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The COVID-19 Pandemic and Relief Measures for the ICMS Tax Burden

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Abstract: The purpose of this article is to recommend measures to be adopted by Brazilian tax authorities to relieve the tax effects of the economic crisis associated with the coronavirus (COVID-19) pandemic and also allow taxpayers to continue contributing to tax revenues. The measures are aligned with OECD recommendations and do not represent any tax relief, since they mainly simplify procedures and recognize exemptions.

The coronavirus (COVID-19) pandemic is impacting all sectors of human life, particularly economic activities, causing interruption of financial flows, values and wealth that the tax systems use to finance the States, not only to provide public services, but also, especially at this time, to fund the extraordinary efforts inherent in fighting the current epidemic. That is to say, the capacity to collect money is reduced when the States most need it.

The purpose of this article is to suggest a few alternatives that, while not representing tax breaks (exemptions or waivers from obligations), characterize cash relief opportunities for companies that pay the Tax on the Circulation of Goods and on Services of Interstate and Intermunicipal Transportation and Communication (ICMS).

Governments all over the world have endeavored to develop relief measures for taxpayers, in order to mitigate the effects of the economic crisis while simultaneously preserving their ability to continue contributing to tax collection in the post-pandemic world, mitigating the harmful effects of the generalized shutdown.

The Organization for Economic Co-operation and Development (OECD) published, on March 16, and 20, 2020,[1] reports suggesting several measures to be adopted by tax administrations to ease the burdens on taxpayers in this moment of economic vulnerability.[2] We highlight the following:

- Extension of the period for payment of taxes and delivery of ancillary obligations;
- Suspension of penalties for delivery of an accessory obligation after the deadline;
- Suspension of tax procedures during the crisis period;
- Simplification of VAT (Value-Added Tax) refund procedures for non-performing transactions (including the reduction of the minimum default period to receive the refund); and
- Faster tax refund measures (including VAT).

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Trying to harmonize these OECD guidelines to Brazil, especially regarding indirect taxation, which is the responsibility of the States and the Federal District, we understand that the following measures can be adopted by the States and the Federal District to mitigate the impact on the financial health of companies in the face of the COVID-19 pandemic:

1. Deferral of ICMS on operations in which the final consumer has defaulted;
2. Recognition of the non-incidence of ICMS on transactions involving goods given as a bonus; and
3. Simplification of procedures and immediate refund of the accumulated ICMS credit balance by exporting establishments.

The general rule is that ICMS tax benefits are subject to article 155, paragraph 2, X of the Federal Constitution and Complementary Law No. 24/75, that is, they must be the object of an agreement between the States in the form of Agreements of the National Council for Tax Policy (Confaz), a body composed of the State and Federal District Finance Secretaries. Thus, incentives that result in a reduction of the tax burden in terms of ICMS should, as a rule, be authorized by means of the Confaz Agreement.

However, the suggested measures can be adopted unilaterally by the States and the Federal District, as they do not depend on authorization from Confaz. It should be noted that such proposals do not correspond to the waiver of tax revenue, being basically the recognition of rights provided for in the legislation and simplification of procedures by the tax authorities.

We will detail below the possible measures to be adopted.

Deferral of ICMS on Operations in which the Final Consumer Has Defaulted[3]

The restrictions on the circulation of people and goods accompanied by the measures adopted by governmental entities restricting economic activity are contributing to a significant cycle of contractual defaults.

In this regard, we understand that there are good arguments for granting deferral of ICMS in operations in which there was a default by the final consumer (de facto taxpayer). This is because, considering that the businesses subject to total default do not have an economic substance capable of being taxed, the incidence of ICMS ends up falling on the taxpayer's own assets.[4] Thus, in the absence of consumption, the ICMS must be deferred until the final consumer pays the transaction price.

In the case of acknowledging the consumer's absolute default (the transaction was not fully completed), once the price has been charged and it is recognized that it is impossible to collect such price, the ICMS credit highlighted in the transaction should be authorized.

Fundamentally, such measures would be political actions by the States and the Federal District and would not constitute any waiver of revenue by the tax authority.

We also point out that some taxpayers have sought to recognize the non-incidence of ICMS in such operations, arguing the violation of the principles of non-cumulative[5] and ability to pay;[6] however, we have not been aware, until now, of favorable decisions with binding effects.

