



Navigating the Brazilian Tax Reform:

Stay Ahead and Prepare for Change

Executive Summary:

Brazil is undergoing a significant transformation in its tax system, which will have far-reaching effects on businesses and the economy at large. This Tax Reform in Brazil aims to simplify the tax system over consumption, enhance transparency, promote fiscal justice, increase efficiency, and encourage investments in the country.

From an indirect tax perspective, the biggest change is the introduction of the dual VAT system (federal & state/municipal). The implementation will follow a phased approach from 2026 to 2033. The new dual VAT rates are set to be comparable to current effective rates, with a unified IBS rate estimated between 17-18% and CBS rate around 8-10%, though final rates will be determined by complementary law.

The current tax regime consists of five main indirect taxes. However, after the tax reform transition period, and the introduction of the dual VAT system, Brazil will have CBS at federal level and IBS at state/municipal level, along with IPI/FTZ and IS at the federal level. Staying ahead of the changes is crucial for multinational businesses operating in Brazil to ensure compliance, optimize tax strategies, and mitigate potential risks.



Introduction:

Brazil, the largest economy in Latin America, is in the midst of a transformation aimed at reforming its complex and often cumbersome tax system. This reform is being driven by the need for modernization, the simplification of compliance processes, and the reduction of regulations that have been an obstacle to economic growth and efficiency.

The goal is to create a tax environment that is more transparent, business-friendly, and aligned with international standards. The reform introduces destination-based taxation for cross-border transactions, aligned with international VAT/GST principles. A unified national return filing system will replace multiple state and federal declarations, while the combined CBS and IBS rates will apply uniformly across goods and services. However, the process is complicated and requires businesses to be proactive in understanding how the changes will impact businesses and then planning accordingly.

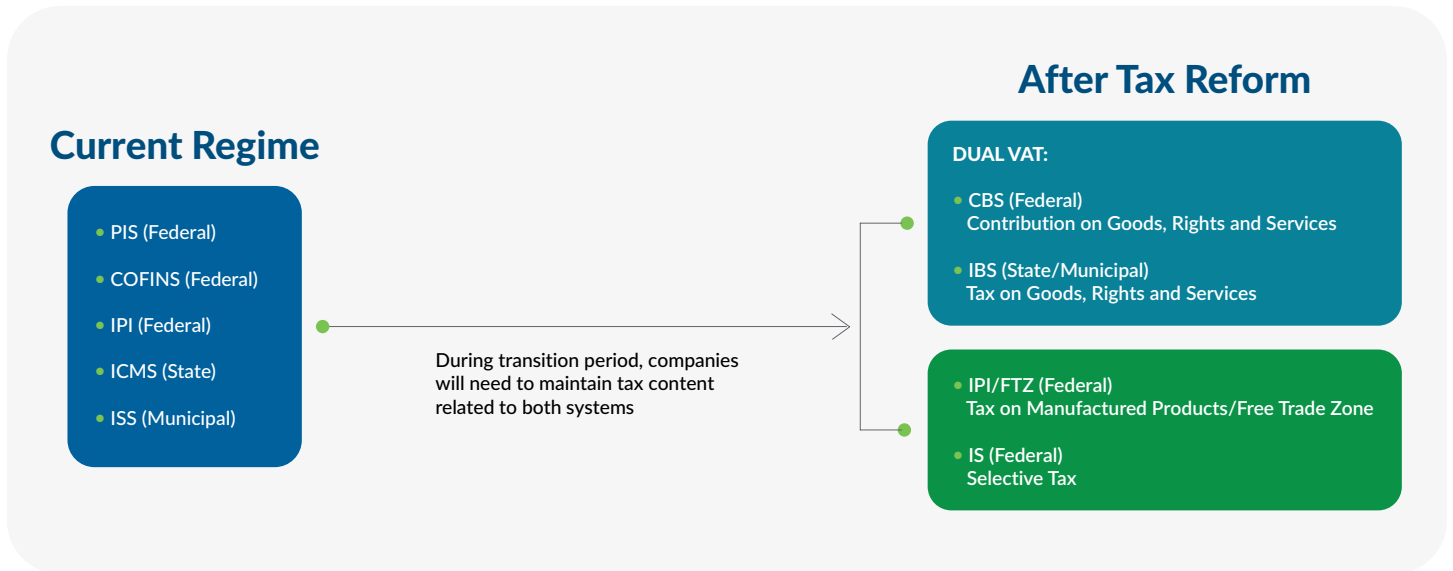
The Current State of Brazil's Tax System:

Brazil's tax system is widely regarded as one of the most complex in the world. According to a 2017 World Bank study, Brazilian companies spent an average of 1,501 hours per year to comply with tax obligations, which was significantly higher than the global average of about 240 hours. Recent studies show companies still spend over 1,200 hours annually on compliance, with international businesses particularly impacted by complex registration requirements, state-by-state regulations, and mandatory real-time digital documentation including NF-e and CT-e.

