

# Doing Business and Investing in Brazil

## Information Guide Series

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This Guide on Brazil supersedes the Guide dated January 2005.

Any reader who would like a more detailed discussion of the subjects dealt with herein is cordially invited to contact a partner in any of our offices.



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# Doing Business and Investing in Brazil

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- I. Investment climate
  - II. Doing business
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## Foreword

I am delighted to present our “Doing Business in Brazil 2010” edition. The objective of this publication is to provide an informative and easily understandable overview of Brazil’s business landscape, helping make it easier to understand the Brazilian market and economy.

Brazil is one of the most promising emerging markets in the world. The country has overcome the recent turbulent international economic crisis and returned as a stronger and more attractive global player. A higher degree of diversification of our economy and a broader selection of trading partners, coupled with tightly regulated financial systems, were key to successfully mitigating the worst effects of the recent crisis. This was the result of nearly two decades of political and currency stability, tight fiscal discipline, increasing international reserves, solid macroeconomic indicators and a fast expanding internal consumer market.

The current economic climate alongside the government’s aggressive infrastructure plans and increasing expectation around investment opportunities linked to the discovery of the pre-salt oil fields attracts world attention to our country. This event marked an important moment for the Brazilian oil industry, because recent discoveries in the world oil scene have been rare. Also as the global appetite for commodities continues to grow and agribusiness gains momentum in the international picture, especially with biofuels, highlights even more our presence on the world stage as a relevant business destination. Not to mention, to the upcoming soccer World Cup that will be held in 2014 and Olympic Games, in 2016.

The purpose of this publication is to provide an introduction to the major business and legal issues to be considered by foreign companies in establishing business operations in Brazil. The discussion under each heading is not intended to be an exhaustive analysis but rather to provide general observations and guidance to the many questions we have encountered from clients. Particular businesses or industries may also be subject to specific legal requirements not referred to in this guide. In addition, certain projects may require specialist advice and appropriate accounting and legal advice from one or more of our dedicated teams.

PricewaterhouseCoopers’ professionals are available for further information on the matters covered in this publication and on our services, designed to ensure successful and profitable business in Brazil.

Fernando Alves  
CEO  
PricewaterhouseCoopers - Brazil

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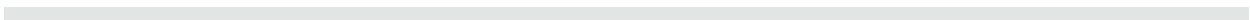
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## Chapter 1

# Brazil - A profile



## Investor considerations

- Brazil is the world's fifth largest country. With a population of some 184 million (2007), it is also the world's fifth most populous country after China, India, the United States and Indonesia.
- The Brazilian economy is large by almost any standard. Brazil has the biggest economy in the world in terms of Gross Domestic Product (GDP) derived from purchasing power parity (PPP) calculations.
- Brazil has a very rich biodiversity.
- Abundant agricultural, mineral and energy potential.
- Enormous internal growth potential.
- Broad industrial base and infrastructure and a diversified economy.
- Fast-changing business conditions.
- Social extremes.
- Heavy bureaucracy.

## Geography and climate

Brazil is the world's fifth largest country, occupying an area of 3,287,000 square miles (8,514,000 square kilometres), equivalent to almost half of the entire South American continent. It borders all South American countries except Chile and Ecuador, with a total border length of 9,777 miles (15,735 kilometres). Its coastline runs for more than 4,578 miles (7,367 kilometres), mostly along the South Atlantic Ocean. Brazil is comprised of 26 states and the Federal District of Brasilia, the capital city. Its comparative landmass is slightly smaller than the USA's.

Brazil is made up of five main geographical regions:

- North (mainly the Amazon basin).
- Northeast (roughly east from 46° west longitude and north from 16° south latitude).
- Southeast (the coastal states south of the Northeast region down to São Paulo plus the state of Minas Gerais).
- South (from the state of Paraná southwards).
- Central-West (states of Mato Grosso, Mato Grosso do Sul, Goiás and the Federal District).

Over half of Brazil's landmass lies at about 650 feet (200 metres) above sea level, but only a fraction rises above 3,000 feet (915 metres). The highest peaks have an altitude of less than 10,000 feet (3,050 metres), only six of which exceed 9,000 feet (2,745 metres): two in the far North and four in the Southeast. The Great Escarpment runs the length of the coast from the state of Bahia southwards and drops off at varying distances inland; fertile valleys cross most of the terrain.

Land use is essentially as follows:

<b>Land Use ( Ha)</b>	<b>1985</b>	<b>1995</b>	<b>2006</b>
Total Area	374,924,929	353,611,246	354,865,534
%	2.8%	-5.7%	0.4%
Permanent Crops	52,147,708	41,794,455	34,865,534
%	6.2%	-19.9%	83.0%
Meadows and Pastures	179,188,431	177,700,472	172,333,073
%	2.7%	-0.8%	-3.0%
Forest and Woodlands	88,983,599	94,293,598	99,887,620
%	0.9%	6.0%	5.9%

### Extra official source

Arable land is found mainly in the Central-West and South regions, but this is changing with the need to develop land for agriculture throughout the rest of the country, particularly in the Central-West and the North. The river system is extensive; the Amazon and its tributaries, which are great rivers in their own right, drain over half of Brazil's land mass. Other large rivers include the São Francisco River in the Northeast and the Paraná and Paraguay rivers in the Southwest, both of which are tributaries of the River Plate.

The equator runs north of the Amazon River and the Tropic of Capricorn crosses the state of São Paulo. Most of Brazil therefore lies in the tropical zone, with only the south lying in the temperate zone, which experiences occasional temperatures of below zero. The North is hot, humid and rainy. Along the coast the tropical heat is tempered by sea breezes whereas inland, especially along the Central Plateau, it is the altitude that keeps temperatures down. Humidity is high all along the coast and rainfall is heavy. The inland Northeast region contains dry land.

Nearly every type of climate can be found except for harsh wintry weather. The country does not suffer from earthquakes and hurricanes, but rainstorms, drought and frost do occasionally cause considerable damage.

The country boasts some spectacular scenic beauty, particularly along the coastline.

## History

Brazil was discovered in 1500 by the Portuguese navigator Pedro Álvares Cabral and remained a Portuguese colony for over 300 years. Brazil declared its independence in 1822, when a constitutional monarchy was established. A federal republic was proclaimed in 1889, and democratic administrations have been interrupted twice since. From 1930 to 1945 the country was subject to the civilian dictatorship of Getúlio Vargas. Subsequently in 1964, following political, economic and social unrest, a new administration was established by the military and considerable economic growth and development was achieved during the next 20 years, although not without political and social repercussions. Democracy was restored in 1985.

A new constitution was enacted by Brazil's National Congress in 1988, which upheld the presidential system while simultaneously decentralising political power. The Constitution is lengthy, consisting of 250 permanent articles and 94 provisional articles. In recognition of possible flaws in the wording, the Constituent Assembly made an express provision for its review. This review is behind schedule, although several amendments have already been approved but yet to be regulated.

## Political system

The federal republic has three independent branches: executive, legislative and judicial.

The President heads the executive branch and oversees a number of executive departments, the heads of which are appointed and are known collectively as the Cabinet. The Cabinet is answerable to the President. Unlike in many parliamentary democracies, its members need not be members of the legislative branch. Besides the executive departments, there are a number of independent agencies, many of which are regulatory.

Legislative power is exerted by a National Congress consisting of a Senate and a House of Representatives. There are 81 senators, three from each state and the Federal District of Brasilia. The total membership of the House is 513 and each state's number of representatives is determined by its population. Voting is compulsory at the age of 18, but 16- and 17-year-olds, the over-70s and the illiterate can opt to vote.

The judicial branch consists of a system of federal, state and local courts throughout the country, headed by the Federal Supreme Court. The federal courts rule on the constitutionality of laws and decisions appealed from the lower courts to which the Federal Union is party. The Supreme Court's decisions are final and cannot be appealed. The state and municipal courts act independently of the federal courts, within the bounds of the Constitution.

State governments follow a pattern similar to that of the federal government. Each state has a governor as chief executive and power is divided among the state executive, legislative and judicial branches.

There are many political parties, although ideologies are not clearly developed.

## Legal system

The principal source of Brazilian civil law is the Civil Code, which dates from 2002, and subsequent legislation. The legal system is slow and cumbersome.

## Population and social patterns

### Population

The population is roughly 184 million (2007) and estimated to be growing at about 1.11 percent (2007) per year.

About 12 percent of the population is under 24 and 11 percent is over 60.

The average life expectancy is 72.48 years.

A reduction in poverty has been witnessed, especially among those living in extreme poverty (with income of up to  $\frac{1}{4}$  of a minimum wage per capita).

Table I denotes the comparative distribution of population, area and GDP per capita by region.

### I. Population Distribution by Area and GDP per capita - 2003-7

Region	Land Population (In millions)	mass %	GDP per capita (In Reais)
North	14.62	8	9,135
Northeast	51.53	28	6,749
Southeast	77.87	42	19,277
South	26.73	15	16,564
Central-west	13.22	7	17,844
	183.97	100	13,914 (average)



São Paulo is one of the fastest-growing cities in the world.

Estimates for 2009 rank the state of São Paulo as the most populous state, with 41.4 million inhabitants, followed by Minas Gerais (20 million) and Rio de Janeiro (16 million). These three states in the Southeast Region concentrate around 40.4% of the population.

The majority of Brazilians are of European or African descent. Apart from the original Portuguese settlers, others who have settled in Brazil and significantly influenced its culture include Germans (mainly in the southern states), Italians and Japanese (mainly in the state of São Paulo). There are many other smaller ethnic communities in the larger cities representing most nationalities. There are also some sparse indigenous tribes in the jungle regions.

### **Language**

The official language of Brazil is Portuguese. There are no significant local dialects or other deviations from the official language, but a number of words and phrases differ from those used in Portugal. English is the foreign language most used by the business community.

