WILLIAM FREIRE

Strategic Assessment of Tax Reform in Brazil

Presentation

The Constitutional Amendment No. 132/2023 and the Complementary Law No. 214/2025 represent a significant milestone in modernizing the **Brazilian tax system by introducing the Dual VAT (IBS/CBS)** and the **Selective Tax**. Implementing this new structure will pose substantial challenges for companies and taxpayers, requiring meticulous strategic planning to ensure compliance and operational efficiency.

The transition will be gradual until 2033, during which taxes such as ICMS, ISS, IPI, PIS, and Cofins will be phased out. This change necessitates a comprehensive review of financial and structural impacts across various economic sectors.

This document provides a strategic assessment of the implementation phases and necessary solutions for Brazil's consumption tax reform.

Our Tax Law team is ready to support you at every stage of this process, from impact analysis to implementing tax optimization strategies.

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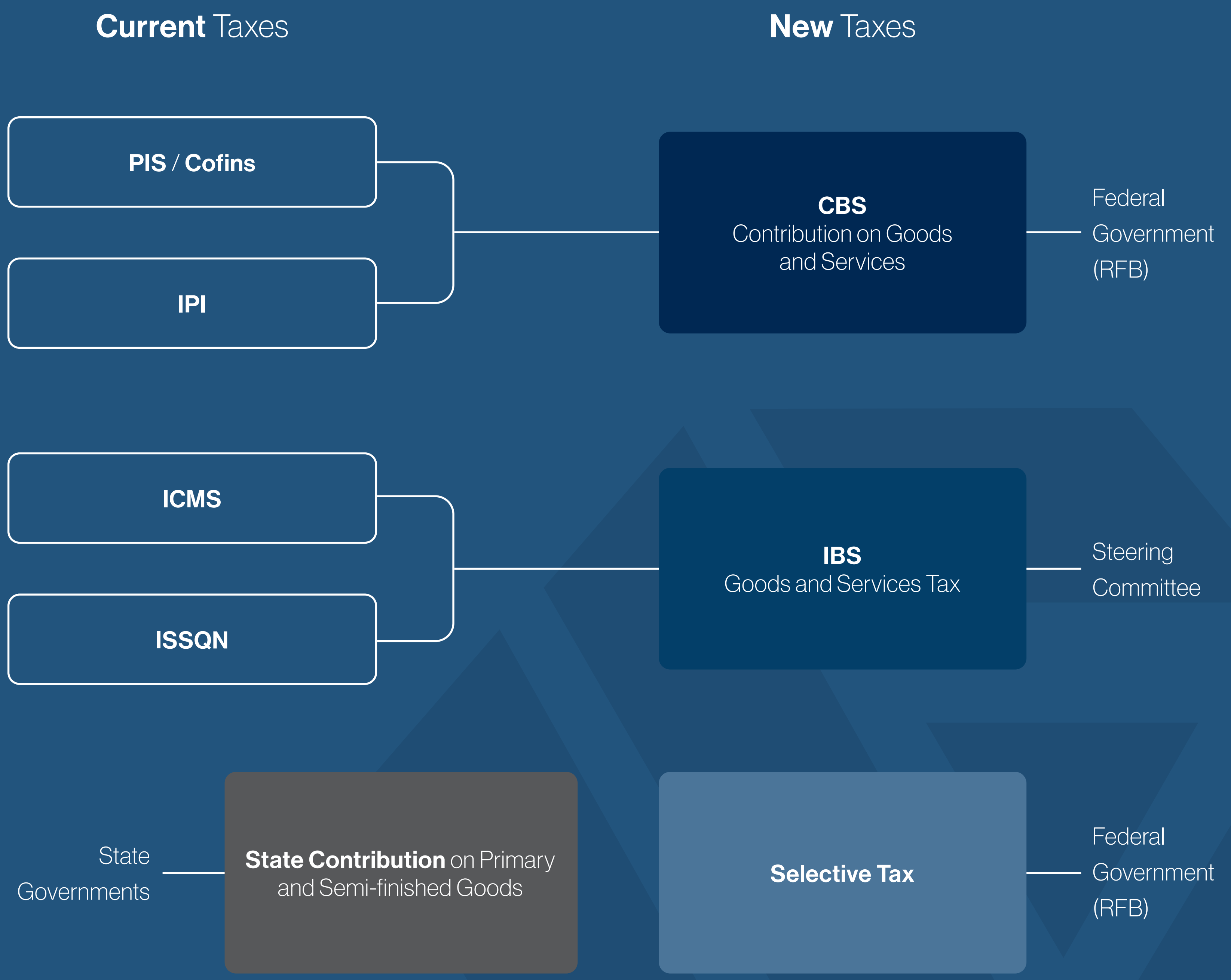
General Framework



Transition Timeline

2026
Start of transition

2027
Abolition of taxes and new tax

2029-2032
Gradual transition

2033
New consolidated tax model

2026 - IBS at 0.1% and CBS at 0.9%

Taxpayers meeting ancillary obligations under the law will be exempt from IBS and CBS payments.

If no exemption applies, the 1% IBS/CBS can be deducted from Cofins without increasing the tax burden. From 2027 to 2028, the 0.1% IBS will be offset against CBS.

