

TAXATION*by José Antonio Schöntag**Coordinator of the Tax Nucleus of FGV Projetos***19 FEBRUARY 2015****THE BASIS FOR CALCULATING THE COFINS AND ICMS TAXES**

The Supreme Federal Court (STF) has not yet reached a definitive decision on whether the Tax on Sales and Services (ICMS) is part of the basis for levying the Tax for Social Security Financing (Cofins). The matter was dealt with in Special Appeals (RE) number 240.785 for ten years, from 1998 to 2007. It began with the rapporteur's vote in favor of the tax-payer. Five ministers then also voted in favor, the seventh vote was in favor of the Government, while the eighth minister requested inspection of the files and the process came to a halt.

Anticipating the likelihood of defeat, in 2007 the Government filed Declaratory Action of Constitutionality (ADC) number 18 in order to obtain from the STF a sentence declaring the ICMS to be at the basis of the Cofins. So far, the practical effect of this ADC was to obtain from the Court the – temporary! – decision to stay the RE and accordingly grant precedence to the ADC.

Seven years later, the STF inverted its decision; the RE re-appeared and was judged. On 6 October 2014, the Court decided that the ICMS is not part of the basis for the Cofins tax. The decision was limited in scope, being valid only for the RE company. There is no deadline date scheduled for the Court to decide on the Advanced Course in Technology of Management Processes; the decision reached in the new process will be definitive, binding and with a general effect for all, including companies that filed and brought action against the RE.

The rapporteur minister's vote in the RE process can be summed up in the following two statements:

- 1) The concept of billing has to do with the private revenue or wealth of the person who bills. Cofins tax-payers do not bill the ICMS, whose value denotes a disbursement to the public entity qualified to charge it;
- 2) It is not feasible to admit levying the Cofins tax on the ICMS when Complementary Law (LC) number 70, dated 1991, in keeping with the Constitution, itself annulled the possibility of including in the basis for calculating the Cofins the value owed as IPI excise tax.

Before addressing these two statements, it is important to offer some preliminary remarks in respect to the taxes in question. Bearing in mind the fact that the rapporteur-minister also mentioned the IPI, besides the ICMS, it is appropriate to begin with them. First of all, it should be emphasized that the ICMS and the IPI contain a somewhat strange and little-known feature, namely, the definitions of their bases for calculation are themselves based on how their respective taxpayers are defined. This originates in the old consumer tax, in the case of the IPI, and in the tax levied on sales and consignments, in the case of the ICMS. At that time, as now, the factories and shops of large companies were located in different cities and different states. Also at that time, but no longer, so-called revenue inspectors (the "revenue" of the state, nothing to do with income tax) enjoyed a share of the total value of fines levied in tax-inspection actions. This fact made it necessary, first of all, to limit the territories of the fiscal units where the tax inspectors were to work, and - more importantly - to grant the status of taxpayer to all the establishments (ICMS) or only to the factories (IPI) located in that area. After all, tax agents can only charge taxes from taxpayers.

Another equally or more relevant reason for this status, in the case of the ICMS, sprang from the need to tax transferences between the various establishments of a company, especially those not located in the same state. As a result, the previous IPI and ICMS taxes were faced with definitions of the bases for calculating without economic effects, because transferences between a company's establishments do not qualify as earned revenue. Both defined their bases for calculating as "the value of the outflow operation", which is still used today. Unlike "revenue", a legal term adopted in commercial and corporate law, this "value of the operation" was not a legal expression. Tributary law had to define it. This made it necessary for the laws that instituted the IPI and the ICMS to specify in full detail what was to be understood as the respective bases for calculation. (In the case of the Cofins, whose basis for calculation - revenue - was already a legal concept, so the instituting law did not need to define it. All that was necessary was to enumerate some items that should be excluded).

The legal matrix of the IPI, Law 4.502 of 1964, did not include the tax itself in its basis for levying. In turn, the legal matrix of the ICMS (Complementary Law 87 of 1996) defined the tax as being one of the portions that were to make up its own basis for calculation. (As a matter of fact, ever since Amendment 33 of 2001, the Constitution also provides that the value of the ICMS is part of its own basis for calculation, which for the Judiciary Power makes it an undisputable and unquestionable legal fact).

The definition of the operation value is obviously applicable to any type of operation, including sales. Consequently, in sales the two taxes incur on the same basis for calculation - revenue - that

includes the ICMS but not the IPI. The result of this is that the IPI generally speaking is applied to the ICMS but the ICMS, which is levied on itself, is not applied to the IPI.