### **Religion**

The predominant religion is Roman Catholicism. Many other religions are also practiced, introduced by immigrants of different creeds that settled in Brazil. There is freedom of religious and religion is not a source of unrest.

### **Education**

Government-subsidised (free) and private educational facilities from primary school through university, offer full- or part-time curricula. The government also subsidises national apprenticeship training programmes to prepare labour for various industrial and commercial sectors and an educational program to reduce illiteracy. About 90 percent (2008) of the adult population is considered to be literate. The general level of education requires much improvement. Approximately 9.5 percent of enrolled students go on to higher education.

Improvements in the public's education levels have been observed, compared to the previous decade.

### **Living standards**

The living standards of a large proportion of the population are very low, while those at the top are extremely high. This income gap between rich and poor has been a constant preoccupation of successive governments. Basic social indicators highlight the differences in regional development.

The gross domestic product (GDP) per capita in 2007 was the equivalent of about USD 8172 per annum (R\$ 14,465 in Reais).

### **Cultural and social life**

With its mixed background of Portuguese, Italian, German, Japanese, East European and African immigrants, Brazil offers a broad spectrum of cultural and social activities, depending on the region. Most major cities support cultural institutions. Leisure and recreation activities are mainly outdoors, taking advantage of the favourable climate. Many clubs in Brazil offer extensive sports and social facilities.

## The Economy

### General description

The Brazilian economy is large and diverse by almost any standard. There is still considerable state and semi-state participation in various strategic sectors, such as transport and utilities. Brazil has undergone several privatisation programmes of state-owned companies, most of which took place in 1998 when the telecoms were sold. Nearly all of the former state companies are now controlled by the private sector.

Natural resources and agriculture have been the traditional mainstay of the economy, supported by abundant human resources. Since the 1960s, however, the emphasis has been placed on industrial development financed largely by international loans and investments. As a result, exports today reflect a much more balanced mix of commodities and manufactured items. Moreover, the profile of imports became more restricted during the 1970s and 1980s because of import substitution and the scarcity of foreign exchange. This situation is changing following the lowering of trade barriers and the increased opening of the economy to globalisation.

The wealthiest areas of Brazil, in which industrialisation and a modern regional economy have taken hold, are the Southeast and the South. In contrast, the North-eastern and Central Western regions are predominately agricultural and relatively poor because economic and social programmes have not yet been modernised. The Northern region, dominated by the Amazon rain forest, has a low population density and remains virtually unexplored.

Major trends are summarised in Table II.

## II. Major Economic Trends

	<b>2007</b>	<b>2008</b>	<b>2009</b>
GDP (USD billion) - at year-end exchange rates	1,367	1,636	1,577
Real GDP (inflation indexed) growth (% per year)	6.1%	5.1%	-0.2%
Unemployment rate – Average Annual (% of labour force)	9.3%	7.9%	8%
General price index - IGP-DI	7.9%	9.10%	-1.43%
Consumer price index - IPCA	4.46%	5.90%	4.31%
Exchange rate at year-end (R\$/USD)	1.75	2.39	1.75
Public sector deficit (% of GDP)	2.7%	1.9%	3.3%
Public sector debt (% of GDP)	42.8%	38.4%	42.8%
(*) A new method was introduced in 2002			
Selic Interest Rate (end referential, % p.a.) (Average daily interest rate, annualised based on 252 working days)	11.18%	13.66%	8.65%

### in USD billion

Exports	160.6	197.9	152.9
Imports	120.6	172.9	127.6
Trade balance	40.03	24.9	25.3
Current-account balance (USD bn)	-2.1	-28.2	-24.3
International reserves	180.3	206.8	239.1
Direct foreign investment	34.6	45	25.9
Total foreign debt	240.5	262.9	277.5

## Mineral and energy resources

Brazil is rich in natural resources and has some of the largest iron ore deposits in the world. Brazil is one of the world's largest producers of tin, quartz and niobium and one of the three largest producers of iron ore, manganese and tantalum.

The Brazilian steel industry ranks amongst the seven largest in the world. Many other metals, minerals and precious stones are also mined on an increasing scale.

Brazil's natural resources also include petroleum and hydropower. Most of Brazil's electricity comes from hydropower and it possesses extensive untapped hydroelectric potential, particularly in the Amazon basin. The Itaipu dam in the extreme south-west is the world's largest hydroelectric power plant in terms of energy generation.

Petrobras' recent oil and gas discoveries in the pre-salt area could place Brazil amongst the top oil-exporting countries in the world.

The replacement of fossil fuels as the main source of energy will fuel the demand for agro-energy. Brazil has been developing successful initiatives in renewable energy sources for years. Through the expansion of the ethanol sector focusing on efficiency and productivity, Brazil is acknowledged as a world leader in bioenergy. Alcohol production from sugarcane is a successful example worldwide and it is possible to repeat the process with other types of biomass.

The alcohol sector in Brazil is currently undergoing a major expansion, with heavy investment being made by national and international groups.

Foreign investors are now being encouraged to engage in the mineral and energy sectors.

## Agriculture, fisheries and forestry

Vast areas of land are suitable or adaptable for agriculture.

The country has made long-term investments in agricultural research and now has a very advanced tropical agricultural technology in the world. This has allowed agribusiness to develop and increase its production and exports.

Brazil is currently the world's biggest producer of the following products: Coffee, sugar and orange juice. Brazil also has a very significant production of soybeans of 60 million tons, about 25% of global output.

In terms of exports, Brazil is the main exporter of the following products: soybeans, coffee, sugar, orange juice, ethanol and beef.

Other important crops include maize, cocoa, tobacco and bananas.

Agribusiness performance has improved in the last five years, primarily driven by exports of soy and soy products, beef, pork and poultry.

The Brazilian cattle herd growing continuously and has made advances in productivity. The production cost of Brazilian beef is amongst the lowest in the world, which makes it extremely competitive. It is believed that Brazil will continue to be the leading global exporter of beef and poultry.

Brazil occupies an outstanding position in the biofuels and bioelectricity sector, which has the capacity to make the global energy matrix greener and more renewable. The sector is stimulated by certain other significant competitive edges, like highly qualified human resources, the initiatives of private and public research institutes of international repute, and the agricultural credit supply

at competitive interest rates. The country is now therefore capable of meeting the world's food demand, thanks to successive production and productivity records. It is also capable of meeting domestic demand and generating a growing surplus for export.

The fishing potential along the 4,578 miles (7,367 kilometres) of coastline is significant but has not been properly exploited.

Forest areas still abound, particularly in the Amazon basin. International protests have been raised against forest clearance and the potential damage to the environment.

The advance in land clearing mainly affects the Central-West and North regions.

### III. Brazil has global leadership positions in the main agricultural products

	<u>Production</u>	<u>Market Share (world)</u>	<u>Exports</u>	<u>Global share</u>
Soybeans (thousand tons)	67.000	27%	25.600	34%
Corn (thousand tons)	51.300	5%	8.000	6%
Beef (thousand tons)	8.940	15%	1.596	21%
Poultry (thousand tons)	11.023	15%	3.222	38%
Pork (thousand tons)	3.130	3%	707	12%
Sugar (thousand tons)	35.750	20%	23.850	46%
Ethanol (million litres)	29.291	29%	4.418	97%
Coffee (thousand sacks 60kg)	51.450	39%	38.390	32%
Orange Juice (thousand tons)	1.411	52%	1.275	83%

### Principal Foreign Trade Goods

<b>Exports</b>	<b>USD billion</b>	
	<u>2008</u>	<u>2009</u>
Coffee	4.13	3.76
Soybeans	10.95	11.42
Orange Juice	1.94	1.62
Sugar	5.48	8.11
Meat	11.19	8.95
Tobacco	2.68	3
Iron and ore	16.53	13.25

## **Manufacturing**

Major manufacturing industries include petrochemicals, steel, automobiles, mining, cement, paper and related products, agribusiness and food processing. There is huge potential for expansion in all sectors. There are still restrictions on foreign investments in certain sectors (See Chapter 3 for further details).

## **High-tech industries**

The high-tech sector mainly entails the assembly of imported components and parts. Multinationals dominate, but there are several large Brazilian groups. As in other parts of the world, in the past couple of years Brazil has witnessed the creation of new start-up businesses in the Internet sector and an increase in venture capital being invested in these businesses.

## **Service industries**

Service-providing industries are a significant and growing part of the economy. There is good growth potential for the tourist and information services areas. Business services are considered to be fairly sophisticated. Multinationals have a strong presence in advertising, computer services and management consultancy. Many large industrial groups have their own distribution networks. Apart from restrictions in the banking, financial services and telecommunications sectors, amongst others, foreign investors may operate in service industries.

## **Transport and communications**

Since the inclusion of government-controlled railroads in the Brazilian National Privatisation Program, there has been significant investment in the development and modernisation of the railroad network. This network is mainly located in the Southeast and South regions, although there are plans for some major extensions in the North and Central-West regions. Urgent investment has been earmarked for the Northeast region. However, road transport still dominates for both long-distance and intercity traffic. Most major federal and state highways are also in a poor state of repair. Nearly all road transport and haulage companies are privately owned. In addition, the government intends to privatise the remaining roads which have not been privatised yet.

The air transport infrastructure is well developed and the majority of airline company voting stock is in private hands. Urban transport continues to present significant problems in major centres. Limited subway systems are now functioning in Rio de Janeiro and São Paulo, mainly in the latter, which has expanded its network. However, until a more extensive network has been developed, subways will not significantly alleviate the problems affecting urban transport. Many companies provide private bus services for their employees. The potential of the waterways and coastal transport has not been exploited.

The postal system, which is government-controlled, has made considerable progress over the past few years and compares favourably with the postal systems in Europe and in the United States. Private courier services are widely available, offering both local and international delivery services.

As mentioned earlier, the telecommunications system is now controlled by the private sector. It should be noted that the telecommunications companies are also controlled and supervised by the National Telecommunications Regulatory Agency (ANATEL). (See chapter 6 for further details).