Recognition of the Non-Incidence of ICMS on Transactions Involving Goods Given as a Bonus

We understand that there are good arguments to rule out the collection of ICMS on transactions with goods given as a bonus, in view of its unconditional discount nature.

According to a decision issued by the Superior Court of Justice (STJ) in Special Appeal No. 1,111,156 (analyzed under the system of repetitive appeals), a bonus consists of a discount modality characterized by the delivery of a greater quantity of merchandise sold instead of granting a reduction in the sale price. Therefore, according to the STJ, the value of the goods given as a bonus cannot be included in the ICMS calculation base.

Assuming that the goods given as a bonus have an unconditional discount nature, we understand that, since it is not subject to ICMS, the States and the Federal District should avoid any collection in this regard. In addition, in bonus remittance operations, there is no quantitative element of the tax levy.

Accumulated ICMS Credit Balance by Exporters: Simplification of Procedures and Immediate Refund

The difficulty of using the accumulated ICMS credit balance denatures and mitigates the principle of non-cumulative tax, not only making it an essentially cumulative tax, but also burdening the investment cost in the economic chain. In practical terms, although the right is established in the legislation, there are bureaucratic issues that result in the denial of the offset/refund. As a result, the credit becomes a cost to the company, since it incurred an expense (ICMS included in the purchases price) and its sales were not taxable.

Considering the unfeasibility of fully exercising economic activity during the current state of emergency in the face of the COVID-19 pandemic, there is an urgent need to relieve companies' cash flows by creating new mechanisms for monetizing their credit balances, such as crediting to a bank account.[7] Such measures would only bring effectiveness to the command of the constituent legislator,[8] who ensured the right and use of the ICMS credit resulting from export operations.

This recommendation was actually one of the OECD's suggestions in the report addressed to the tax authorities, as mentioned above. According to this document, the restitution processes must be prioritized and subject to speedy processing. In this regard, the OECD suggests that the tax authorities adopt certain criteria (such as taxpayer compliance history and minimum refund amounts) to make such procedures feasible.

The OECD stresses, for example, that such measures were adopted by El Salvador, which recently accelerated the processes of refunding VAT to exporters. In the same vein, similar measures have also been adopted by the tax administrations of Hungary and Latvia.

Having made the above considerations, we suggest the study of the issues exposed considering the particularities of each taxpayer, as well as a review of internal tax policies in order to identify possible alternatives for reducing the tax burden and relieving companies' cash flows.

Endnotes

[1] Available at: https://oecd.dam-broadcast.com/pm_7379_119_119698-4f8bfnegoj.pdf and https://read.oecd-ilibrary.org/view/?ref=119_119695-dj2g5d5oun&Title=Emergency%20tax%20policy%20responses%20to%20the%20Covid-19%20pandemic.

[2] A new report was published on April 21, 2020, presenting the measures already taken by the tax administrations. Available at: https://read.oecd-ilibrary.org/view/?ref=126_126478-29c4rprb3y&title=Tax_administration_responses_to_COVID-9_Measures_taken_to_support_taxpayers.

[3] Subject matter of Extraordinary Appeal No. 1,003,758, affected by the system of general repercussions.

[4] We point out that the Federal Supreme Court, when ruling on RE 574.706 and RHC 163.334, signed two different theses, but with the same legal-tax basis, namely: that the de facto taxpayer works as a collaborative entity, being a mere "repeater" of the ICMS paid by the final consumer. Adopting this same premise for cases of absolute default, it is possible to conclude that the ICMS must always be paid by the final consumer.

[5] The non-cumulative principle means that only the value added in the chain must be taxed. In other words, ICMS levied on purchases generate credits to be offset against the ICMS due on sales.

[6] The ability to pay principle means that the taxpayer contributes according to its capacity (e.g., the amount of tax an individual pays should be dependent on the level of burden the tax will create relative to the wealth of the individual).

[7] This is one of the measures proposed by the Proposed Amendment to Constitution No. 45/2019 (PEC 45), which provides for an agile refund mechanism for credits accumulated by exporters.

[8] According to article 155, §2°, X, "a" of the Federal Constitution.