

# Kluwer International Tax Blog

## Broadening the VAT Base: Financial Services and Supplies of Real Property in the Brazilian Tax Reform

Melina Rocha Lukic (York University, Canada) and Daniel Loria (Loria Advogados) · Tuesday, March 4th, 2025

*The authors would like to thank Bernard Appy, Secretary for Tax Reform at the Ministry of Finance (Brazil) for his comments and inputs.*

It is well established in the academic literature and suggested by international organizations that a broad-based VAT reduces distortions, increases economic efficiency, promotes growth and simplifies the system (Bird et al, 2007, Brys et al, 2016, Acosta-Ormaechea, 2019). Additionally, empirical evidence suggests that reduced rates and exemptions tend to benefit high-income households more in absolute terms than low-income households and, therefore, are not the most effective way to achieve equity (OECD/KIPF, 2014; Thomas, 2020; OECD, 2024).

In recent years, the most common recommendation for broadening the VAT base has been to reduce rates differentiation and exemptions and to implement targeted VAT refunds to low-income households to address regressivity and equity concerns (Thomas, 2020; Barreix, 2022; de la Feria et al, 2024). However, most jurisdictions still apply reduced VAT rates to a range of goods and services considered essential, and many countries also make extensive use of VAT exemptions (OECD, 2024).

Like other countries, the political economy obstacles to implementing a broad-based VAT were present in the tax reform recently introduced in Brazil. The country is currently implementing a Dual VAT system (IBS/CBS, the acronyms in Portuguese for GST) that will maintain the same tax burden of the replaced taxes relatively to GDP, which means the standard rate will be determined based on the revenues collected from the taxes that will be replaced. For political reasons, the reform included a list of goods and services subject to reduced rates and beneficial regimes, which will, in turn, increase the standard rate. Following empirical studies and best practices recommended by international organizations, the reform will also implement a personalized refund of the VAT paid by lower-income households (named as “cashback”) to address distributional goals.

Although Brazil could not fully implement a broad-based VAT due to the numerous reduced rates and beneficial regimes, the Brazilian reform has broadened the VAT base by including supplies that are normally not subject to VAT in other jurisdictions, such as financial services (specifically margin-based services) and supplies of real property (such as sale and rental of used residential property). Both models are described in further detail below.

## Brazilian VAT model on financial services

As Pierre-Pascal Gendron once said, “the incorporation of financial services into the base of a value-added tax (VAT) operated on a transaction-by-transaction basis using the invoice-credit method remains the last unconquered frontier for this type of tax” (Gendron, 2016).

Financial services, especially margin-based ones, are exempt from VAT in most countries. Some countries do apply VAT on certain fee- and commission-based services provided by financial institutions. The non-taxation of margin-based financial services is primarily due to the complexity of determining the tax basis (i.e. taxable financial margin) and calculating it on a transaction-by-transaction basis. However, the VAT exemption on financial services has created complexity, distortions and impacts on neutrality, mainly because the financial services providers cannot claim input tax credits on their purchases (Gendron, 2016, López-Laborda et al, 2018).

During the discussions of the group responsible for drafting the model, academic models for applying VAT on financial services that are compatible with the credit-invoice method were considered, such as the “mobile-ratio method” proposed by Julio López-Laborda and Guillermo Peña (2018) and the model proposed by Næss-Schmidt et al (2016).

Ultimately, as Brazil currently applies a turnover-tax (PIS/COFINS) on financial services, the reform adopted a “subtraction approach” similar to the one in place with the current taxes. As such, while the financial services based on fees and commissions will follow the regular transaction-by-transaction VAT model, the margin-based financial services will follow an accounts-based method under a specified regime. According to this regime, the VAT will be calculated at a specific rate on the difference between revenues and deductible expenses related to the financial services. More specifically, VAT will apply to certain financial revenues (e.g. revenues from loans, foreign exchange transactions, and transactions with securities and financial instruments) after the deduction of certain amounts (e.g. financial expenses incurred as cost of funding, foreign exchange expenses, losses on securities and financial instruments).

To avoid distortions and cascading, the Brazilian model will implement a non-cumulative system under the financial services regime. Financial services providers subject to the regime will be able to claim input tax credits on their expenses and the purchasers of financial services registered for VAT will also be able to claim input tax credits, with specific rules and exceptions.