### **Trade balance and foreign trade**

The trade balance and principal foreign-trade products are summarised in Tables IV and V.

#### **IV. Trade Balance**

	<b>(USD billions)</b>		
	<b>2007</b>	<b>2008</b>	<b>2009</b>
Trade Balance – FOB	40	24.9	25.3
Export	160.6	197.9	152.9
Import	10.6	11.5	12.2

**VI. Principal Foreign-Trade Goods**

	(USD billions)		
<b>Exports</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Primary products			
Total	20.2	21.4	26.2
Industrialised products			
Total	38.0	39.0	46.9
	58.2	60.4	73.1

<b>Main Products Exported in 2009 USD Million</b>	<b>Amount</b>	<b>% 2008/9</b>	<b>Share %</b>
1. Soybeans and related Products	17,251	- 4.1	11.3
2. Transport Material	16,160	- 40.2	10.6
3. Oil and Fuel	14,947	-35.1	9.8
4. Ore	14,453	- 22.8	9.4
5. Meat	11,471	-19.7	7.5
6. Metallurgy Products	11,104	- 42.8	7.3
7. Chemicals	10,877	- 11	7.1
8. Sugar & Ethanol	9,716	23.4	6.4
9. Machinery & Equipment	6,256	-35.3	4.1
10. Paper & Pulp	5,001	-14.3	3.3
11. Electrical Equipment	4,964	-23.6	3.2
12. Coffee and related Products	4,251	-10.2	2.8
13. Tobacco and related Products	3,046	10.7	2.0
14. Footwear & Leather	2,764	-32.0	1.8
15. Textiles	1,895	-21.8	1.2



<b>Main Products Imported in 2009 USD Million</b>	<b>Amount</b>	<b>% 2008/9</b>	<b>Share %</b>
1. Mechanical Equipment	21,022	-18.1	16.5
2. Fuel and Oil	18,865	45	14.8
3. Electrical and Electronic Equipment	15,581	-22	12.2
4. Motor Vehicles and parts	11,456	-11	9
5. Organic and Inorganic Chemicals	8,631	-21.1	6.8
6. Optical and Precision Equipment	4,874	-18.6	3.8
7. Plastics and related Products	4,790	-16.8	3.8
8. Iron, Steel and related Products	4,592	-25.2	3.6
9. Pharmaceuticals	4,478	4.6	3.5
10. Fertilisers	3,903	-58.1	3.1
11. Cereals and Milling Products	2,538	-21.1	2
12. Rubber and related Products	2,294	-31.3	1.8
13. Airplanes and parts	2,213	-23.2	1.7
14. Synthetic and Artificial Filaments and Fibers	1,512	-6.3	1.2
15. Copper and related Products	1,314	-46.7	1

**Trading Partners and Suppliers****Principal Trading Partners – 2009**  
**USD Million**

	<b>Amount</b>	<b>% 2008/9</b>	<b>Share %</b>
1. United States	20,183	-21.8	15.8
2. China	15,911	-20.6	12.5
3. Argentina	11,281	-14.9	8.8
4. Germany	9,866	-18	7.7
5. Japan	5,368	-21.1	4.2
6. South Korea	4,818	-11	3.8
7. Nigeria	4,760	-29	3.7
8. Italy	3,664	-20.6	2.9
9. France	3,615	-22.7	2.8
10. Mexico	2,783	-10.9	2.2
11. Chile	2,616	-33.8	2
12. Taiwan	2,413	-31.8	1.9
13. United Kingdom	2,408	-5.6	1.9
14. India	2,191	-38.5	1.7
15. Switzerland	2,060	-8.8	1.6

**Major Importers to Brazil – 2009**  
**USD Million**

	<b>Amount</b>	<b>% 2008/9</b>	<b>Share %</b>
Asia	36,142	- 23.3	28.3
European Union	29,216	-19.2	22.9
Latin America & The Caribbean	22,673	-20.3	7.7
Mercosur	13,107	-12.2	10.3
LA & The Caribbean (exc. Mercosur)	8,564	-36.7	6.7
United States	20183	-21.8	15.8
Africa	8,465	-46.3	6.6
Middle East	3,142	-49.6	2.5
Eastern Europe	2,105	-60.6	1.6

## Tips for business visitors

### Guest visas

Foreigners seeking entry to Brazil as non-immigrants must first obtain the appropriate visa. Applications should normally be made to a consular office in the applicant's country of origin or current residence.

Business visas are required by foreigners travelling to Brazil for specific business purposes such as attending meetings and workshops, getting to know the Brazilian market and visiting clients. Holders of business visas may stay in the country for a period of up to 90 days, extendable for the same period. As a general rule, business visa holders do not acquire tax residency in Brazil. Business visas are not required for citizens of those countries with which Brazil has specific reciprocal arrangements.

### Currency

The monetary unit is the "Real" (R\$; plural, reais) which is divided into 100 units called centavos.

The Central Bank allows the official exchange rate to float freely, but forex trading is restricted to authorised dealers. The Bank intervenes when there are signs of speculative operations. There is an active parallel exchange market that, although illegal, is quoted in the daily newspapers, as well as an official tourist rate that normally approximates the parallel rate.

The official bank sale exchange rates as of December 30, 2009 are as follows:

	<b>R\$</b>
\$ 1	1.74
£ 1	2.79
€ 1	2.50

The parallel exchange rate at the same date was USD 1 = R\$ 1.86

**International time**

Brazilian Standard Time in relation to Greenwich Mean Time (GMT) and to U.S. Eastern Standard Time (EST) is as follows.

Zone	Hours	
	Behind GMT	Ahead of EST
Eastern Brazil	3	2
Western Brazil	4	1

Daylight saving time runs from October to February, when the clocks are put forward by one hour.

**Business hours**

The working day is normally eight hours for commercial offices, typically from 8:30 a.m. or 9:00 a.m. to 5:30 p.m. or 6:00 p.m., Monday to Friday, with a lunch break of between sixty and ninety minutes. A few factories still work Saturday mornings. Most retail outlets open on Saturdays and Sundays. Banks are generally open to the public from 10:00 a.m. to 4:00 p.m. and government offices from 9:00 a.m. to 5:00 p.m. Both are closed on Saturdays.

**Bank holidays**

Brazil has the following bank holidays:

New Year's Day	January 1
Shrove Tuesday (Carnival)	Variable
Good Friday	Variable
Tiradentes Day	April 21
Labour Day	May 1
Corpus Christi	Variable
Independence Day	September 7
Brazil's Patron Saint Day (N.S. Aparecida)	October 12
All Souls' Day	November 2
Proclamation of the Republic	November 15
Christmas Day	December 25

Holidays that fall on a Saturday or Sunday are not moved to a weekday.

In addition to the above, municipal authorities may decree three additional holidays, normally on dates of local significance. The most celebrated of these is Carnival (Mardi Gras) in February/March each year, when business virtually comes to a standstill Monday through Wednesday.

### **Weights and measures**

Brazil uses the metric system, but some traditional or unusual measures still appear in real-estate transactions.

### **Dates and numbers**

Dates are usually written in the order of day, month, and year; e.g., 1 May 1996 or 1/5/96.

Numbers are written with a full stop to denote thousands and a comma to denote fractions; e.g. R\$ 2.000,50 (two thousand reais and fifty centavos).

### **Local customs**

Business is generally conducted in a fairly formal manner, especially in the large cities. Business meetings are rarely held at breakfast time, although business lunches and dinners are common. Business entertainment often involves attending social events.

### **Research Sources**

Brazilian Institute of Geography and Statistics (IBGE)  
Foreign Trade Secretary  
Brazilian Central Bank  
Agribusiness sites  
National Bank for Social and Economic Development (BNDES)  
National Civil Aviation Agency  
Terrestrial Transport National Agency

## Chapter 2

# Business environment

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## Investor considerations

- Fast-changing business conditions.
- Considerable bureaucratic interference and regulation.
- Multiple and high taxes.
- Inflation under control.
- Abundance of semiskilled and unskilled labour.
- Commodity powerhouse.
- Tax incentives negotiable in some locations.
- Industrial modernisation during the last decade.
- Underinvestment in infrastructure matrix.

## Industrial climate

Governments have customarily supported free enterprise and the free-trade system. However, some state and semi-state entities still control part of the public utility sectors, the petroleum industry is still a government monopoly, excluding distribution, and oligopolistic situations exist in a few sectors. There is considerable bureaucratic intervention; regulations change constantly and there are complex labour and tax codes. On the other hand, there is a motivated work force and the development of labour-intensive industries and ventures directed toward exporting is encouraged.

Generally speaking, Brazil was a relatively closed economy in the 1970s and 1980s. However, trade liberalisation took place in the 1990s, resulting in the lifting of trade barriers and protective practices; local manufacturers are now more competitive internationally.

## Framework of industry

The Brazilian economy is fairly broad-based, including almost every type of industry imaginable. It is a mixed economy and includes listed companies, state monopolies, semi-state companies, foreign-owned companies, joint ventures, closely-held companies, family enterprises, and many small businesses operating in various formats. Financial markets and an active stock market exist. The São Paulo Stock Exchange (BM&FBovespa) has become one of the three largest in the world in market cap. A number of Brazilian companies have raised billions of dollars in recent IPOs and are included amongst the world's top fundraising operations.

Brazil is widely acknowledged as a global commodities powerhouse, and is the leading exporter of a great variety of items including animal produce (meat and chicken), grain (mainly soy and beans) and sugar, amongst many other items.

The state-owned oil & gas company Petrobras, one of the largest of the world, has announced the discovery of a mega oil field in the so-called pre-salt layer off the São Paulo state coast. This region boasts huge potential volumes of oil and could place Brazil amongst the top oil exporting countries in the world. Massive investment in this sector is expected in the years ahead.

