RE 882,461 (Topic 816)

Collection of ISS tax on custom manufacturing activities

Rapporteur
Justice Dias Toffoli

Voting
By Majority (10 x 1)

Majority Opinion
Justice Dias Toffoli

Competent Court
Full Court

Decision Date
February 26, 2025

Format of the Session
In Person

Facts

An extraordinary appeal, with general repercussions (Topic 816), which discusses whether the 1988 Federal Constitution allows the collection of Service Tax (ISS) in cases of custom manufacturing. This occurs when a company performs a service with materials supplied by the customer and, at the end, returns the resulting product to the customer, which may be sold or used in another stage of the production chain.

In this specific case, the appellant company cut steel coils. It received the coils from the customer, cut the material to transform it into steel sheets, and then returned these sheets, which were sold and/or used in civil construction. The Municipality of Contagem (state of Mina Gerais) fined the company for not collecting ISS on this activity, based on item 14,02 of the list of services attached to Complementary Law 116/2003.

The company argues that, for tax purposes, this activity is not a service, but rather an intermediate stage in steel production. For this reason, it claims that the law could not subject it to ISS, and that the applicable tax in this case is the State Tax on the Circulation of Goods (ICMS), which is levied by the state. In addition, the company contests the application of a 30% late payment penalty (for late payment of the tax) on the amount of the tax, arguing that this percentage is confiscatory in nature.

Legal Issues

1. Does the Constitution allow the imposition of an income tax (ISS) on custom manufacturing operations, in which the company provides services using materials supplied by the contractor, with the intention of delivering the resulting product to the contractor?

Legal Reasoning

1. The 1988 Federal Constitution allows municipalities to levy Service Tax (ISS), provided that the activity is not subject to ICMS, which is under the jurisdiction of the states. Taxable services are those listed in the annex to Complementary Law116/2003. Item 14,05 of this list provides for the levying of ISS on activities involving the cutting and trimming of "any objects". This provision replaced the former item 72 of the list attached to Decree-Law 406/1968 (revoked by LC 116/2003), which mentioned cutting and trimming services "of objects not intended for industrialization or commercialization."

2. By not excluding services related to products intended for industrialization or commercialization from item 14,02, the legislator departed from the constitutional concept of services taxable by ISS. This is because the taxation of industrialization by order must take into account the position of the activity in the production chain. If the activity occurs at an intermediate stage of the production cycle, it should not be taxed by ISS. As the resulting product will still be commercialized or undergo further industrialization, the appropriate taxation is by ICMS. In this case, the activity does not constitute a service provision for tax purposes, but rather a phase of the production process of the goods.

3. The impact of ISS on activities within the goods production chain can have an undesirable cumulative effect. The ISS is a cumulative tax—it does not generate credits for subsequent stages of production—unlike the ICMS, which allows for the deduction of tax paid in previous stages, avoiding an increase in the final price of products.

4. Finally, with regard to tax fines, the Federal Supreme Court has already ruled, in a general repercussion (Topic 214), that the constitutionally appropriate limit for late payment fines is 20% of the tax amount. Therefore, the fine imposed in this specific case must not exceed this percentage in order to respect the proportionality and the constitutional prohibition of confiscation (article 150, item IV of the 1988 Federal Constitution).

Voting and Decision

Decision by Majority

Majority Opinion: **Justice Dias Toffoli** (rapporteur)

Dissenting Opinion(s): **Justice Alexandre de Moraes, Justice Gilmar Mendes, and Justice Cristiano Zanin (partial dissent on the modulation of effects).**

Decision of the Court

The Full Court ruled that the levying of the Services Tax (ISS) on contract manufacturing operations, in which there is an intermediate stage in the production cycle of the goods, is unconstitutional.

For the majority of the collegiate body, custom manufacturing is a stage in the production process, whose ultimate goal is the production and circulation of goods and merchandise. Thus, it is not subject to ISS.

This understanding shall take effect upon publication of the decision minutes. Taxpayers who paid ISS on this type of activity up to the day before that date are not required to pay IPI and ICMS in relation to the same taxable events.

The Court also ruled that tax penalties imposed by the federal government, states, the Federal District, and municipalities for late payment of taxes must not exceed 20% of the tax debt.

Type and Number: **RE 882,461**

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