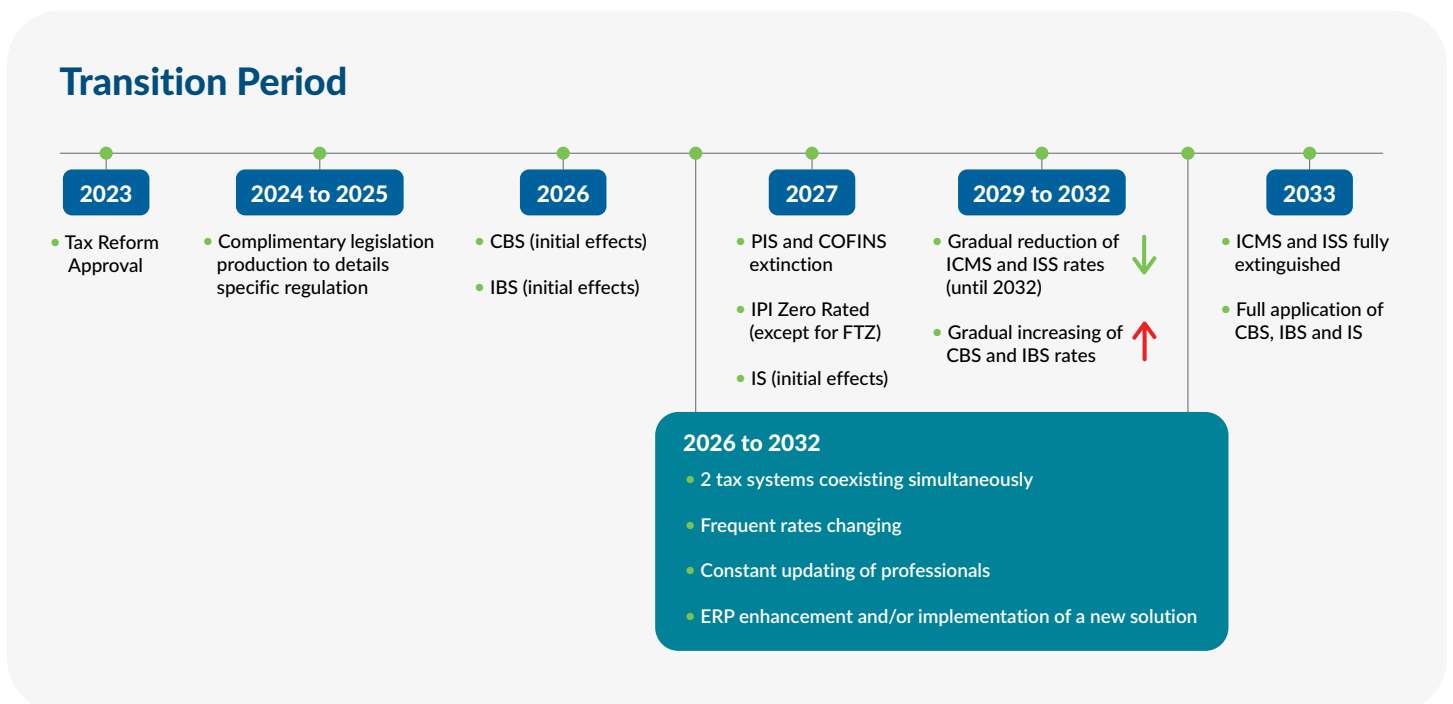
The fiscal system involves a range of federal, state, and municipal taxes that businesses must manage, often leading to confusion, inefficiency, and high administrative costs. Key features of the current system include:

- **Multiple Tax Layers:** Businesses in Brazil face a mix of federal taxes (such as PIS, COFINS, IPI), state taxes (like ICMS), and municipal taxes (such as ISS).
- **High Compliance Costs:** The complexity of the system requires businesses to maintain extensive documentation and often results in increased legal and accounting fees.
- **Inefficient Tax Collection:** The decentralized nature of the tax system leads to a lack of coordination and inefficiencies in tax collection and compliance enforcement.

These issues have prompted the government to initiate sweeping tax reform aimed at restructuring the system.



Given the level of change, a transition period for the reform is set to last from 2026 to 2033—allowing the government and taxpayers time to adapt to the new system. During this 7-year period both current and new tax systems will coexist—the current taxes will be gradually replaced by the new ones through a phased reduction of the current tax rates alongside a progressive increase in the new CBS and IBS rates.



