



International Tax

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Brazil

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New Provisions related to Brazilian service tax (ISS) approved by the President

Lei Complementar n. 116 was approved by President Lula and subsequently published on August 1, 2003. The new provisions make significant changes to ISS (*Imposto sobre Serviços – ISS*).

Background

ISS is a municipal tax on revenues derived from the provision of services. The tax base is generally the gross amount of the fees generated from the provisions of "covered" services. While ISS is a municipal tax, the services subject to ISS are defined by federal law, which generally provides list of covered services applicable to all cities. The applicable rate depends on each municipality - minimum rate is 2 percent but the most common rate is 5 percent.

Changes

Some of the significant changes to ISS contained in the new provisions include the following:

- The list of covered services subject to ISS was expanded. Some of the added services are quite significant. For example, the license of certain intangibles (trademarks or trade-names) was included in the list of covered services (note: the addition of this item is subject to discussion). Another significant example is the application of ISS with respect to services provided by financial institutions authorized to operate by the Brazilian Central Bank – the list of covered services was expanded to include many types of banking services that were previously not covered. These include currency exchange services, services related to the opening of bank accounts, leasing transactions, and among many others.
- The new provisions also provide for an exemption from ISS for revenues generated on the export of services. Previously, no ISS exemption existed for the export of services. (Note: this was contrary to many other Brazilian tax provisions which provide exemptions, reductions, or other type of tax relief to stimulate exports. For example, there is a PIS and COFINS exemption applicable to certain revenues generated from the export of services).



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However, the definition of exported services specifically does not include services provided in Brazil whereby the results or the benefits of the services is received in Brazil – even if the payment for the services is received from a non-resident.

- Under the new provisions, ISS now may apply to services provided by non-residents for the benefit of a Brazilian resident where the services were provided outside of Brazil or initiated outside of Brazil and terminated inside Brazil. This is a significant change – generally services provided by non-residents were not subject to ISS.
- A maximum applicable rate of 5 percent was established for all services. Note: prior versions of the provisions provided for a maximum rate of 10 percent for certain services.

KPMG Observation

The new provisions are generally immediately applicable as soon as the municipalities adopt implementing provisions; it is arguable that some of the provisions (resulting in increased taxation) would not be effective earlier than January 1, 2004.

The definition of services provided to a non-resident where the benefits or results of the services are received in Brazil is not clearly defined. However, it is clear that mere payment of a service by a non-resident may not be sufficient to constitute an export of service for ISS purposes.