In the case of loans, the input tax credit for registered businesses will be equal to (a) the financial expenses (i.e. interest) in excess of the risk-free interest rate (in Brazil, Selic), multiplied by (b) the tax rate paid by the creditor of that loan on its margin. More specifically, the basis for the input tax credit will be calculated by deducting from each loan installment, at the time of payment in cash: *i*) the portion of the loan payment that corresponds to the principal amount (following the amortization schedule set in the loan contract); and *ii*) the amount equivalent to the Selic rate on the principal.

There will be a difference between the basis for the VAT applied on the services and for its corresponding input tax credits, since banks will be able to deduct actual cost of funding, while the debtors will deduct Selic. However, in practical terms, this was deemed to be more equitable than allowing banks to deduct Selic, since the larger ones have funding costs that are lower than this rate (due to interest-free deposits from their clients), while smaller banks have higher funding costs.

Another important point is that banks will be able to deduct from the basis provisions for losses on the loans, including on the principal amount, following generally accepted accounting principles. This can lead to a potential mismatch between the VAT applied on the services and its corresponding input tax credits. For bonds and other debt instruments issued in the capital markets, a zero percent rate applies on the creditor side when it is a financial service provider, while creditors who are not taxpayers (e.g. the general investor base) will not be subject to tax. In these cases, there is no input tax credit for the debtor, but it is expected that lower interest rates will be available under these circumstances, due to the difference in VAT.

Last, the law was not able to design a credit system for foreign exchange transactions, due to practical constraints on how to measure the foreign exchange margin on each particular transaction.

### **Brazilian VAT model on supplies of real property**

VAT on real property is another complex area where jurisdictions adopt very different approaches. Some countries apply VAT on the sale of new residential properties and exempt the sale and long-term rental of used residential properties. In respect of commercial properties, some jurisdictions apply VAT on the sale and the rental of both new and used properties as the purchasers/lessees are generally entitled to input tax credits. This is the case in Canada, New Zealand, India and Australia. As with financial services, the VAT treatment of real property has led to distortions and cascading effects due to input tax credit restrictions, as well as complexities arising from qualification issues (Poddar, 2010).

Academics have proposed that all transactions with real property should be included in the VAT base (Cnossen, 2010, Poddar, 2010, van Brederode, 2011). The taxation of newly built residential property is considered a second-best approach and a reasonable proxy for the discounted value of the VAT that should have been applied to exempt rentals or the owner's use of the property. However, because residential properties usually appreciate, this approach does not account for increases in property value that should be subject to VAT (Cnossen, 2010, Peacock, 2023). To address this issue, it has been proposed to apply VAT to the difference between the selling price and the purchase price, either directly or through a margin scheme that allows an immediate tax credit against sales at the time of purchase (Cnossen, 2010). Another proposed model involves applying VAT to an imputed rent, treating owner-occupiers as if they were supplying residential services to themselves as tenants for a specific period, such as a year, while excluding the first sale of residential properties from the VAT base (Peacock, 2023).

In Brazil, the model that will be implemented in the reform tried to address the issues above. All supplies of real property such as sale and rental will be subject to IBS/CBS under a specific regime. Persons selling or renting real property in the course of commercial activities will be subject to the specific regime. Additionally, individuals who make supply of real property will be required to register for and apply IBS/CBS on their supplies if the following conditions are met: *i*) if they rent or lease more than three different properties and their revenues with these supplies exceeds R\$ 240,000 (Brazilian real) in the previous calendar year; or *ii*) if they sell more than three different properties, including transferring property rights, in the previous calendar year. Further, individuals who sell real property or transfer real property rights on properties they have built themselves will be required to register if, in the previous calendar year, they sold more than one property they built within the last five years prior to the sale.

The VAT on the sale of real property by registered persons will apply on the added value at each stage of the construction and commercialization process of real estate, as follows:

- VAT will apply only to the difference between the sale price and the land and building cost. The cost amount will be generally the original purchase price of the property adjusted for inflation. For example, if a taxable person buys a property for R\$ 1 million and sells it for R\$ 1.1 million, the taxable amount is only \$ 100,000.
- In addition, a \$ 100,000 BRL (approximately \$17,000 USD) deduction will be applied to the taxable amount on the sale of newly built residential properties. This ensures a progressive tax structure, reducing the tax burden on affordable housing.
- The tax rate applied to the reduced taxable amount will be 50% lower than the standard rate. This results in an effective rate of approximately 13.25% if the standard rate is 26.5%. The reduced rates for both sale and rental were included for political reasons. Ideally, supplies of real property should be subject to the standard rate.
- The registered seller will be entitled to claim input tax credits in respect of all IBS/CBS paid on construction materials and services.