The IPI, not being contained in the price of the product, but always levied on the seller, must be mentioned in the invoice of the industry. This is also because the buyer of the product needs to know it, being part of the purchase price. Failure to mention the IPI punishes with a hefty fine any industrial establishment that emits the invoice. As for the ICMS, special mention in the invoice is totally dispensable, and when it exists, this is merely for illustration. After all, it is already contained in the price of the operation. To charge the IPI outside the price means that it is not part of the “added wealth expressed in the increase in the seller’s assets”, in the words of the rapporteur-minister, who mistakenly referred in the vote to the ICMS. It is really the IPI that is received on behalf of the Government, since the industrialist is a mere depository of the value. For this very reason, article 2 of Decree-law 326, dated 1967, declared it a crime of embezzlement, provided in article 168 of the Penal Code, to use the product of charging the IPI for purposes other than collecting taxes. (The fruit of deliberate “legislative contraband”, the last article of LC 70 revoked this provision in 1991).

With regard to the Cofins tax, the taxable event only applies to sales operations. Accordingly, its basis for calculation is always revenue. Consequently, the Cofins also does not apply to the IPI, but since it applies to revenue, it does apply to the ICMS, which in reflex applies to the Cofins. Of the three, only the IPI does not apply to itself. Here we should stress that the IPI, as well as the import tax, is an exception. The general rule of the levying of taxes, including income tax, ICMS, PIS, Cofins, the tax on services (ISS) and so many others, is for the tax to be part of the earned income or of the seller’s revenue, and accordingly is legally entered into his “stock of wealth”.

To return to the vote in the RE, it can now be affirmed that the first statement would be absolutely correct if, instead of the ICMS the rapporteur was referring to the IPI. Nothing that was said there applies to the ICMS, which enters the company wrapped in the revenue from sales, as indeed has been acknowledged by the very Court in other decisions. The titles given by some tax experts to their articles: “The inclusion of the ICMS in the basis of the Cofins”, merely denotes the cunning intention to suggest that the ICMS would stay outside revenue until it was unduly included by the Cofins law. After all, one can only include what is not contained.

In the second statement, the rapporteur was betrayed by an incongruent, useless provision of LC 70. Incongruent because the IPI was never part of the revenue from sales or of the value of any other sort of operation between taxpayers; and useless because it had a portion excluded that has always been already outside.

If there remains any doubt, it suffices to read the law that rules the non-cumulative Cofins, Law 10.833 of 2004. On defining the basis for calculating the tax, this law authorized several deductions and exclusions from revenue, without mentioning the IPI. Why didn’t any taxpayer complain about this “lapse of memory”? On the other hand, if the LC 70 was right in excluding the IPI from the basis for the Cofins, as was presumed by the rapporteur, this would run counter to his line of argument, since exclusion of the IPI could not serve as an argument for presuming the exclusion of the ICMS, which was not even mentioned in the LC 70 of 1991 – which, by the way, since 2004 has only applied to special, economically insignificant situations.

Finally, it should be noted that excluding the ICMS from the basis for the Cofins, as the Court decided, raises some questions that are difficult to answer. Take the taxpayer who won the right (in the RE) to calculate the Cofins according to the STF’s decision. Up to the moment this person is the only Brazilian citizen who possesses such a right. Take also the fact that he or she is a correct tax-law-abiding person. Well, now the decision made by the Court contradicted the following provisions:

- 1) The basis for calculating the ICMS is the value of the merchandise outflow operation (LC 87, article 13, item I). (Being a sales operation, the value of the operation is given the name "revenue").
- 2) The ICMS is part of its own basis for calculation, so it is included in the revenue (Constitution, article 155, § 2º, item XII, subitem i; LC 87, article 13, § 1º);
- 3) The basis for calculating the Cofins is the revenue (Constitution, article 195, item I; Law 10.833, article 2).

This being so, citizens who exclude the ICMS from their company's revenue will be disobeying two norms of a complementary law, one article of law, and two provisions of the Constitution, simply because the Cofins will be calculated on a basis without the ICMS, that is to say, a smaller basis than the revenue from sales. But that isn't all. Let's consider that the RE citizen, apart from being a correct law-abiding person, is also an ethical citizen who will not appropriate the tax gain resulting from the Court's decision. In other words, he/she will pass on to his/her clients, by bringing down prices, the tax reduction that was earned. This raises a second question. Reducing prices obviously implies a reduction in revenue, which in turn will reduce the tax basis. This, therefore, will mean not only a lower Cofins (as the Court wants), but also a reduced IPI and ICMS. After all, the three of them share one single basis.

So, there is only one possible conclusion as to what happened in the RE process: the Supreme Court approved an illegal, un-constitutional decision. It's a good thing that it benefited a single company. For the time being, at least. Now let's wait and see the outcome of the ADC 18!