

## TAX BARRIERS FOR THE NATURAL GAS INDUSTRY

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The natural gas market is gaining more and more relevance in Brazil as a way to diversify the country's energy sources. To foster the development of the sector, changes in legislation and regulations have been discussed, especially since 2016, when the Ministry of Mines and Energy launched the Gas to Grow (*Gás para Crescer*) initiative, with the participation of the entire natural gas market and some government bodies.

The development of the market, however, depends on the success of public calls for the purchase and sale of natural gas, which will allow the integration of new agents and the diversification of a highly monopolized sector. Tax obstacles, mainly related to the ICMS tax, and other challenges, however, make difficult the advance of public calls and the development of the sector.

The ICMS is a tax whose competence is assigned to the states and the Federal District, and complementary law defines the structural aspects of the tax. An analysis of state legislation with respect to natural gas points to complexity, unevenness, and uncertainty as characteristic elements.

Among the points of unevenness that represent tax challenges, the following stand out: the diversity of rates applicable to natural gas; the difference of tax burden due to special tax regimes; and the difference in the treatment of non-cumulative credits.

As for the diversity of ICMS rates, there is a large disparity between the states in relation to intrastate transactions involving natural gas, which vary from 12% up to 25%. This is because some states have internalized ICMS Agreement No. 18/1996, which provides for reduction of the ICMS tax basis so that the effective tax burden results in 12%. However, some states did not adhere to the agreement, applying the general internal rate (ranging from 17% to 18%) for natural gas transactions. There is also the state of Amazonas, which adopts a 25% rate for natural gas transactions.

In addition, it should be noted that some states establish additional rates for internal transactions, which usually correspond to 1% or 2% of the ICMS tax basis.

Many states also have unclear legislation regarding the application of tax benefits to imports of natural gas or liquefied natural gas, creating legal uncertainty for importers.

An additional point of dissimilarity concerns the existence of different special regimes for the taxation of natural gas. Some states have introduced tax benefits or differentiated regimes in the supply of natural gas to thermoelectric plants (PPTs) in relation to certain industries or import operations, in order to neutralize points of redundant taxation. This is the case, for example, of the granting of internal outputs of natural gas for electricity generation, which favors the development of PPTs in some states where it is applied, while others have no plans to solve the problem.

Also in relation to tax benefits, some states instituted obligatory payment of a percentage over the economic advantage obtained with the tax benefit to the State Tax Equilibrium Fund (FEEF), accentuating the discrepancy in treatment.

Another relevant aspect is the divergence in the treatment of non-cumulative ICMS credits. There is a lack of clarity and uniformity in the legislation that defines the treatment of credits in transactions benefiting, for example, from the reduction in the calculation basis or other special regimes. There are states that allow the maintenance of credits recorded, while others require the reversal of these credits, burdening the natural gas value chain and making it less competitive compared to other energy grids.

Finally, the assignment of responsibility for tax substitution in state legislation is an ingredient that reinforces the complexity of the system. The asymmetry between the various state laws obviously creates complexity, increases compliance costs and distortions in the chain, and often aggravates the cost itself of operations. Standardization and rationality are essential for proper development of the market.

The viability of many transactions is also dependent on regulations regarding compliance with ancillary obligations, especially those related to transport through gas pipelines. They are simple measures that should not change tax collection. Their implementation gains complexity because of our tax system, but they are essential for us to take this step forward.