## Aims of government policy

General policy has been to promote overall economic growth and fight poverty. However, this policy has been adversely affected over the years by the political situation, problems of servicing and reducing the foreign debt, and tough economic measures to shackle inflation, including the adoption of high interest rates.

### Economic development plans

There is a clear political need to improve the overall living conditions of low-wage earners by assuring adequate housing, health care and food supplies at reasonable prices. As a consequence, the specific objectives of recent governments have been as follows, in no particular order.

- Achieving a more even distribution of income and wealth, on both an individual and a regional basis.
- Maintaining inflation at manageable levels through containment of government expenditure and control of monetary expansion.
- Maintaining foreign-trade surpluses.
- Establishing an energy-expansion program.
- Developing the agricultural sector.
- Upgrading the labour force by intensifying educational, training, health and social welfare programmes.
- Strengthening the local capital market by attracting personal savings and foreign capital.
- Privatising certain public-sector companies.
- Reducing the so-called "Brazil Cost", which consists of the costs related to doing business in Brazil and which may diminish investment opportunities.



There is general recognition that the historical uncertainties concerning the political and economic climate over the years has deprived Brazilian business of the necessary investment to modernise and become internationally competitive. The country is now viewed by most of the international community as a much more predictable place to invest.

### **Brazil's performance during the 2008/2009 international financial crisis**

Brazil overcame the international economic turbulence and crisis in 2008/2009 and emerged stronger and more attractive from it. Brazil is the first Latin American country, and probably one of the first countries worldwide, to have emerged from the international recession.

Although the global environment remains difficult and the export sector is therefore continuing to struggle - also as a result of a strongly appreciated Real - Brazil's sheer size (2009 GDP of approximately USD 1.6 trillion) and the strength of its domestic demand (60% of GDP) have made an economic recovery possible.

A highly diversified economy and trading partners, as well as a solid financial system – leveraged by active regulators and the Central Bank, have also helped to counter the effects of the crisis in Brazil.

The economic impact of the global financial crisis and falling demand has been less severe for Brazil than for the USA, Europe and Asia. This is a consequence of successful long-term joint public and private initiatives for growth. A combination of factors, such as more than fifteen years of political stability, the pursuit of fiscal discipline, high international reserves,

solid macroeconomic indicators (based on a strong focus on inflation control) and the strengthening of the middle class' consumption power, have led Brazil to this position.

Furthermore, credit is due to the government for reacting promptly and implementing anticyclical measures to sustain the consumption of durable goods and the flow of credit, particularly for the automotive and construction industries and for households. These measures contributed to lower unemployment and the economy recovery.

One year on from the bankruptcy of Lehman Brothers, the event that triggered the international financial crisis, there is now increasing recognition that Brazil was one of the most successful countries in fighting the crisis. While most countries were making tentative recoveries, Brazil was one of the first to emerge pretty much unscathed from the crisis.

Financial and strategic investors are aware of these opportunities and realise that Brazil is the place to be. Cross-border merger and acquisitions and strong capital markets will play an important role.

Brazil has been chosen as the host nation for the 2014 FIFA World Cup. Rio de Janeiro has also been elected to host the 2016 Olympics. Long-term strategies and investments (including pre-salt oil exploration opportunities) are now top of the agenda. Brazil is a veritable potential economic powerhouse.

The country's social and economic inequality is also being addressed and the government has made significant inroads into poverty (through programmes like the "Bolsa Família" welfare programme).

These initiatives are expected to yield results in the medium and long term. Some regions, namely the northeast, now face the challenge of reaching out for opportunities that are already available to the rest of the country.

Brazil deserves close attention while it is preparing itself for the future. The country has huge infrastructure demands and a need for further public and private investment in education and healthcare. Top priorities on the government's agenda should include structural tax reforms and tight controls over government expenditure to spur the country's economic growth.

### **Regional/special industry development**

The government and most states promote the attraction of new investment, generally for all types of industry, and provide assistance to obtain financing and advisory services. Tax incentives are commonly negotiable and granted at federal, state and municipal levels.

### **Free-trade zones**

Brazil has a long-term free-trade zone in the city of Manaus (Zona Franca de Manaus) until 2023. A number of multinational companies have operations in Manaus, mainly in the electronics and automotive sectors (see "Free-trade zones" in Chapter 4).

### **Financial services**

Brazil has some of the most sophisticated financial institutions in the world. The largest Brazilian banks are included amongst the most solid banks globally. All the major international banks operate in the country. Moreover, the government has established several financial aid credit facilities to further the development and modernisation of key sectors. For information on available banking and financial services see Chapter 7. However, financial centre operations and offshore financial services are not available.

### **Public/private sector cooperation**

The private sector has many industrial, commercial and banking federations at state level that cooperate with, and have access to, ministries and senior government officials. There are also national confederations for various sectors of the economy. The National Confederation of Industry, made up principally of leading businessmen, meets regularly with various ministers responsible for economic affairs.

### **Industrial/management relations**

Brazil has a large labour force, but many workers are semiskilled and unskilled. There is a shortage of technical and skilled personnel.

Trade unions are a force to be reckoned with in the country and can be quite militant. Fringe benefits and social security costs are a significant element of overall labour costs. For more details of industrial/management relations see Chapter 10.

## Overseas trade relations

### Membership of trade blocs

Brazil is a member of the Latin American Integration Association (ALADI), the World Trade Organisation (WTO), formerly the General Agreement on Tariffs and Trade (GATT) and the Common Market of the Southern Cone (MERCOSUL), whose members currently include Brazil, Argentina, Paraguay and Uruguay, with Chile, Bolivia, Peru, Colombia, Ecuador and Venezuela being associated countries. Under the MERCOSUL treaty agreement, tariffs are abolished; the movement of labour, goods and services is unrestricted; capital investment is encouraged; macroeconomic policy is coordinated; and foreign-trade policies and tariffs for non-member countries are harmonised.

### Exports

Brazil encourages exports by offering a number of incentives, including duty exemptions or reductions for imported materials that are used in exported goods, value-added-tax benefits, special financing arrangements and others. For more details on investment incentives see Chapter 4.

Special export licenses are normally required for goods that are in short supply in the domestic market. There is some regulation concerning the export of certain goods, which are subject to previous government approvals.

### Trade barriers

All imports and exports are controlled by DECEX (“Departamento de Operações de Comércio Exterior”), the foreign trade department of the Bank of Brazil. For many years, local industry was protected from imports and the overall tariff burden was high. In general, trade barriers were set up because of the need to industrialise and to develop local industries, but also because of the foreign-debt situation.

In the last few years, however, import duties and trade barriers have been gradually reduced and imports of various products are encouraged when local prices are higher than international prices or when there is a shortage of local products. For more information on exporting to Brazil see Chapter 8.

## Chapter 3

# Foreign trade and investment opportunities

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## Investor considerations

- Foreign investment is generally welcome.
- Brazil is accepting of Latin American expansion programs.
- Large potential consumer market and a booming middle class.
- Export-based enterprises are generally favoured.
- Foreign investors are eligible for most available incentives.
- Restrictions on foreign ownership exist in few sectors, including aviation and publishing.
- Favourable changes in business culture and spread of corporate governance and best practices
- Robust performance of IPOs and M&A markets in recent years.
- “Investment Grade” rating awarded by all major agencies.

## Investment climate

### Government attitudes towards foreign investment

The Constitution states that foreign investment should be in the national interest and is welcome provided it represents a long-term commitment to economic development, particularly in those areas that are high on the government’s list of priorities. These include the development of agriculture, technology and labour-intensive industries and the manufacture of goods that are currently imported and goods that will increase exports.

Direct foreign investment was rising significantly until the year 2008. However, a considerable contraction was witnessed in 2009 following the global credit crunch, as shown in the table below in millions of US dollars.

2004	2005	2006	2007	2008	2009
20,265	21,522	22,231	33,705	43,887	25,949

All forms of investment are welcome, as long as they do not contravene local policy regarding foreign investment and national security.

The restrictions on foreign ownership are imposed mainly for national security reasons in the areas of defence and air transport.

## Trade policy

Brazil is generally supportive of free trade, but high tariffs are imposed on many imports. For more information concerning overseas trade relations see Chapter 2.

## Taxation policy

The federal tax system is not biased against foreign investment and there are no tax incentives that favour foreign investors. Save a few exceptions, foreign investors are generally entitled to the same tax treatment and incentives as their local counterparts. Various states and municipalities actively seek foreign investment. For more information on tax incentives see Chapter 4.

## Local competitor attitudes towards foreign investment

In general, local businessmen welcome foreign investment. Certain sectors have lobbied hard to protect their activities by various means, including the imposition of trade barriers and restrictions on foreign investment. Such lobbying was quite successful in the past, although this situation is gradually changing as governments seek greater efficiency and competitiveness.

## Labour attitudes towards foreign investment

If foreign investment and management can be seen to bring jobs and competes on an equal footing with Brazilian business, it tends to be embraced by workers. (For details on Foreign Individuals see Chapter 20 – Taxation of Individuals and Chapter 10 – Industrial relations and Social Security in the section Expatriate Personnel in Brazil).

## Special investment opportunities

In general, Brazil is an attractive investment opportunity for companies interested in the following:

- Tapping the local market's considerable potential. There are still many dissatisfied consumers.
- Taking advantage of the abundant raw materials and natural resources.
- Using the sizable and growing labour force.
- Locally producing items that are currently imported.
- Using Brazil as a manufacturing base for exports, especially regarding Mercosur opportunities.
- Improving infrastructure has become a priority (including railways, motorways, ports, airports, water and waste treatment and power generation).
- Taking advantage of the massive investments which are expected in relation to the huge pre-salt oil reserves, the 2014 FIFA World Cup and 2016 Olympic Games.

