Automotive Tax Insights

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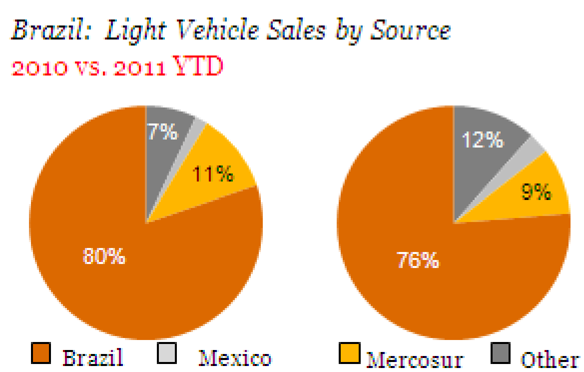
Brazil's Decree 7567 Would Increase Tax on Imported Vehicles by 30%

Growing share of imported vehicles

On the surface, a 30 percentage point hike in sales tax rates on imported vehicles in Brazil should theoretically slow their rise in the Brazilian market. However, already high levels of investment in Brazil's auto sector and Mercosur and Mexican exemptions will limit the impact, but serve to slow Chinese imports.

Although the overall Brazilian light vehicle sales are up 7.5% 2011 YTD, the market has seen a 1.6% decrease in demand for domestically built cars. Because domestic cars account for 61.5% of the domestic light vehicle market, this decline has held domestic light vehicle sales growth to a modest 1.2%. The driver of overall market growth has been imports, as year-to-date total import sales are up 34.7%, with imported cars (up 43.2%) leading the way.



Tax change from government

On September 15th, the Brazilian government announced Federal Decree number 7567. The decree has a dual purpose – to reduce demand for imports and to encourage local manufacturing and export growth. The headline change is a 30 percentage point increase across the board in Federal Excise Tax (IPI) rates on vehicles. In fact, the increased IPI rates apply regardless of the vehicles being imported or produced locally. Importantly, local manufacturers meeting certain requirements will benefit from tax reductions that negate the IPI increase on imports from Mercosur and Argentina. Requirements include 65% local content, a commitment to local R&D, and the onshoring of 6 out of 11 production processes outlined in the decree. For the purposes of calculating the level of local content, the decree expressly mentions that parts imported from Mercosur should be considered locally produced goods. It is expected that the rate rise could increase prices of vehicles not meeting the above conditions by 25-28%.

Impact of tax hike likely to be muted

While the policy change has made headlines, the plan's true impact will likely be muted. As noted, Mercosur and Mexican imports are exempt if automakers meet the conditions above. Vehicles imported from North America, Europe, and Asia will be affected the most, with the rise of Chinese vehicle sales the most worrying for Brazil's policy makers. Chinese makers have succeeded in gaining 3.3% market share after being in the market just over a year.

While the decree is also designed to bolster and encourage local investment by global automakers in Brazilian facilities, it is likely that most manufacturers with plans for future Brazilian capacity have already declared their investments - however, its requirements will undoubtedly improve the quality of those investments. By 2017, it is expected that 2.2 million units of light vehicle capacity will be added to Brazil.

Temporary Suspension of Decree 7567

On October 20, the Brazilian Supreme Court decided unanimously that the federal government's move to increase the IPI (import tax) for cars can only enter into force from the second half of December. The court also found that the decision has retroactive effect. This means that those taxpayers who bought the car with the higher tax rate should receive the difference. At the request of DEM, all nine ministers present at the meeting voted to suspend Article 16 of Decree 7567, published on September 16 this year, which determined that the increase in IPI occur immediately. The court ruled the immediate entry into force is unconstitutional ruling that any change in taxation must respect the principles of the prior legislation. In other words, it must wait ninety days to avoid surprises for the taxpayer.

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