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CONSULATE OF THE UNITED STATES
OF AMERICA

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Belem

TO : DEPARTMENT OF STATE
INFO : Brasilia, Belem, Recife,
Sao Paulo, Porto Alegre

APR 24 REC'D

BELEM, PARA, BRAZIL

FROM : AmEmbassy, RIO DE JANEIRO

April 19, 1968

SUBJECT: Recent Changes in State Excise Tax (ICM)

REF. : Emb. A-894, April 7, 1967

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1. The states of the center-south region ^{1/} began collecting a 16% ICM ^{2/} tax on April 1 amid protest from small manufacturers and processors of agricultural products. The rate which had increased from 15%, is scheduled to increase to 17% on May 1 and to 18% on June 1. The higher rates are applicable only to intrastate movement of goods; interstate rates, which are under federal jurisdiction (Article 8, Section XVII of the Constitution), continue at 15%.

2. In response to pressures from protesting groups anticipating the tax increase, the Finance Secretaries of these States met in Porto Alegre on February 12-16, 1968 and again in Rio on March 18-19, 1968 to consider exemptions or rate reductions for certain agricultural and industrial products. The Ministry of Finance participated in these meetings and

Enclosures:

1. Porto Alegre Agreement
2. Rio de Janeiro Agreement
3. Summary of Sao Paulo Decree 49423

1/ States included in the center-south region are: Federal District, Espirito Santo, Goias, Guanabara, Mato Grosso, Minas Gerais, Parana, Rio Grande do Sul, Rio de Janeiro, Santa Catarina and Sao Paulo.

2/ The ICM (Imposto sobre Circulacao de Mercadorias) is a value added excise tax imposed by the states in 1967 to replace the earlier IVC (Imposto de Vendas e Consignacoes) which was collected on a turnover basis.

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gave counsel on administration and participated in working out rate reductions and exemptions with the view of holding down prices of essential feedstuffs, encouraging industrial production and promoting agricultural exports. Agreements were reached at these meetings which enter into effect in each state upon approval by each state government. Informal translations of the texts of these two agreements are submitted as Enclosures 1 and 2.

3. Conversations among the center-south states concerning an increase in tax rate began in early 1967 shortly after the new ICM tax became operational. Yield from the new tax fell below expectations, partly because of depressed economic activity during the first quarter of 1967.

4. Tax elimination or reduction will affect mainly agricultural products, ship construction, government procurement of manufactures financed by foreign governments or international lending institutions and sale of nationally manufactured producers goods. Of significance to United States exporters is Clause 9 of the Rio Agreement (enclosure 2) which guarantees equal treatment to LAFTA countries exports of fresh fruits to Brazil. United States fresh fruit exports are not granted this benefit.

5. According to Dr. Alceu Reposo, Secretary of the Ministry of Finance Economic and Financial Technical Council, the agreements have been approved by all states: the last two being Sao Paulo which approved by Decree 49423 dated April 1, 1968 summarized in Enclosure 3; and the Federal District which by Decree "N" No.718 of March 15, 1968 and "N" No. 721 of April 1, 1968 simply approved the two agreements. States of the Northeast region, except Amazonas, adopted an 18% rate on September 14, 1967. The rate in Amazonas remains at 15%.

COMMENT :

1. U.S. fruit disadvantage - The suspension of the tax on fruit imports from LAFTA countries represents a competitive disadvantage for U.S. fruit sales to Brazil. Foreign Ministry officials concerned with LAFTA matters state that equal internal excise treatment is required under the terms of the LAFTA agreement. According to a Guanabara participant in the regional meeting, Article 9 was added at the specific request of the Foreign Ministry.

2. Export stimulus - Instead of an 18% tax rate beginning June 1, 1968 effective rates of 7.2% for meat exports and 10.6% for exports of corn, soybeans and rice will apply with the application of rate

reductions provided by the two agreements. This will help to make Brazil's prices for these products competitive in world markets. State Governments previously have had the option of reducing or removing the circulation tax on export items. Rio Grande do Sul took advantage of this option in 1967 and reduced the tax from 15% to 6% on exports of fresh, chilled, and frozen beef. The tax is not applicable to canned meat as this is considered a manufactured product (AGR-62, Feb. 16, 1968). Grain exporters complained bitterly about the circulation tax during 1967 and blamed Brazil's poor showing in corn exports for that year to a large extent on the cost of the tax.

3. Food cost reduction - The suspension of the tax on fruits and vegetables seafood, chickens, and eggs (Clause 2 of the Porto Alegre agreement) is expected to bring a significant reduction in the cost of these products to the consumer. Minister of Finance Delfim Neto met with food wholesalers on April 15 and stressed the need to translate these tax benefits into lower consumer prices as soon as possible.

4. Manufactures - The reductions concerning manufactured goods - producer goods and sales to government - were taken to stimulate expansion of the industrial sector.

5. Tax Administration - Exemption from the circulation tax on the first sale by the producer (Clause 1 of Porto Alegre Agreement) is a change in the method of collecting the tax. The full amount of the tax (18% after June 1) still will be paid on the value of the goods sold by the producer, but the tax will be paid at a later stage rather than at the time of the first sale. This will facilitate sales by producers outside their municipalities since they no longer will have to pay the tax prior to taking the commodity outside the municipio, a practice which in many cases required payment of the tax prior to sale of the commodity. This change in collection should make more goods available outside the producing area.