It is generally possible to import vital components/consumables if there is inadequate or no local production thereof, although there are restrictions in specific areas (see "Government attitudes towards foreign investment" above), bureaucratic delays and high import duties that can nullify the advantages. However, regardless of the points outlined above, most products can be imported, subject to local legislation.

## Planning guide for foreign investors

### National and local government policy considerations

- The federal government and the states generally support free enterprise and free trade.
- Foreign investment is generally welcome but should provide benefits to Brazil and its citizens, i.e. job and wealth creation.
- Local and foreign investors are treated the same, in general.
- Current policy favours the lessening of bureaucratic interference and the deregulation of business, except those related to infrastructure, such as telecommunications, energy utilities, petroleum, water supply and healthcare, which are subject to regulatory oversight.

### Investment possibilities/restrictions

- Federal and state governments generally have an open attitude towards foreign investment.
- In general terms, 100 percent foreign ownership is possible.
- There are some restrictions on foreign ownership of financial institutions, communications companies, certain other strategic sectors and rural land.
- Joint ventures with local partners may be favoured but are not essential.

### Prior approval or registration

- Prior approval is not required except in rare circumstances.
- Registration of foreign investment with the Central Bank is a condition for repatriation of capital and remittance of dividends and profits.
- A permit is required to operate a financial institution.
- Registration requirements vary at state level.

### Possible business structure

- For foreign investors, the most common form of doing business is through an incorporated subsidiary or limited-liability company.
- Branches are difficult to form and depend on Presidential Decree approvals, whereas it is more straightforward to establish corporations (“sociedades por ações”) and private limited-liability companies (“limitadas”) in terms of bureaucracy and approvals.
- In general, there are no nominal minimum capital requirements, except for financial institutions.
- While joint ventures do not require participation by a local entity, it is generally helpful to have one.

### Setting up or acquiring business

- Foreign investors generally incorporate new companies or acquire existing enterprises.
- Setting up new companies is relatively straightforward and inexpensive, and normally takes about a month.
- A Brazilian holding company may be set up to acquire a business.
- Asset or share acquisitions should be planned with care.
- For additional considerations see Appendices XIV.

### Investment incentives

- Foreign investors are generally eligible for the available incentives.
- The federal government offers tax incentives in certain underdeveloped or strategic areas.
- Many state and local governments offer incentives to attract investment.

### Location/industries

- Location is generally determined by key business factors.
- Regulations concerning various aspects of business (e.g., indirect tax rates and incentives) vary from state to state.
- Special federal programmes reward investments in the poorer North and Northeast regions.
- Discussions with state development agencies are recommended.

### Finance

- Foreign-controlled companies can be listed on the stock exchanges and raise capital through public subscriptions or debenture issuances.
- A wide range of credit and financial services is available from local and foreign banks operating in Brazil.
- Long-term financing is available from investment companies and government investment banks.

### Repatriation of capital and profits

Capital and earnings may generally be repatriated on a tax-free basis, limited to the amount registered at the Central Bank of Brazil. Amounts in excess of the registered amount may be treated and taxed as capital gains (subject to income tax at the rate of 15%, which can rise to 25% if the beneficiary is located in a tax haven, as provided for in Brazilian legislation).

### Work force and labour costs

- A plentiful labour supply exists, but many of the workers are semiskilled or unskilled.
- Payroll charges and taxes tend to be higher than in other countries.

### Market studies

- Market studies are advisable. PricewaterhouseCoopers Brazil can assist in such studies and in other phases of setting up Brazilian operations as well as in potential investment and acquisition analyses.



### **International financial centre**

- Brazil is not a centre for international financial services and offshore operations.

### **Information and assistance**

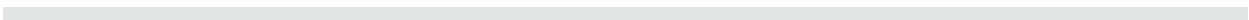
- Any further information and assistance may be obtained from PricewaterhouseCoopers offices throughout the country. For the addresses of our offices see the inside cover.

### **Current Trends**

- Overall modernisation of the economy.
- Increase in private investment is forthcoming to cope with growing demand.
- Increasing foreign direct investment.
- 2014 FIFA World Cup and 2016 Olympic Games to be hosted by the country.
- Reduction of government involvement in business.
- Gradual elimination of restrictive and protectionist practices.
- Lowering of trade barriers to foreign competition.
- Increasing and diversified export base.
- Maintaining fiscal discipline and solid macroeconomic indicators.
- Increasing credit facilities (real estate/consumer).

## Chapter 4

# Investment incentives



## Investor considerations

- Local and foreign investors are generally treated equally as regards investment incentives and tax concessions.
- There are no special federal tax incentives to attract foreign investors.
- Many state and local governments offer investment incentives in the form of reductions in indirect taxes.
- Tax concessions are available for locating in the poorer Northeast and Amazon regions, including reductions in federal income tax.
- Incentives are available for the promotion of exports.

## Investment policy

Foreign investment is generally welcome and actively sought, particularly if it brings new technology, creates new jobs, develops agriculture and increases exports or decreases imports.

There is a wide variety of federal programmes designed to encourage the economic development of Brazil and also to promote regional development. They tend to favour operations in the poorer Northeast (SUDENE) and Amazon (SUDAM) regions. Several programmes provide export incentives.

State and local governments also encourage investment and they generally offer incentives to attract local and foreign investors.

There are no specific incentives for establishing holding companies and regional administrative offices, and there are no tax havens or offshore financial facilities. There is a free-trade zone in Manaus and fiscal benefits apply in areas of the Western Amazon region (see “Free-trade zones” further on).

## Tax concessions

Few federal tax concessions are available to local and foreign investors. Those that exist are designed to accelerate the development of certain less-developed regions and industries considered of importance to the economy. However, in general, there are no specific tax concessions to attract foreign investors.

State and local tax concessions vary depending on the importance of the prospective investor to the area.

## Regional incentives

### Regions affected

The following regional agencies are responsible for development in the listed states:

#### *SUDENE (Northeast region)*

Alagoas  
Bahia  
Ceará  
Espírito Santo  
Maranhão (part)  
Minas Gerais (part)  
Paraíba  
Pernambuco  
Piauí  
Rio Grande do Norte  
Sergipe

#### *SUDAM (Legal Amazon)*

Acre  
Amapá  
Amazonas  
Maranhão (part)  
Mato Grosso  
Pará  
Rondônia  
Roraima  
Tocantins

### Eligibility

In general, incentives are available to both local and foreign-controlled companies. However, the granting of incentives depends on approval by the federal government agencies SUDENE and SUDAM for the implementation of new industrial projects or the planned expansion, diversification or improvement of an existing industry. SUDENE and SUDAM evaluate not only a project's technical and economic feasibility, but also its suitability as part of the region's overall economic development.

### Tax incentives

For the Northeast and Amazon regions, the investment incentive plans administered by SUDENE and SUDAM, respectively, offer certain fiscal benefits to companies operating approved projects, as follows:

- Reduction of 75% of the income tax and non-refundable surcharges from January 1998 to December 2013 due on operating profit ("lucro de exploração"), for implementation, expansion, diversification and improvement projects submitted by December 2013 relating to economic segments considered as priority for regional development, for a maximum period of ten years.

- Gradual reduction of income tax, from 25% to 12.5%, from January 1998 to December 2013, for legal entities which maintain economic enterprises in economic segments considered as priority for the development of the aforesaid region or which are headquartered in the Manaus Free-Trade Zone.
- Exemption from the Merchant Marine Fee - AFRMM and Tax on Financial Transactions - IOF (for exchange transactions made to pay for imported goods) for enterprises which implement, expand, diversify and improve businesses in the Northeast and Amazon, and are declared as being of interest to regional development by the regional development agency.

The corporate income tax reduction cannot be distributed to the company's quotaholders/ shareholders and must be booked and kept as a subsidy reserve (capital reserve), to be used only for capital increases or offsetting existing losses.

Certain state VAT (ICMS) incentives are also made available to certain businesses depending on the nature and peculiarities of the project.

### **Nontax incentives**

For companies in the Northeast and Amazon regions, low-cost loans or loan guarantees are granted by government development banks, such as the Bank of Northeast Brazil (BNB), the Amazon Bank (BASA) or the National Bank for Social and Economic Development (BNDES).

### **Earnings**

Taxes on earnings repatriated to foreign shareholders are detailed in Chapter 17.

Any unrepatriated earnings may be invested in the same or any other company in Brazil.

### **Industry incentives**

The import of capital goods, which are not available in the Brazilian market, might qualify for an Import Duty reduction, subject to government approval, in order to stimulate the broadening, modernization and restructuring of the Brazilian industrial sector. Some of these capital goods also benefit from an excise tax (IPI) reduction.

The National Bank for Social and Economic Development (BNDES) provides low-cost financing for investment projects, the acquisition of equipment and the export of goods and services. Moreover, the bank shores up the capital structures of private entities and allocates its non-refundable finances to projects which further the social, cultural and technological development of Brazil.

For companies engaged in agricultural activities, capital expenditure may be taken as a tax deduction in the year of acquisition.

Taxes on earnings repatriated to foreign shareholders are detailed in Chapter 17.

## Fiscal incentive investments

Brazilian and foreign-controlled companies may choose to invest part of their tax liability in certain approved investment projects owned by them until 2013. Such investments are generally referred to as fiscal incentive investments and in total may not exceed the rate of 30 percent, nor be lower than 9 percent of the total annual income tax liability. This percentage varies depending on the investment period and location. These approved investment projects are normally granted total or partial tax exemption for varying periods of time.

## Special-use company incentives

In principle, special-use company incentives do not exist in Brazil

## Free-trade zones

The Manaus free-trade zone (Zona Franca de Manaus, Amazônia Ocidental e Área de Livre Comércio de Macapá/Santana) was created in 1967 to attract industry and commerce to the Amazon region. All imported foreign goods are tax free, provided they are consumed within the zone or are exported abroad. Sales or transfers of these goods to other parts of Brazil result in payment of the previously exempted taxes. Foreign-controlled subsidiaries may establish assembly operations and enjoy the same benefits as local companies. Sales from other parts of Brazil to the Manaus free-trade zone are also entitled to certain tax benefits. These fiscal benefits also apply to certain specific areas of the Western Amazon region, which cover the states of Acre, Amazonas, Rondônia and Roraima.

