TAXATION ON IMPORT AND EXPORT OF SERVICES: SHIFTING TO A COMPETITIVE INDUSTRY

- *Services affect industry in two different ways: they can affect production costs and contribute to add value to, differentiate and customize products.*
- *The increasing complementarity between industry and services in creating and adding value requires both sectors to be competitive in order to benefit each other.*
- *Leveraging foreign trade in services in Brazil depends to a great extent on addressing problems and distortions in the tax system applied to the sector's imports and exports.*

One of the most important aspects of the phenomenon known as "servicification" of the world economy is the increased relevance of services incorporated into the industrial production of countries. When accounted for as inputs, services already represent 40% of the value of manufacturing production in the world and act to add value to and differentiate products and increase business productivity.

The contribution and complementarity of services for industrial production are also high in Brazil. The intermediate consumption of services in the total value of the manufacturing industry reaches 18%, while the intermediate consumption of services in the value added of the manufacturing industry is as high 62%.

Services also represent an increasing share of world exports. Although they account for a quarter of total trade, services incorporated into global exports of goods represent 45%.

In Brazil, services on the value added of exported goods are some of the largest among emerging countries, reaching 49%. Nonetheless, imported services have a very small participation in exports of goods in Brazil of only 4.8%.

Brazil can export more and increase its share in the foreign trade in services if it overcomes the distortions that are concentrated in the tax area. The competitive offer of services to add value to and reduce costs in industrial production depends on an ambitious agenda that addresses the problems of the tax system applied to imports and exports in Brazil.

The tax burden on service imports in Brazil is complex and high and has a negative impact on the Brazilian competitiveness, affecting both imports and exports in the country.

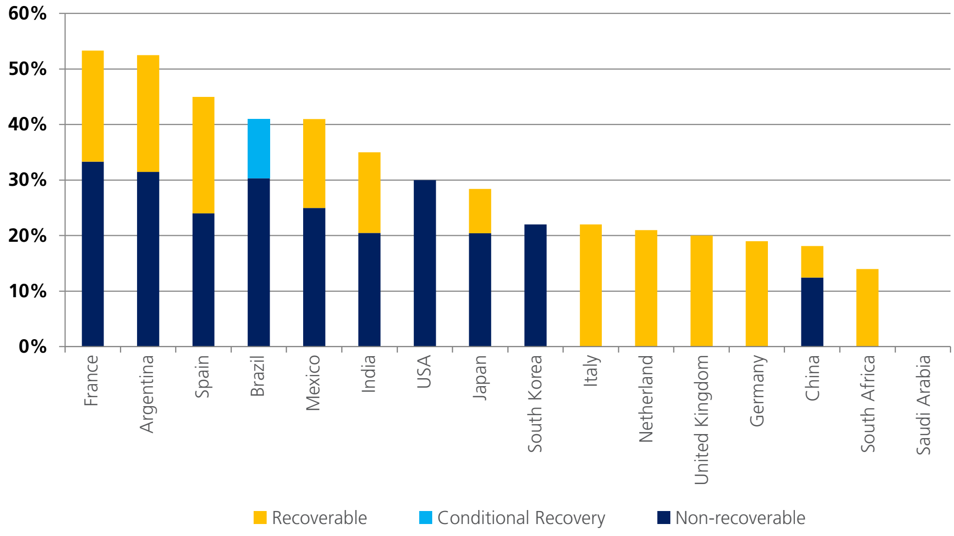
Main recommendations

To eliminate tax distortions in service imports:

1 The amount and complexity of the tax burden should be reduced through the unification of consumption taxes on service imports; elimination of taxes levied on the calculation basis of the Social Integration Program (PIS) - Import/Social Security Financing Contribution (COFINS)-Import; exemption from the Contribution for Intervention on the Economic Domain (CIDE) - Repayments to the service importer; and exemption from the Tax on Credit, Exchange and Insurance Operations (IOF) - Exchange on currency conversion transactions for the payment of imported services.

2 New criteria for the deductibility of expenses incurred in the import of services involving the transfer of technology must be established.

TAXES ON SERVICE IMPORTS – RECOVERABILITY



Source: NATIONAL CONFEDERATION OF INDUSTRY (CNI). International Comparison of Taxation on Service Imports. Brasilia: CNI, 2016

3 The enforcement of treaties to avoid double income taxation should be improved to provide for both the inclusion of CIDE- Foreign Remittances in such treaties and the non-taxation of income at source for certain imported services as royalties.

4 The extension of the drawback mechanism for the suspension of taxes on the import of services used in the export of goods should be provided for.

To eliminate tax distortions in service exports:

1 Brazilian transfer pricing legislation should be improved to expand the hypotheses for price adjustments, allow the enforcement of transfer pricing rules for goods and services marketed together, and adopt the Advanced Pricing Arrangement rule, in order to pre-determine the prices practiced by companies.

2 Offsetting of the Corporate Income Tax (IRPJ) paid abroad on service exports by companies opting for assumed profit should be allowed.

3 Distortions related to the Tax on Services of Any Kind (ISSQN) on service exports should be eliminated by converting the ISSQN into non-cumulative tax; creating a suspension or non-levy system for acquisitions by preponderantly exporting companies; and developing a mechanism of ISSQN reimbursement to exporters.

4 Distortions related to ISSQN on service exports should be eliminated in order to make the adoption of the cumulative PIS/COFINS regime optional, create credit mechanisms for service exporters, and set a maximum time limit for the reimbursement of PIS/COFINS credits.

5 A new law should be formulated to eliminate the IOF-exchange tax on the entry in the country of service export revenues, as is the case of goods.

The full version of the document can be accessed through the QR code on the side or at: http://www.cni.com.br/eleicoes2018/downloads/ This summary is part of the series Proposals of Industry for the 2018 Elections comprising 43 documents. The series, which is based on the *2018-2022 Strategy Map for Industry* is a CNI contribution to the new federal administration and presents analyses and proposals of priorities to increase Brazil's competitiveness. Brasília-DF, July 2018.

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