Rentals of real property by registered persons, including both commercial and residential properties, are also taxable under the specific regime and the tax rate for these supplies will be 70% lower than the standard rate. Additionally, a deduction of \$600 BRL (approximately \$102 USD) will apply to the rental amount for residential property.

## Conclusion

Although it was not able to fully implement a broad-base VAT due to the introduction of various reduced rates and differential regimes for political economy reasons, Brazil is adopting new models for financial services and real property transactions. These models will expand the VAT base to include margin-based financial services as well as the sale and rental of used residential properties. By broadening the VAT base, these models aim to reduce distortions, tax cascading, and complexities that are currently in place in jurisdictions where such supplies are excluded from the VAT base.

## References

- Acosta-Ormaechea, S and Morozumi, A (2019), “The Value Added Tax and Growth: Design Matters”, IMF Working Paper 19/96, Washington, D.C, [The Value Added Tax and Growth: Design Matters](#)
- Bird, R. and Gendron, P.-P. (2007), *The VAT in Developing and Transitional Countries*, Cambridge University Press.
- Brys, B. et al. (2016), “Tax Design for Inclusive Economic Growth”, OECD Taxation Working Papers, No. 26, OECD Publishing, Paris, <https://doi.org/10.1787/5jlv74ggk0g7-en>.
- Cnossen, S. (2010), *Improving the VAT treatment of exempt Immovable Property in the European Union*. Working Paper WP 10/19, Oxford University Centre of Business Taxation, <https://oxfordtax.sbs.ox.ac.uk/sitefiles/wp1019.pdf>

de la Feria, Rita and Swistak, Artur (2024). Designing a Progressive VAT. Working Paper WP/24/78, International Monetary Fund, Washington, D.C, <https://www.imf.org/en/Publications/WP/Issues/2024/04/05/Designing-a-Progressive-VAT-546923>

Gendron, P. (2016), “Policy Forum: Canada’s GST and Financial Services—Where Are We Now and Where Could We Be?,” Canadian Tax Journal, Canadian Tax Foundation, vol. 64(2), pages 401-416, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2909922](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2909922)

López-Laborda, J., and Peña, G. (2018). A New Method for Applying VAT to Financial Services. National Tax Journal, 71(1), 155-182. <https://doi.org/10.17310/ntj.20>

Næss-Schmidt, H. et al (2016), “Why and how to apply a Value Added Tax on financial services”, Copenhagen Economics, <https://copenhageneconomics.com/wp-content/uploads/2021/12/copenhagen-economics-2016-why-and-how-to-to-apply-vat-to-financial-services.pdf>

OECD/KIPF (2014), The Distributional Effects of Consumption Taxes in OECD Countries, OECD Tax Policy Studies, No. 22, OECD Publishing, Paris, <https://doi.org/10.1787/9789264224520-en>.

OECD (2024), *Consumption Tax Trends 2024: VAT/GST and Excise, Core Design Features and Trends*, OECD Publishing, Paris, <https://doi.org/10.1787/dcd4dd36-en>.

Peacock, Christine (2023), “Shifting from pre-paid to periodic GST on the consumption of residential premises”, Australian Tax Forum, 38(2), pp. 199-223, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4605685](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4605685)

Poddar, Satya (2010), “Taxation of housing under a VAT”, Tax Law Review (63), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1669559](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1669559)

Thomas, A. (2020), “Reassessing the regressivity of the VAT”, OECD Taxation Working Papers, No. 49, OECD Publishing, Paris, <https://doi.org/10.1787/b76ced82-en>.

van Brederode, Robert (2011), “Theory and Practice of VAT Treatment of Real Estate”, in *Immovable Property under VAT: A Comparative Global Analysis*, Kluwer Law International, pp. 1-27.

---

*To make sure you do not miss out on regular updates from the Kluwer International Tax Blog, please subscribe [here](#).*

2024 Future Ready Lawyer Survey Report

# Legal innovation: Seizing the future or falling behind?

Download your free copy →

 Wolters Kluwer



This entry was posted on Tuesday, March 4th, 2025 at 11:38 am and is filed under [Brazil](#), [Financial services](#), [Tax reform](#), [VAT](#)

You can follow any responses to this entry through the [Comments \(RSS\) feed](#). You can leave a response, or [trackback](#) from your own site.