Key Elements of the Brazilian Tax Reform

The Brazilian Tax Reform comprises several crucial changes designed to simplify the tax structure and improve overall tax compliance and efficiency.

- **Simplification of Indirect Taxes**

One of the primary goals of the reform is to simplify the indirect tax system. The current system's five main taxes (PIS, COFINS, IPI, ICMS, and ISS) will be consolidated into a dual VAT system, reducing the administrative burden on businesses.

- **Introduction of Dual VAT System**

A major overhaul in the reform includes the introduction of a dual VAT system: CBS at the federal level and IBS at state/municipal level. This system will apply uniformly across the country, reducing tax cascading and promoting more efficient tax collection. The destination principle will apply to both taxes.

- **Selective Tax (IS)**

The reform introduces a new federal-level Selective Tax (Imposto Seletivo) that will be levied on specific goods and services considered harmful to health or the environment, such as tobacco and fossil fuels, functioning similarly to an excise tax.

- **Special Tax Regimes**

The reform constitutionally guarantees the continuation of the Manaus Free Trade Zone benefits, while establishing clearer criteria for other special tax treatments and zones.

- **Revenue Sharing Mechanism**

The reform establishes a new mechanism for sharing tax revenue between federal, state, and municipal governments, including the creation of special funds to ensure no government entity loses revenue during the transition.

The reform aims to streamline these taxes into a dual VAT system, slashing compliance hours and administrative costs while bringing Brazil's tax system in line with international standards.

Impact to Global Organizations

The expected tax reform is going to present several challenges for multinational organizations operating in Brazil. These challenges stem from the complexity of the system, changes in tax rates, sector-specific impacts, administrative burdens, uncertainty, and further compliance risks.

Foreign companies operating in Brazil will need to navigate the complexities of the Brazilian tax system, which will see further intricacy during the seven-year transition period, with the introduction of new rules and regulations. This could lead to confusion and increased compliance costs. During this period, the organizations will need to maintain two systems in parallel (current and future)—which even further increases the level of complexity. Furthermore, revisions in tax rates can impact financial planning and cash flow for these businesses, affecting pricing strategies and profitability.

The Selective Tax (IS) will be levied on services and products considered harmful to the environment and human health. Therefore, the sectors impacted by this new tax will need to conduct an early assessment of the tax consequences on the costs of production, extraction, trading and importing of their goods and services

Administrative burdens may also affect multi-national companies in Brazil, as they may need to continue investing in tax and accounting systems to comply with changes. Choosing a solution that is used by the wider organization will help to reduce training and administrative costs—while providing reporting consistency for leadership. The right solution with experienced tax professionals and an intuitive user experience will also help to reduce the required investment on specific tax training for the new tax model and new systems.

Other opportunities include:

- **Simplified Tax Filing:** The introduction of a dual VAT system will reduce the complexity of tax filing and allow businesses to spend less on compliance and reporting. The unified national return filing system will replace multiple state and federal declarations.
- **Boost to Economic Growth:** A simplified and more transparent tax system tends to attract international investment, contributing to overall economic growth, which would benefit businesses in Brazil. The alignment with international VAT/GST principles will make Brazil more attractive for foreign investment.

Preparing for the Brazilian Tax Reform

Businesses must start preparing now to ensure they are ready for the changes ahead. Proactive planning will help minimize risks and optimize opportunities during and after the reform's implementation.

Early Action Steps for Businesses

- **Stay Informed:** Keep up to date with the latest news and developments surrounding the tax reform. Understand the specific changes, transition timelines (2026-2032), and impacts on your business operations.
- **Engage with Experts:** Work with tax advisors, legal professionals, and financial experts who can provide insights into the reform and assist with strategic planning. Consider partnering with technology providers experienced in Brazilian tax compliance.
- **Evaluate Current Tax Structures:** Review current tax strategies and identify areas that may need to be adjusted to align with the new system. Pay particular attention to how the transition from five taxes to the dual VAT system will impact your business model.

Importance of Internal Tax Reviews

Conducting an internal tax review is an essential step for businesses. This review should focus on:

- **Identifying Tax Exposure:** Assess impact areas including the new dual VAT system, IS (Selective Tax), and changes in tax calculation basis and rates.
- **Assessing Compliance Risks:** Evaluate readiness to handle parallel systems during the transition period and prepare for the new unified national return filing system.
- **Evaluating Potential Benefits:** Identify opportunities from simplified compliance, reduced administrative costs, and alignment with international VAT practices.

