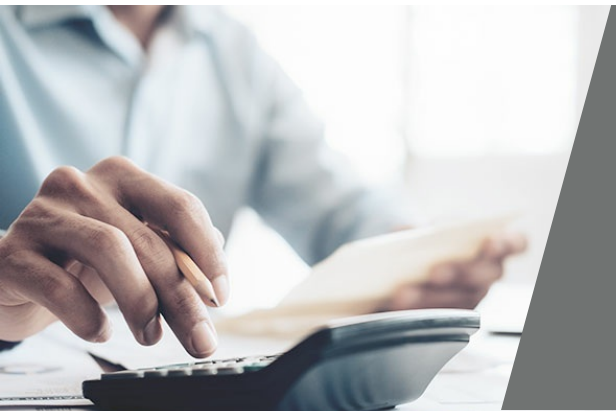

TAX

APPLICATION OF THE SELECTIVITY CRITERION ACCORDING TO THE ESSENTIALITY OF THE PRODUCT OR SERVICE FOR THE ICMS

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AUTHORS

CAMILA GALVÃO
PARTNER / SÃO PAULO

ISABELA SILVA DE CARVALHO CANTARELLI
LAWYER / SÃO PAULO

Since the promulgation of the Federal Constitution of 1988 (CF/88), a widely discussed topic has been the selectivity applicable to the Tax on Circulation of Goods and Services (ICMS). Amid wide-ranging debates regarding tax reform and changes in the constitutional tax system – including a proposal that aims to end the selectivity of the consumption tax – the question of the scope of selectivity for the ICMS has not yet been settled.

The CF/88 adopted the selectivity technique for the ICMS and for the Tax on Industrialized Products (IPI). However, the constitutional text used different expressions when dealing with the application of this technique for each tax, providing that the IPI "may be selective, depending on the essentiality of the product" (art. 153, paragraph 3, I) and the ICMS "may be selective, depending on the essentiality of the goods and services" (article 155, paragraph 2, III).

In both cases, the criterion selected by the framers of the Constitution to guide the implementation of selectivity by political entities was essentiality, that is, essential products should be taxed in a less burdensome manner, while less essential (superfluous) products will be subject to more burdensome taxation.

Analyzing the constitutional text, the main question is: when using the word "may", the CF/88 would have conferred on the state legislature the power to adopt selectivity in the setting of ICMS rates? If so, what would be the reach of this option?

This important controversy is being reviewed by the Federal Supreme Court (STF) in Extraordinary Appeal (RE) No. 714.139, Topic 745 of the General Repercussion.

In the specific case, the taxpayer requires recognition of the unconstitutionality of the rate of 25% levied on the supply of electricity and the provision of communication services, instituted by the state of Santa Catarina (SC), where the general rate is 17%. In other words, electricity and communication services are taxed with a much higher burden than general taxation, applying the same level adopted for products expressly considered superfluous by the legislation (weapons, ammunition, perfumes, cigarettes, etc.).[1]

This practice is not restricted to Santa Catarina. Other states rely on the argument that selectivity is an optional technique for the ICMS and set up increased rates for products that are clearly essential.

The recurring taxpayer in Topic 745 maintains the unconstitutionality of the legislation of Santa Catarina that uses the onerous rate applicable to superfluous products to also tax electricity and communication services, in violation of the selectivity imposed by the CF/88. In the taxpayer's view, even if the adoption of selectivity is optional for the ICMS, once differentiated rates are established (to the detriment of a single rate), essentiality is a mandatory criterion to be followed by the states. Based on this same argument, the laws of various states that impose exorbitant rates on essential items are questioned in the judiciary. The states argue that, in the case of ICMS, the CF/88 gave the state legislatures the power to choose whether or not to follow the technique of selectivity when setting rates.

The Federal Attorney General's Office presented an opinion in favor of partial granting of relief to the appeal, agreeing that the legislation of Santa Catarina is incompatible with the principle of selectivity due to essentiality when providing rates higher than the general rate for electricity and communication services. It also recommended modulating the effects of the decision.

Thus far, Justice Marco Aurélio (reporting judge), Justice Alexandre de Moraes (who inaugurated a dissenting opinion), Justice Dias Toffoli, and Justice Carmen Lucia (who concurred with the reporting jdge) voted. The judgment was suspended due to request for a review of the record by Justice Gilmar Mendes and should be resumed soon.

The reporting judge, Justice Marco Aurelio, ruled unconstitutional the legislation of Santa Catarina that set the rate of 25% for electricity and communication services as he considered them a clearly essential good and service, ordering the levy of the general rate of 17%. In the Justice's view, "the option to use the method does not mean that there is no essential nucleus in the precept to be preserved" such that "once selectivity is adopted, the criterion may be nothing other than essentiality". From the moment the state legislature began to encompass differentiated rates for the ICMS, the gradation of the rates must necessarily be determined by the essentiality.

Justice Alexandre de Moraes voted to partially grant relief to the appeal and rejected only the application of the

25% tax rate on the communication services. With regard to electricity, the Justice considered the state legislation to have "applied the principle of selectivity of the ICMS (...) together with the principle of contributory capacity by establishing extra-taxation effects for it" by setting the 12% rate for classes in which consumption is considered essential, disincentivizing rampant consumption and energy waste.

The higher levels of more significant and relevant energy consumption, however, do not reflect waste, but industrial, commercial, and productive use, reinforcing and not subtracting from its essentiality.

The vote of Justice Marco Aurelio, with Justice Dias Toffoli and Justice Carmen Lucia concurring, reflected the unquestionable essentiality of electricity and communication services, which became even more evident during the pandemic.

Of course, in the middle of the application of selectivity, the principle of contributory capacity and extra-taxation are contemplated to some extent, because superfluous products purchased by the more affluent classes are taxed more heavily. However, one cannot rely on these other precepts of the CF/88 to allow electricity and other essential products to be taxed at levels equivalent, and sometimes higher, to those of obviously superfluous products such as weapons, cosmetics, cigarettes, alcoholic beverages, among others.

Despite concurring with the reporting judge on the merits, Justice Dias Toffoli proposed softening the effects of the decision so that it is effective only as of the beginning of the next fiscal year, leaving out lawsuits filed up to the eve of publication of the judgment on the merits.

This discussion is not only relevant for electricity and communication services. States often institute heavy taxation for other clearly essential products, ignoring the CF/88.

In this sense, Justice Marco Aurelio himself, when presenting justifications that confirm the essentiality of electricity and communication services (justifications that are even expendable), brings to light Law No. 7,883/89, which deals with limitations on the right to strike. This law, in article 10, subsection I, considers as essential services or activities "water treatment and supply, production and distribution of electricity, gas and fuels", in addition to other activities listed in the other subsections.

Fuels are an example of products often taxed at very high levels. The state of Amazonas, for example, applies the rate of 25% for operations with natural gas, gasoline, and fuel alcohol, in the same point that includes jewelry, luxury cars, weapons, ammunition and other superfluous goods. Several other examples can be found in the laws of all states.

Taxpayers should be aware of the outcome of this important case and evaluate their strategy for seeking judicial measures to avoid the unconstitutional levying of increased ICMS rates for the products stated, especially considering the possibility of softening the effects of any final decision by the Federal Supreme Court.

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[1] In relation to the supply of electricity, in addition to the general rate of 25%, the state of Santa Catarina established a more beneficial treatment for some specific situations.