actions, the GST Council recommends how to divide taxpayers between the Centre and State governments for audits and examinations under the dual VAT system. For the Canadian GST/HST, audit are carried out by the federal government except for businesses registered in Quebec, for which audits are carried out by the Province of Quebec. Revenu Québec also audits the application of the QST.

Table 12.: Audit powers under the dual VAT in Brazil, Canada and India

Brazil	Canada	India
Audit and assessment of the IBS will be carried out by tax administrations of States and Municipalities, each within their respective territories, with a coordinating role for the IBS Steering Committee. The coordination between the Federal level for the CBS and the IBS Steering Committee for IBS is yet to be determined.	Audits for the GST/HST are carried out by the federal government (Canada Revenue Agency) for all businesses except for those registered in Quebec. The latter are audited for GST/HST by the Province of Quebec (Revenu Québec). Audits for QST are carried out by the Province of Quebec (Revenu Québec).	The audit of a taxpayer for CGST, SGST, IGST is carried out by the respective tax administration having administrative jurisdiction over the concerned taxpayer.

5.5. Litigation

The need for consistency in administrative guidance and audit activity extends to administrative and judicial litigation as the final critical element to achieve the objective of a coherent federal VAT. This issue has not yet been fully resolved in the first stage of Brazil's reform, as it focused on the necessary amendments to the Federal Constitution for the introduction of the CBS and IBS.

The administrative courts that will decide the administrative disputes concerning the IBS will be subordinated to the IBS Steering Committee, which will have the power to appoint the representatives of the States and Municipalities in these administrative courts. Further discussions will be needed on the arrangements to ensure consistency of administrative and judicial litigation concerning the application of the CBS and the IBS.

In India, administrative decision-making on GST disputes is *de facto* centralised across CGST, SGST and IGST through "cross-empowerment" of the proper officer handling the case. If the proper officer under one administration (Central or State) has issued an order, any appeal, review, revision, or rectification against that order will only lie with that officer, who due to the cross-empowerment has the authority to rule on the federal and sub-federal component. Individuals aggrieved by the order passed by the officer can appeal to the appellate authority. Specialized tribunals called GST Appellate Tribunals, which function as second level of appeal, have been established within the GST framework as a common forum of dispute resolution.

These tribunals are composed of Judicial as well as Technical Members both from the Centre and the States. They have been created to ensure uniform GST dispute resolution at the judiciary level. Appeals against these Tribunals' decisions can be filed with High Courts and the Supreme Court on points of law. In Canada, administrative disputes concerning GST/HST are decided at the federal level by the Canadian Revenue Agency, except for GST/HST disputes involving businesses registered in Quebec, which are decided by Revenu Québec. Appeals against administrative decisions on GST/HST disputes are decided before federal court, including GST/HST disputes involving businesses registered in Quebec. Administrative disputes concerning the QST are decided by Revenu Québec while appeals are decided by the Court of Québec.

Table 13.: Litigation

Brazil	Canada	India
The Brazilian Federal Constitution determines that the IBS Steering Committee will "decide" administrative disputes relating to the IBS. The coordination between the Federal level for the CBS and the IBS Steering Committee for the IBS is yet to be determined.	Administrative GST/HST disputes are decided at the federal level, except GST/HST disputes involving businesses registered in Quebec, which are decided by Revenu Québec. Appeals against administrative decisions on GST/HST disputes are decided by federal court, including for businesses registered in Quebec. QST disputes are decided by Revenu Québec and, in case of appeal, by the Court of Québec.	Administrative decision-making on GST disputes is *de facto* centralized across CGST, SGST and IGST through "cross-empowerment" of the proper officer handling the case. GST Appellate Tribunals, have been created as a common forum for dispute resolution for CGST, SGST and IGST, to decide appeals against administrative decisions on GST disputes. Appeals from these tribunals can be filed with High Courts and the Supreme Court.

6. The transition towards the new regime

Given the depth and the breadth of Brazil's consumption tax reform, a phased approach has been adopted for the gradual transition towards the new regime over a considerable period of time. This should allow public authorities, businesses and consumers to gradually adjust to the new reality and to avoid undue economic and financial shocks notably for States and Municipalities. The transition to the new system will unfold gradually between 2026 and 2033. The full introduction of the CBS is planned for completion by 2027 while the full implementation of the IBS has been scheduled to be completed by 2033. A 50-year transition period has been agreed to absorb the revenue impact of the shift from origin- to destination-based taxation under the new IBS for states and municipalities (see sub-section 5.2 above). Box 2 below presents further detail on the transition period for the introduction of both the CBS and the IBS.

Box 2. The main phases of the transition towards the new regime.

Brazil's consumption tax regime will gradually transition towards the new regime over the course of a period from 2026 to 2032, with full implementation by 2033. The main phases of this seven-year transition will be as follows:

2026:

- CBS will be introduced at a rate of 0.9% for testing. The existing federal taxes (IPI, PIS and COFINS) will continue to be levied.
- IBS will be introduced at a rate of 0.1% for testing. The existing State and Municipal taxes (ICMS and ISS) will continue to be levied.
- Businesses will be allowed to offset the amounts paid for the CBS and IBS against the amounts due for the PIS and COFINS, or any other federal tax. The 1% CBS and IBS will however not be collected for registered persons that comply with reporting requirements (e.g. issue an electronic invoice with CBS and IBS).

2027-2028:

- CBS will be fully introduced.
- The IPI rate will be reduced to zero (except for certain products in the Manaus Free Trade Zone - ZFM).
- PIS and COFINS will be abolished (provided that the CBS is effectively introduced).
- The IBS will be levied at the State rate of 0.05% and a Municipal rate of 0.05% to test its revenue potential. The CBS rate will be reduced by 0.1% during this period to avoid an increase in the tax burden.
- The IS (Selective Tax) will be charged in full.

2029-2032: The IBS rates will gradually increase with concurrent gradual reductions of the ICMS and ISS rates. ICMS and ISS rates (and incentives) will be reduced to 90% in 2029; to 80% in 2030; to 70% in 2031 and to 60% in 2032. The applicable IBS rates during this transition will be set by the Federal Senate in a Senate Resolution.

2033: The new system will be fully implemented. IBS will be charged at full rate and ICMS and ISS will be abolished.

Treatment of Accumulated Credit Balances of Extinct Taxes. Businesses will be allowed to offset any ICMS credit balances that exist at the end of 2032 against their IBS liabilities, upon approval by the respective state. They will be able to offset ICMS credits linked to the acquisition of fixed assets in 48 monthly instalments. Other ICMS credits will need to be offset against IBS liabilities in 240 monthly instalments. These credit balances will be adjusted to inflation based on the consumer price index (IPCA) as of 2033. The Constitutional Amendment allows supplementary legislation to establish alternative uses for these credit balances, such as transferring them to third parties, as well as to regulate the possibility to offset IPI and PIS and Cofins credit balances, including presumed credits, against the CBS or other federal taxes, or alternatively, provide for reimbursement in cash.

Contractual Adjustment Mechanism. The Constitutional Amendment allows supplementary legislation to introduce mechanisms to adjust contracts signed prior to the enactment of the laws regulating the CBS and IBS, including public concessions, to avoid undue economic or commercial consequences of the transition to the new regime.[47]

[47] See article 373 and subsequent provisions of Supplementary Law No. 214/2025.