## Export processing zones

These zones (Zonas de Processamento de Exportação) are characterized as free-trade areas and are located in certain less-developed regions in need of investment. Authorized companies must produce or process merchandise exclusively for export. Imports and exports are exempt from import and excise taxes and also enjoy favourable income tax treatment. These zones were created in 1988.

## International financial-centre operations

There are no special concessions to encourage the establishment in Brazil of holding companies, investment vehicles, regional headquarters, administrative offices, tax-haven activities or offshore operations.

## Export incentives

The various incentives available to exporters include the following:

- Under the Special Customs Drawback Scheme, suspension and exemption can be obtained for import duties, excise tax and value-added tax on sales and services as well as other taxes and charges for imported goods to be used in the manufacture of products for export. These incentives are normally available for up to two years. Exporters may also benefit from the new modalities of drawback, “green-yellow” and “integrated”, which permit the suspension of taxes levied on the goods acquired in the domestic market for the manufacturing of products to be exported.
- Exemption from withholding tax, under certain conditions, on export commission paid to overseas agents, except when paid to countries considered as tax havens (overall income tax rate lower than or equal to 20%), in which case the tax is levied at the rate of 25%.
- Exemption from excise tax (IPI), value-added tax on sales and services (ICMS), social contribution on billing (COFINS) and contributions to the social integration program (PIS) on exports of manufactured products.
- Low-cost export financing.
- Other programmes and special customs schemes may apply. For further information please see Chapter 8.

Export credit guarantee insurance is provided mainly by banks through letters of credit for export transactions. The “Instituto de Resseguros do Brasil” (Brazilian Reinsurance Institute - IRB) also provides this coverage.

## Incentives to invest in other countries

As a general rule, Brazil offers no specific incentives to individuals and companies wishing to invest abroad. However, various benefits are available for investments that result in greater export revenue for Brazil, as described earlier in “Export incentives”.

## Foreign-investment incentives and strategy

It is government policy to welcome foreign investment and investment incentives are generally available to both local and foreign investors. No special privileges are given to foreign investors, but export manufacturing and import substitution are encouraged. Several tax treaties have been signed and others are currently being negotiated; see Chapter 23 and Appendix V.

### Constitutional Investment Fund

The Constitutional Investment Fund was created to foster national integration through economic and social development and to diminish regional differences. The funds are invested in projects approved and managed by operator banks in the Central and Eastern, Northeast and North regions. These funds are provided to support specific projects, such as companies setting up in underdeveloped municipalities, the formation of regional clusters and forest management, amongst others.

## Chapter 5

# Restrictions on foreign investment and investors

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## Investor considerations

- Foreign capital is generally treated the same as local capital.
- Foreign ownership of local companies is normally permitted except in sectors considered to be of strategic importance.
- Registration of all foreign investments with the Central Bank of Brazil is required.
- Exchange controls are in place.
- Repatriation of capital and earnings is controlled.
- Foreign ownership of rural land is restricted.

## Regulatory climate

### Regulatory authorities

The National Monetary Council (“Conselho Monetário Nacional”) is the exchange control and foreign investment authority. Foreign-exchange policy is controlled and supervised by the Central Bank of Brazil.

### Regulatory legislation

The Constitution outlaws discrimination against foreigners residing in the country with regard to their basic rights of personal liberty, security and property ownership, although there are some restrictions on their ownership of rural land and certain business. Additionally, foreigners may not be employed by the government on a permanent basis.

Foreign investment is legislated by Law 4131 of 1962 and subsequent amendments. The exchange control regulations are set out in the rules, directives and circulars issued by the Central Bank and by the Federal Revenue Service.

Exchange-control and foreign-investment policies are established by the National Monetary Council, whose president is the Minister of Finance. The legislative, executive and administrative aspects of these policies are the responsibility of the Central Bank, which includes a number of departments specifically concerned with foreign investment and exchange. They normally operate by means of internal directives that are not published. The Foreign Trade Department (DECEX) of the Ministry of Development, Industry and Foreign Trade (MDIC) is responsible for foreign-trade policy, along with the Brazilian Federal Revenue Office, which is responsible for establishing foreign-trade procedures in Brazil.

For many years the overall policy has been to generate an exchange surplus sufficient to service the foreign debt and to build up an adequate foreign exchange reserve.

In general, tight control of foreign-currency transactions is exercised by the authorities. The fine for infringing exchange control regulations is limited to BRL 250,000 and is imposed by the Central Bank, according to the regulations issued by the National Monetary Council. Foreign-currency transactions may be effected through authorised financial institutions only.

Foreign currency is exchanged at different rates, depending on the nature of the transaction. The official commercial (import and export) rate is used for most trade and financial transactions and the Central Bank may intervene to control this rate. At the beginning of 1999 the National Monetary Council decided to liberalise exchange controls, letting market forces be the determining factor.

There is also an openly used (although illegal) parallel exchange market. This rate is traditionally higher than the commercial rate.

## Exchange controls

### Inward investment

The general policy is to admit foreign capital and treat it in the same way as local capital. However, there are some restrictions on foreign investment in certain sectors (see below). All inward investment must be registered at the Central Bank to ensure ultimate repatriation rights. There are no special exchange rates for specific transactions. It should be noted that acquisitions of local companies may be investigated to confirm their substance and real underlying value.

### Registration of foreign capital and technology

- Foreign capital

The basic legal concepts regulating foreign capital in Brazil are defined in Laws 4131 of 1962 and 4390 of 1964, which were regulated by Decree 55762 of 1965. The legal concept of foreign capital includes tangible and intangible assets.

An important concept in foreign-capital legislation in Brazil is that which reflects the constitutional principle (Federal Constitution, article 5) that guarantees equal treatment to all. This principle, in Law 4131/62 and later amendments to the Federal Constitution, affords foreign capital invested in Brazil the same legal treatment as that given to local capital on equal conditions, and any discrimination not permitted by this law and subsequent amendments thereto is prohibited.

To qualify for the remittance of profits and to ensure ultimate repatriation rights, foreign capital entering Brazil must be registered at the Central Bank. Capital remittances must be registered within 30 days. Foreign capital may take the form of cash, rights and assets sent to Brazil at fair market value, reinvested earnings, conversion of foreign-currency loans or current-account balances, liabilities and others. Reinvested earnings in this context are defined as profits earned in Brazil on registered foreign capital that have been formally allocated to increase capital. Capital increases from this source are registered in the currency of the country to which the profits could have been remitted.

Investments structured as advances for future capitalisation are prohibited by the Central Bank, except those exclusively related to participation in National Privatisation Programmes and public service concessions or which have been specifically authorised by the Central Bank for projects of interest to the Brazilian government.

The nationality and legal classification of an investor is irrelevant, provided that the investor resides or is domiciled abroad.

The Central Bank has also recognised that foreign investments directly or indirectly made in holding companies can be registered under the terms of Law 4131/62.

Prior approval of the Central Bank is no longer required for all foreign-currency loans received, but they must be documented by a formal contract stipulating the interest rate; the Central Bank of Brazil has to be informed of all the loan terms, as approval is granted or refused after the loan transaction has actually been implemented. The bank may refuse to accept loans which are charged interest over and above the rates prevailing in the country of origin. The Central Bank's prior approval is also necessary for operations relating to the conversion of certain liabilities into investment.

- Technology

Technology transfer agreements, including those involving patents and trademarks, must be approved by and registered at the National Institute of Industrial Property (INPI). This approval depends on the necessity of the services to be rendered and/or availability of the technology within Brazil. In the case of royalties, registration of the agreement also depends on proof that the related patent or trademark has been duly registered in Brazil and is still valid. In the case of technical assistance, the authorities reserve the right to verify that services have been effectively rendered. A computerised service facilitates the obtainment of information about registered patents and trademarks and the process of monitoring registration applications.

## Currency accounts

The use of foreign-currency bank accounts by local or foreign investors and traders is generally not allowed (the legislation makes some exceptions). However, banks authorised to deal in foreign exchange may hold local-currency funds for non-resident individuals or entities. Such bank accounts may be operated in the name of the non-residents and are often used to hold blocked local-currency funds.

## Repatriation of capital and earnings

Capital may be repatriated free of tax up to the amount registered in foreign currency at the Central Bank. Any excess is considered a capital gain subject to exchange provisions and is therefore subject to withholding income tax of 15 percent (25 percent for beneficiaries domiciled in jurisdictions considered to be tax havens).

Profits may be remitted abroad without limit, up to the registered foreign capital and available retained earnings. As from January 1, 1996 profits/dividends distributed to non-resident beneficiaries relating to periods beginning on or after this date are not subject to withholding income tax.

Loans may be repatriated within the terms of the registered loan contract. Interest can be freely remitted within the loan contract terms subject to withholding income tax at the rate of 15 percent (25 percent for beneficiaries domiciled in jurisdictions considered to be tax havens).

Remittances for technology transfers, including patents and trademarks, also require the Central Bank's prior approval, which will only be granted if the agreements have been previously approved and registered at the INPI. Requests for remittances that are not seen to be on an arm's-length basis are normally not approved. Royalty and technical service remittances are subject to 15 percent withholding income tax or lower rates based on tax treaties. A 25 percent withholding income tax applies should the payment be made to beneficiaries domiciled in jurisdictions considered in Brazil to be tax havens.

Exchange currency for imports may be freely remitted. However, in certain cases, an import license is required if payment of the purchase price of the imports is deferred for varying periods.

Supporting documentation must be presented for approval of all applications for repatriations and remittances. Proof must also be furnished that the applicable withholding tax has been paid.