6. Exemption of the first sale from tax has another important effect. Except for Rio Grande do Sul which has entered into a special compact with its municipalities for distribution of their share of tax proceeds, municipal participation in the ICM tax has been disturbed. Exemptions of first sale from tax, where sale is made outside the municipality, eliminates the 20% share that otherwise is accruable to the municipality where the initial economic activity takes place. Decree Law 347 prepared by the Executive would have corrected this situation by distributing the 20% municipal participation on the basis of coefficients related to where the economic activity takes

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place regardless of deferral due to the timing of actual tax collection. This arrangement was rejected by the Congress on December 29, 1967 on grounds that it constituted a "participation fund" not contemplated by the constitution and because of political rivalries at the municipal and state level. There is optimism that a substitute measure in preparation at the Finance Ministry will be successful. However, private group efforts continue to set aside the rate increases on the ground that state executive authority is not sufficient to increase the tax rates without legislative approval.

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PÓRTO ALEGRE AGREEMENT

The conference of Secretaries of Finance of the center-south region meeting in PóRto Alegre February 12 to 16, 1968

AGREES:

Clause 1 - To permit the signatory entities to grant exemption from the ICM tax for the shipment of unprocessed agricultural products, on the first intrastate operation made by the producer.

Sele para. - That provided in this clause does not apply to the states of Minas Gerais and Santa Catarina which will be able to maintain or expand the fiscal benefits now allowed in their states, in a manner not to increase the present tax burden on these products.

Clause 2 - To permit the signatory states to grant exemption from the ICM for the intrastate shipment of fruit, vegetable and poultry products described in Clause 1 of the Cuiaba Agreement and in Clause 5 of the second Agreement of Rio de Janeiro held in June 7, 1967 as well as for the intrastate shipment of fish, fowl and eggs in natural or frozen state.

Sele para. - That fiscal credit system provided in the cited agreements is revoked concerning the intrastate shipment of locally made products.

Clause 3 - To permit the signatory states to reduce the ICM rate on exports by 60% for meat, and by 40% for corn, rice and soybeans.

Clause 4 - The signatory states will be able to permit industrial establishments to credit against the ICM tax beginning April 1, 1968 acquisitions of nationally made industrial equipment that will form part of their fixed assets.

Para. 1 - The tax credit will be entered in the books of the establishments in which the industrial equipment comes to be utilized, in the form that may be determined by state regulation.

Para. 2 - Approval of the credit will not exceed 10% of the tax to be collected in each period. Tax payment will be required on the shipment of goods referred to in this Clause in the form established by state legislation.

Clause 5 - To consider legal with respect to present legislation (Complementary Act 35, Art. 7 and its first para.), the application of the ICM on exports abroad of crude lumber.

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Clause 6 - To recommend to the signatories to make a detailed analysis of the financial/economic situation of lumber producers and exporters to determine the need for easing the tax burden.

Clause 7 - To approve the supplementary protocol prepared by the Production Finance Commission.(1)

Clause 8 - The norms established in this agreement will enter into effect in each participating state upon approval by the respective chiefs of state upon publication in the official gazette.

(1) Translation not furnished. The protocol concerns procedures for collection of the tax without interference with the Federal Government minimum price system.

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AGREEMENT OF RIO DE JANEIRO
March 1968

AGREES:

Clause 1 - Signatory states are authorized to grant exemption to shipbuilding firms whose construction or repair contracts were made before Sept. 30, 1968.

Clause 2 - Signatory states are authorized to grant exemption for interstate and export shipments as provided in Clause 2 of the Porto Alegre Agreement.

Sole para. - The exemption provided in this Clause will not apply:

- 1) to interstate shipments destined for processing;
- 2) to shipments of fresh fish and fish eggs, crustaceans, molluscs, fowl and eggs.

Clause 3 - To recommend the simplification and if possible the elimination of present tax burdens on products referred to in the previous clause.

Clause 4 - To revoke the exemption granted by item 6 of the first clause of the first Rio de Janeiro agreement, concerning shipment of animal feed.

Clause 5 - (concerns pure blood horses).

Clause 6 - To permit the states to grant exemption from the ICM tax on shipments of locally made machinery, vehicles, apparatus and equipment resulting from sales made to autarquias, autonomous entities and federal state or municipal governments where such purchases are made from resources provided by foreign governments or international institutions.

Clause 7 - (concerns used equipment).

Clause 8 - (concerns animal medicine).

Clause 9 - Extends to fresh fruit coming from LAFTA countries the same fiscal treatment that the states give to national products.

Clause 10 - Permit the states to grant a tax credit of up to 30% of the value of tax on shipments of pure bred animals to be used for reproduction.

Sole para. - This clause is not applicable to pure bred racing horses.

Clause 11 - The same as Clause 8 of the Fôrto Alegre agreement.

SUMMARY OF SÃO PAULO DECREE 49423, April 1, 1968

The merchandise circulation tax (ICM) is

A. Suspended on

- 1) The first sale within the state, by producers, of storable commodities and raw milk;
- 2) Intrastate sales, by any establishment, of fruits and vegetables including fresh fruit imported from LAFTA countries;
- 3) Interstate and export sales of the agricultural products in 1) and 2) except (a) when these products sold outside the state are to be processed and (b) except for fishery products;
- 4) Intrastate sales of fresh or frozen sea food, chickens, and eggs;
- 5) Ships constructed or repaired under contracts made before September 30, 1968;
- 6) Sales of nationally made machines, vehicles, or equipment to Federal, State and municipal governments or autonomous government entities when such purchases are made with resources provided by foreign governments or international institutions.

B. Reduced until December 31, 1968 by 60% on meat exports and 40% on exports of corn, soybeans and rice.