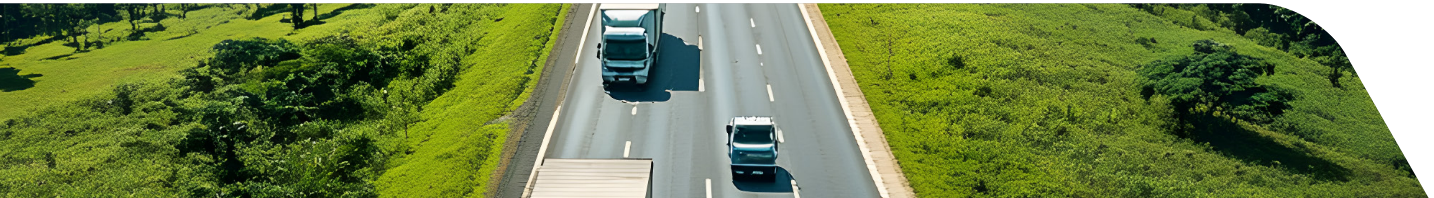
If a taxpayer lacks sufficient debts to apply the Cofins deduction, the amount paid may be offset against other federal taxes or reimbursed within 60 days.

2027 – Full Implementation of CBS

PIS and Cofins are eliminated, and IPI is set to 0%, except for industrialized products in the Manaus Free Trade Zone (ZFM).

Unused or unclaimed PIS/Cofins credits (including presumptive credits) not applied before the contributions were extinguished may be used to offset CBS obligations, provided they are properly recorded. This underscores the importance of conducting a timely credit assessment before 2027.

Implementation of the Selective Tax (IS).



2029 to 2032 – Gradual Transition

Beginning in 2029, ICMS and ISS will be reduced by 10% per year, with full elimination scheduled for 2033.

ICMS tax incentives will be maintained until 2032 in proportion to the ICMS/IBS transition.

The IBS and CBS reference rates will be established by a Senate resolution during this period.

From January 1, 2029, to December 31, 2032, taxpayers experiencing reduced ICMS benefits will be compensated through the Tax Benefit Compensation Fund or the Financial-Tax Compensation Fund.

2032 – ICMS Credit Settlement

Throughout 2032, ICMS credit balances will accumulate. Once explicitly or tacitly approved by the States, these credits may be:

Offset against IBS, transferred to third parties, or reimbursed by the Federative Council.

Used for fixed assets over their remaining useful life.

Compensated over a period of up to 240 months in other cases.

Adjusted for inflation based on the IPCA index starting in 2033.

2033 – Full Tax Reform Implementation

ICMS, ISS, and IPI will be fully eliminated.

Key Tax and Business Adjustments

Corporate Restructuring

Suppliers

Clients and **Markets**

Tax Incentives

Contracts and **Commercial Arrangements**

Corporate Restructuring for Tax Purposes

Sales and services between companies within the same economic group will be subject to internal transfer pricing (TP) tests, as outlined in Article 12, §4.

The taxable base will be determined based on market value, defined as the price applied in comparable transactions between unrelated parties.

Reassessment of existing corporate and tax planning strategies, including:

- Utilizing or monetizing accumulated tax credits.
- Leveraging tax incentives in specific states and municipalities.
- General tax efficiency strategies.

Supplier Selection

Tax credit eligibility will be linked to payment completion.

Client and Market Selection

Potential tax rate reductions while maintaining credit eligibility.

Assessment of Tax Incentive Loss

A detailed evaluation of the gradual reduction of tax benefits throughout the transition period (2029–2032).

Contract and Commercial Arrangement Review

Long-term contracts must incorporate provisions for IBS and CBS to ensure proper price adjustments and financial rebalancing.

Reassessment of CAPEX and OPEX in investment projections.

Valuation reassessment for potential mergers and acquisitions (M&A).

How to Prepare?

PREPARATION PHASES

Sequential Steps

1. Legal Impact Assessment of Tax Reform
2. Scenario-Based Financial Modeling of Reform Effects, based on the legal assessment (Step 1).
3. Tax and Corporate Planning, integrating insights from Steps 1 and 2.
4. Development of a New Income Statement (DRE) incorporating reform data and planned scenarios.

Parallel Steps

- Contract Review
- Tax Credit Optimization
- Implementation of Tax Reform Modules in ERP Systems and Adaptation of Other Software

Step 1: **Legal Impact Assessment of Tax Reform**

Assess the legal implications of the tax reform within the company's core business. This evaluation requires a clear understanding of the new regulatory framework and its application to business operations.

All transactions involving goods, services, and rights that trigger IBS/CBS and IS taxable events must be analyzed throughout each transition phase until full implementation in 2033.

Key aspects to evaluate include:

- Taxable base and incidence criteria.
- Destination-based taxation.
- Timing of taxable events.
- Simulation of applicable tax rates.

Related-party transactions must be assessed using market value taxation and transfer pricing tests.

Step 2: **Scenario-Based Financial Modeling**

Conduct financial modeling using relevant business scenarios to understand the real effects of the reform.

Establish a clear comparison between the current tax burden and projected tax burden at each transition stage until 2033.

Step 3: **Tax and Corporate Planning**

Revise the company's tax and corporate structure based on insights from legal and financial modeling.

Reevaluate business units established in locations that will lose tax incentives.

Review intra-group transactions subject to transfer pricing regulations.

Assess corporate restructuring options, including mergers, spin-offs, and acquisitions.

Step 4: **Full Financial Simulation of Reform Effects (New DRE)**

Develop a new income statement (DRE) incorporating IBS/CBS and IS effects at each transition stage until 2033.

Expand legal assessments beyond core operations to include:

- Imports.
- Energy and fuel transactions.
- Financial and real estate transactions.
- Transfer and disposal of various rights.
- Specialized tax simulation software may be required.

Parallel Steps

Review of Existing Contracts

Update long-term contracts to align with IBS/CBS and IS regulations.

Train procurement teams to negotiate under the new tax framework.

Tax Credit Optimization

Effectively recover and apply PIS/Cofins, ICMS, and IPI credits before transition deadlines.

Strategically offset credits against CBS and IBS obligations.

ERP Systems and Other Software

Implement tax reform modules in ERP systems.

Adapt financial and compliance software to align with new tax regulations.

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