Bilateral or multilateral payment netting deals are generally not permitted. However, simultaneous exchange transactions may be carried out based on their net amount, provided that the respective exchange contracts relating to the inflow and outflow of foreign currency are settled on the same date and have the same parties (in Brazil and abroad) as creditor and debtor.

### **Guarantees against inconvertibility**

There are no government or similar guarantees against inconvertibility. Over the years, however, the regulations related to repatriations and remittances have been respected.

### **Restrictions on foreign investment**

#### **Industries closed to private enterprise**

The government has powers to operate directly, through concessions or through authorisation, a number of activities that are considered to be a public service or of strategic importance. In practice, the federal and state governments tend to supervise activities transferred to private control through regulatory agencies operating in a number of sectors, such as telecommunications, light and power, water supply, railroads, coastal shipping, film industry, oil and gas, healthcare and health products. Nevertheless, government intervention has been diminishing over the past few years.

Government permission is required before a company can begin operating certain other types of businesses, such as banks and financial institutions, mining companies, oil refineries, maritime, road and air transport companies and companies involved in health products and health care.

### **Restrictions on foreign ownership**

Except as noted below, 100 percent foreign ownership of local enterprises and joint ventures is normally permitted. In general, no particular types of operation are given special treatment. A local partner is often advisable to provide local expertise and contacts. Joint ventures with Brazilian partners are encouraged.

The restrictions on foreign investor participation may be summarised as follows.

Communications:

Foreign ownership of television, radio stations or newspapers is restricted.

Aviation:

Foreign ownership of Brazilian airlines is restricted.

Classified government contracts:

Foreign participation in classified government contracts or access to work by other firms on such projects may be restricted.

Coastal and freshwater shipping:

Such shipping may only be carried out by Brazilian companies.

Mining and hydroelectricity:

Exploration and extraction of mineral resources and electricity generation may only be carried out by Brazilian nationals or entities incorporated in Brazil. These Brazilian-incorporated entities may be foreign-controlled except in the frontier zone, where they must be controlled by Brazilian nationals.

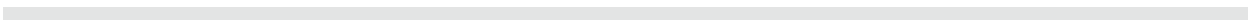
**Other types of restrictions**

Direct or indirect foreign ownership of rural land is regulated and subject to limitations over total area. Ownership of land near Brazil's borders is subject to further restrictions. There are no restrictions on foreign ownership of urban properties.

**Policy trends****Effect on foreign investment**

The tight exchange and foreign-investment controls remained practically unchanged for many years, but since 2005 there has been a gradual relaxation of controls and restrictive and protectionist practices.

There has been a clear preference for foreign companies to establish themselves through subsidiaries and joint ventures rather than simply exporting to Brazil and this is likely to continue, although exceptions are made where imports are clearly cheaper than local goods.



## Chapter 6

# Regulatory environment

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## Investor considerations

- Business activities are generally regulated.
- Prohibitions normally apply equally to local and foreign-owned businesses.
- Considerable documentation and bureaucracy are involved in day-to-day operations.
- Foreign-exchange transactions are controlled.
- Stock markets are active and reasonably developed, but stock ownership is not widespread.
- Patent, trademark and copyright protection is available.

## Regulation of business

The main regulatory agencies concerned with business activities are the following.

- Central Bank (BACEN): Responsible for the implementation of monetary policy, exchange controls, registration and control of foreign capital and profit remittances and the regulation of banks and financial institutions.
- Securities Commission (CVM): Responsible for the securities markets and listed companies.
- Administrative Council for Economic Defence (CADE): Responsible for investigating and suppressing unfair business practices, and antitrust monitoring.
- National Institute of Industrial Property (INPI): Responsible for patent and trade mark registration and technological development. INPI has power over technology transfer agreements.
- Foreign Trade Department (DECEX) of the Bank of Brazil: Responsible for administration of foreign trade and control of export and import licenses.

## Competition policy

In general, competition is encouraged, except in certain sectors where there are restrictions on foreign investment and investors.

### Price controls

Currently, the prices of services rendered may be adjusted for inflation on a yearly basis using an index that properly reflects the weighted variations of imputed costs.

Furthermore, several government agencies are responsible for price controls in special areas, e.g., the National Telecommunications Regulatory Agency (ANATEL) for telecommunications, despite the concession agreements. Control is exercised in various ways, depending on the industry or product involved and the general economic situation.

### Monopolies and antitrust

CADE, a government agency, is responsible for suppressing the abuse of economic power. It may investigate and punish trusts, cartels and monopolies, either at its own initiative or at the request of third parties. Members of CADE are appointed by the President.

The Antitrust Law (Law 8884/94) contains wide-ranging regulations in defence of free-market competition. The Economic Law Department (SDE) is charged with enforcing these regulations. Cartel, monopolistic and oligopolistic situations in various sectors are constantly challenged.

In general, there are no special restrictions on foreign investment.

### Acquisitions and mergers

Except as stated in Chapter 5, there are no restrictions on acquisitions and mergers by foreign investors and the procedures are relatively simple. Central Bank permission is required when financial institutions are involved.

## Securities markets

The Central Bank and the Securities Commission (CVM) are the main regulatory agencies concerned with the financial and securities markets. The main stock exchange is in São Paulo.

The CVM has stated that its policy is not to discriminate against foreign investors, but to treat them in much the same way as local investors.

A public securities issuance, including debentures, may not be made without prior registration at the CVM, which will normally require adequate disclosure of information to safeguard investor interests. Furthermore, only securities issued by companies registered at the CVM may be traded on stock exchanges and over-the-counter markets.

The preparation and approval of a registration statement can be very time-consuming, but once securities have been registered a listing for trading may usually be obtained without undue difficulty.

Companies registered at the CVM and whose securities are traded on a stock exchange are required to file periodic reports and to report significant developments. These reporting requirements also apply to companies whose stock is sold in the secondary over-the-counter market.

A cash tender offer can be made more quickly and with considerably less formality than the CVM registration process. Certain information must be submitted to the CVM and the rules for cash tender offers must be observed.

Several requirements must be fulfilled in order to be listed on the stock exchanges. For example, previous audited financial statements and other detailed information must be submitted. In addition, the particular securities for which a listing is being sought must have a sufficiently wide distribution to offer reasonable assurances that an adequate market exists. When applying these criteria to individual cases, the stock exchanges have developed minimum numerical standards for evaluating applicants for listing.

The over-the-counter market handles securities of publicly held companies that have not applied for listing on the stock exchanges. The procedures for purchase and sale of stock are more informal and are generally handled by over-the-counter brokers who establish the bid and asking price for specific issuances.

Following the recent introduction of accountability and corporate governance regulations, the stock exchange has created different levels of corporate governance, which require better practices and minimal additional rights for investors.

Reporting and disclosure requirements are described in Chapter 11.

## Imports and exports

All importers and exporters must be duly registered at the Foreign Trade Department (DECEX) and the Federal Revenue Service (RFB). For details on import restrictions and duties see Chapter 8. Exports are encouraged by several incentives summarised under “Export incentives” in Chapter 4. Normally there are no restrictions on exports. However, licenses are generally required for both imports and exports.

## Consumer protection

The 1990 Consumer Defence Code considerably strengthens customer rights.

The Ministry of Health maintains control over pharmaceuticals and cosmetics produced in the country or imported. Specific registration of laboratories and laboratory products is required before new products can be launched in the market. Pharmaceutical companies require a special license.

There are also various agencies concerned with standards, quality and supply of foodstuffs including imported products, and specific regulations on weights and measures that must be observed by the consumer products sector.

## Pollution control

Pollution has become a serious problem in several areas and is consequently now one of the main issues on both the political and the economic agenda. Federal and state governments have developed programmes and controls to prevent or reduce pollution, mainly in the more industrialised areas. The treatment of industrial residues and waste to avoid and reduce pollution must be considered when setting up new plants.

Ecological preservation is a subject of public interest and often covered by the local and international press.

The Brazilian Environment and Renewable Natural Resources Institute (IBAMA) is the federal agency in charge of establishing the general criteria for pollution control. Other agencies are required to take IBAMA regulations into account when examining applications for incentives and financing of investment projects. Pollution control is the responsibility of the states and municipalities. Noncompliance with environment control regulations may result in the suspension of tax benefits, credit restrictions or even the closing down of operations.

Over the last couple of years, sustainability issues have been gaining importance and become a part of corporate concerns.

## Special industries

There are specific regulations affecting the operations of financial institutions, as noted in Chapter 7. The same applies to the insurance sector.

Licenses are required from the National Department for Mineral Prospecting (DNPM) in order to proceed with mining operations.

The Software Law (Law 9609/98) defines software and deals with the protection of intellectual software property and the marketing of software in Brazil, as well as the registration of technology transfer contracts.

Law 8955/94 regulates franchising activities in Brazil. Franchising agreements are valid, regardless of registration. If technology transfer is involved, the respective agreements must also be registered at the INPI and the Central Bank in order to support remittances abroad.

## Patents, trademarks and copyrights

Law 9279/96 provides special protection for intangible industrial property, which includes patents, trademarks and industrial drawings. There is also legal protection against video and audio piracy.

Penalties for patent and trademark infringement include confiscation of goods, imprisonment and fines as well as the payment of losses and damages.

## Patents

A patent of invention lasts 20 years and an industrial model or design lasts 15 years as from filing the application with the National Institute of Industrial Property (Instituto Nacional de Propriedade Industrial - INPI). Ownership of patents is transferable. Patent holders in other countries with which Brazil has treaties or conventions covering such matters have priority rights for filing patent applications within the periods specified.

## Trademarks and trade names

Trademarks are registered at INPI and trade names at the local Board of Trade (Junta Comercial). There are a number of restrictions regarding trademarks, which are stipulated in the Industrial Property Code (Código de Propriedade Industrial). Registration is valid for ten years and may be renewed for similar periods indefinitely.