Building a Strong Compliance Framework

A robust compliance framework will be necessary to navigate the new tax system. This should include:

- **Up-to-date Software Systems:** Businesses must invest in tax software that can handle the complexities of the new tax structure. Choose solutions that can manage both current and future tax requirements during the transition period (2026-2032), support the new unified national return, and integrate with your existing ERP system.
- **Ongoing Training:** Employees involved in tax compliance will need training to adapt to the new rules and systems. Focus on understanding the dual VAT mechanism, destination-based principles, and new filing requirements. Consider creating a dedicated tax reform transition team.
- **Regular Audits:** Regular internal audits will ensure ongoing compliance with the new tax rules. Establish clear review processes for both the legacy and new tax systems during the transition period. Document all tax positions and calculations, particularly for transactions that span the transition period.
- **Technology Integration:** Ensure your tax technology can handle real-time compliance requirements and integrate with government systems for digital reporting.
- **Process Documentation:** Create and maintain detailed documentation of tax processes, including specific procedures for the transition period when both systems will coexist.



Adapting to Tax Reforms

Organizations in Brazil should begin preparing for the tax reform and implementing strategies to stay ahead.

How is Vertex preparing for the Tax Reform:

Vertex can serve as a resource to prepare for the Brazilian Tax Reform by taking the following measures to provide support during the transition period:

- Actively working to understand the new tax regulations and their implications for businesses.
- Monitoring legislative changes and updates with their network of Brazilian tax law experts.
- Engaging with Alliance Tax & accounting firms and participating in seminars, roundtable discussions, and presentations to gather insights and stay informed.
- Assessing the impact of the tax reform on Vertex solutions, including tax determination logic, tax content updates, and source system connectors.
- Ensuring readiness by updating Vertex solutions, such as O Series, and making comprehensive content available for testing months before the production date.
- Leveraging product and legislative intelligence measures to best support clients during the transition period.
- Developing specific functionality to handle the transition period requirements, including the ability to calculate taxes under both old and new systems simultaneously.
- Creating comprehensive testing scenarios to ensure accurate tax determination and compliance under the new rules.

Vertex's solutions are being prepared to handle the transition from the current five-tax system to the new dual VAT framework.

Why implement Vertex now?

Incorporating Vertex solutions into your business operations offers numerous benefits in the context of tax reform and the changing tax landscape:

- **Compliance with current tax calculations and innovations:** Ensure compliance with both current tax requirements and upcoming reform changes. Vertex's solutions are being prepared to handle the transition from the current five-tax system to the new dual VAT framework.
- **Efficiency gains:** Optimize workflows and minimize manual interventions, leading to increased productivity and reduced errors. Our automated solutions reduce the complexity of managing multiple tax types and jurisdictions, particularly crucial during the transition period.
- **Smoother transition to the new tax model:** Minimizes operational bottlenecks and ensure a seamless shift to the updated tax system.
- **Risk mitigation:** Identify and resolve tax-related issues early on, reducing the likelihood of costly mistakes and penalties. Benefit from built-in validation rules and automated compliance checks aligned with Brazilian tax requirements.
- **Data integrity at all stages of tax calculation:** Ensure accurate tax amounts in both current and new tax models, even when running simultaneously. Maintain consistent tax determination across your entire business operations, with detailed audit trails and reporting capabilities.
- **Maintain compliance with SPED¹ requirements:** Crucial for generating correct e-invoices.
- **Future-ready platform:** Benefit from regular updates that align with evolving tax requirements, including upcoming changes to rates, rules, and filing requirements.
- **Expert support:** Access to Vertex's team of Brazilian tax specialists who understand both the current system and reform requirements.

Stay ahead of tax reform changes and ask about the Vertex solution for Brazil tax determination. Contact your Vertex representative for more information.

¹SPED, or Public System of Digital Bookkeeping, is a Brazilian government initiative that aims to standardize and digitize the transmission of tax and accounting information. It simplifies the process of submitting tax-related documents and ensures compliance with tax regulations."



Conclusion

Brazil's tax reform represents both a challenge and an opportunity for businesses operating in the country. The transition from the current five-tax system to a dual VAT framework during 2026-2032 will require careful planning and robust systems. However, the long-term benefits of a more efficient, transparent, and predictable tax system are clear. Organizations will benefit from reduced compliance costs, simplified filing through a unified national return system, and alignment with international VAT standards.

Success during this transformation requires three key elements: early preparation, reliable tax technology that can handle both systems during the transition, and expert guidance through the complex change process. By taking early action and working with experts, businesses can navigate this transformation successfully and position themselves for growth in a more competitive economic environment.

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