Brazil evaluates input criteria for PIS and COFINS credits

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Brazil’s Federal Revenue Service provided important clarification regarding the concept of inputs for PIS and COFINS credits, but has still left much to discuss.

As informed in a previous article, Brazil’s Superior Court of Justice (STJ) rendered a binding decision defining the concept of inputs for federal social contributions on gross revenue (PIS and COFINS) credits under the non-cumulative system, which grants taxpayers the right to use credits to offset PIS and COFINS debts.

Pursuant to the interpretation of the STJ, inputs that generate PIS and COFINS credits are deemed to be goods and services acquired by the legal entity when it is:

1. Used in the provision of services or in its production, or to enable them; and
2. Essential for the production or provision of a service that must depend on the acquisition of said input, in such a manner that their removal renders the service provision or production impossible, or results in substantial loss in their quality. Direct contact of the inputs with the product or service is not required.

This precedent is important as it not only binds the judicial and administrative courts (eliminating the previous restrictive interpretation of the tax authorities), but also define concepts, however abstract, that allow a broad evaluation of the item as an input.

Previously, the Brazilian Federal Revenue Service (RFB) accepted the booking of PIS and COFINS credits in accordance with the concepts applicable to the excise tax (IPI) credits, under which an item is considered an input only when directly applied or consumed in the manufacturing process or service provision.

However, in light of the decision, on December 17 2018, the RFB issued Normative Opinion 5/2018, reviewing its previous understanding regarding the PIS and COFINS credits on inputs. Among the matters analysed and stated by the RFB, the following should be highlighted:

- An item may only be considered an input for credit purposes if applied in the manufacturing process or service provision. This excludes items related to the commercial area of the company, a matter that has been broadly discussed by taxpayers and is still denied by the RFB;
• It is possible to book credits related to the ‘inputs of the inputs’, which are goods and services applied in the production of inputs to be used in the production of other goods or provision of services (for example, expenses associated with the planting of orange trees by an orange juice manufacturing company);

• As a rule, credits are limited to the items applied up to the conclusion of the production of goods or provision of the service to the customer;

• Goods and services demanded by law (such as products for quality testing, workers’ safety gear, wastewater treatment, among others) may be considered an input provided that they are related to the production or service provision, and applied up to their conclusion. As an exception, items demanded by law may be considered inputs even when applied after the conclusion of the manufacturing process (if they are a legal requirement to sell the product, such as labelling and quality tests); and

• Expenses associated with the research and prospecting of energy and resource mines, deposits and wells, which do not end up producing goods for resale, should not be considered as inputs (nevertheless, in such activities that result in the production of goods for resale, the RFB only states that it demands a case-by-case analysis).

Normative Opinion 5/2018 represents important progress made by the RFB, as it reviewed its restrictive and illegal interpretation regarding the PIS and COFINS credits, accepting the key aspects of the interpretation construed by the STJ.

Nevertheless, Normative Opinion 5/2018 also establishes certain limitations to the PIS and COFINS credits on inputs, which will probably be discussed by taxpayers, such as credits related to research and to natural resources prospecting, which does not end up producing goods for resale, among others.

Discussion’s around the concept of inputs for PIS and COFINS is far from being over, and has now entered a new phase.