## Industrial Drawings

Registration is valid for ten years and may be renewed three times for five years each time. Registration is also transferable.

## Copyrights

Copyrights are legally protected by agreements, conventions and treaties in force in Brazil. The country is also a signatory of the Berne Convention for the protection of artistic and literary works, the Paris Convention for the protection of industrial property, the Washington Patent Cooperation Treaty, and is a member of the World Intellectual Property Organisation

## Chapter 7

# Banking and finance

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## Investor considerations

- A wide range of credit and financial services is available from an extensive banking and financial network.
- Institutional financing is available for foreign trade.
- Banking and financing business is regulated by the Central Bank.
- Banks and financial institutions are under strict government supervision of operating and accounting matters.

## Banking and finance system

### **National Finance System**

The National Financial System's (SFN) functional structure is formed by the normative system, which congregates the normative and supervisory entities, and the operative system, formed by financial institutions and other institutions authorised to operate by the Central Bank, subsidiary bodies and enterprises regulated and monitored by other supervisory authorities.

The regulatory and supervision entities are the:

- National Monetary Council ("Conselho Monetário Nacional" - CMN):

Oversees the financial system as a whole.

The Council's Members are the Minister of Finance (president of the CMN), the Minister of Budgets and Planning and the president of the Central Bank.

- Central Bank (BACEN):

Carries out traditional central banking functions and implements CMN policies.

- Private Insurance Regulator (SUSEP)

Responsible for the supervision of the insurance industry

- Complementary Pensions Department (SCP):

Responsible for the supervision of the complementary pension industry

- Securities Commission (CVM):

Responsible for the capital markets and asset-management industry.

The Central Bank is the entity responsible for controlling and monitoring: lending and capital limits, compulsory deposit levels, interest rates, accounting procedures, foreign investment and the foreign-exchange market, among other activities. The entities that operate in the financial market can be controlled either by government or private institutions. The main government institutions are the following:

- National Bank for Economic and Social Development (BNDES):

Implements the government's investment policy, granting loans and supervising government financing plans. It is also responsible for managing the National Privatisation Program.

- Bank of Brazil:

A mixed-capital federal company, this is the government's financial agency and handles all federal receipts and payments. It is also a commercial and agricultural bank.

- Federal Savings and Loans Association (CEF):

A savings and mortgage bank, which also administers the FGTS (Employee Severance Indemnity Fund), PIS/PASEP (Social Integration Taxes) and the national lotteries.

The major banks in the private sector have long been organised as financial conglomerates, able to offer a full range of financial services through subsidiary and associated companies as well as associations and mergers with foreign financial institutions. The major banks are considered to be sophisticated and competitive and offer a broad range of financial services, operating on-line.

The Brazilian Financial System can be summarised as follows (Source: Central Bank of Brazil website):



Regulation and Supervision Entities		Financial institutions that receive demand deposits	<ul style="list-style-type: none"> <li>■ Multiple banks</li> <li>■ Commercial banks</li> <li>■ Savings banks</li> <li>■ Credit cooperatives</li> </ul>
<b>C M N</b> <b>National Monetary Council</b>	<ul style="list-style-type: none"> <li>■ <b>BCB</b></li> <li>Central Bank of Brazil</li> </ul>	<b>Other financial institutions</b>	<ul style="list-style-type: none"> <li>■ Multiple or universal banks without a commercial bank portfolio</li> <li>■△ Investment banks</li> <li>■ Development Banks</li> <li>■ Consumer finance companies</li> <li>■ Savings and loan companies</li> <li>■ Mortgage companies</li> <li>■ Development Agencies</li> <li>■ Savings and loan associations</li> <li>■ Micro-entrepreneur Credit Company</li> </ul>
	<ul style="list-style-type: none"> <li>△ <b>CVM</b></li> <li>Securities Commission</li> </ul>	<b>Other financial intermediaries or auxiliaries</b>	<ul style="list-style-type: none"> <li>△■ Commodities and futures exchanges</li> <li>△ Stock exchange</li> <li>△■ Securities brokers</li> <li>△■ Securities dealers</li> <li>■ Leasing companies</li> <li>■ Exchange brokerage companies</li> <li>■ Representatives of Foreign Institutions</li> <li>■△ Independent agents for investments</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>SUSEP</b></li> <li>Private Insurance Regulator</li> </ul>	<b>Insurance and pension entities</b>	<ul style="list-style-type: none"> <li>◆ Private closed pension funds</li> <li>● Private open pension funds</li> <li>● Insurance companies</li> <li>● Capitalisation companies</li> <li>● Health insurance management companies</li> </ul>
	<ul style="list-style-type: none"> <li>◆ <b>SPC</b></li> <li>Complementary Pensions Department</li> </ul>	<b>Portfolio Management</b>	<ul style="list-style-type: none"> <li>△■ Mutual investment funds</li> <li>△ Investment clubs</li> <li>■△ Foreign investors' portfolios</li> <li>■ Consortium managers for self-acquisition of durable consumer goods and services</li> </ul>
		<b>Settlement and clearing systems</b>	<ul style="list-style-type: none"> <li>■ Special system for liquidation and custody of government bonds - SELIC</li> <li>■ Centre for the custody and financial settlement of private issuances - CETIP</li> <li>△ Stock exchange clearing system</li> </ul>

## Banking sector

The Brazilian banking sector is strong, diversified and adequately capitalised. Its high levels of capitalisation and modern corporate governance have allowed it to deal with the recent global credit crunch proficiently. Despite the economic slowdown, credit as well as bank deposits have continued increasing and are also expected to maintain the current rate of growth in the years ahead.

The banking sector offers diversified structured products for wealth management investors, asset management products and insurance products (life insurance and private pension programs) as well.

Commercial banks engage in both wholesale and retail banking and are the primary source of short- and medium-term financing. Financing loans are available to foreign-controlled companies.

Foreign loans are a frequent source of medium- and long-term financing. These loans may take two forms:

- Direct loans from the foreign creditor to the Brazilian borrower.
- On-lending by a Brazilian bank of loans obtained by it from foreign banks. These loans generally have shorter terms than the direct foreign loans.

In recent years there has been a marked increase in the volume of foreign on-lending loan agreements and an increase in the foreign investment coming into Brazilian as well.

In addition to granting loans, commercial banks provide a wide range of financial services, such as accepting deposits, paying cheques, issuing letters of credit, dealing in foreign exchange, cash and asset management services, electronic transfers of funds, investment banking services and investment management.

Investment banks provide a valuable service to both local and foreign investors interested in acquiring medium- and long-term financing. With the assistance of an investment bank, a foreign investor may be able to obtain long-term financing through the sale of stock or debt obligations in the public market or through private placement, as well as performing M&A transactions.

Several prominent foreign banks have subsidiaries in Brazil. In addition, many foreign banks have representative offices to provide various services to the home office and its customers.

Foreign banks have played an important credit role in lending to local companies. However, under the 1988 Constitution, the conditions for foreigners to acquire a capital interest in banks must be regulated by a complementary law which has not yet been enacted. Until these conditions have been established, authorisation for the installation of new foreign-controlled banks and for any increase in existing foreign capital interests are subject to special authorisation. In recent years, there has been a noticeable increase in the acquisitions conducted by foreign entities in the financial sector companies (broker houses, custody companies and even small- and medium-size banks).

## Specialised financial institutions

There are various types of nondepository financial institutions in Brazil, including leasing companies (“arrendamentos mercantis”), finance companies (“financeiras”) and savings and loan associations (“créditos imobiliários”).

Lease finance is readily available from leasing companies. Finance companies provide funding, generally secured by equipment, automobiles and consumer durables. They include subsidiaries of large manufacturing or retail companies and provide consumer financing to facilitate sales of products. Due to the higher risks and cost of funds, finance companies charge higher interest rates than commercial banks.

Factoring is also available.

Savings and loan associations accept deposits from individuals and provide financing secured by real estate and other assets to companies and individuals.

## Investment institutions

Investment institutions other than investment banks include insurance companies, pension funds and investment and mutual funds. The insurance industry is regulated and there are strict controls over investment policies. However, insurance premiums and types of risks covered are now influenced by market conditions. Private and public pension plans have grown significantly during the past few years. Pension funds generally invest in common and preferred stocks, corporate and government debt securities, real estate and mortgages. There are a wide variety of other funds entitled to invest in Brazilian equities and government bonds, including foreign investment funds. Brazilian investment funds were recently allowed to invest in overseas investment funds.

## Financial markets

### Securities markets

Under the development of the stock market in Brazil, from the year 2000 onwards regional stock exchanges had to transfer their stocks to the Brazilian Mercantile & Futures Exchange (BM&F) and to the São Paulo Stock Exchange (Bovespa).

In 2008 BOVESPA S.A. - Securities, Commodities and Futures Exchange was created by merging BM&F and Bovespa.

Together the companies have formed one of the largest exchanges in the world in terms of market value, the second largest in the Americas, and the leading exchange in Latin America.

Among its broad range of trading products, the new Exchange offers equities, securities, financial assets, indices, interest rates, agricultural commodities, foreign-exchange futures and spot contracts.

For further information about the secondary or over-the-counter markets please see Chapter 6.

## Sources of funds

### Local financing

The various forms of local financing available are briefly discussed above. The following sources are also of interest:

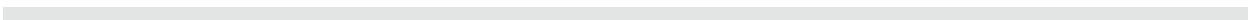
- Some programmes offer low-cost financing. These include working capital for small and medium-size businesses, purchase of capital equipment produced in Brazil (FINAME), export financing and rural credit.
- Low-cost export financing is available, principally in the following forms:
  - Advances against foreign-exchange export contracts.
  - Advances against foreign-currency export receivables.
  - Subsidised interest for the financing of production for export, based on past export history and export potential.

Export financing does not normally exceed 360 days. Various other forms of special financing are available for exports, some of which are directed to special sectors.

### Availability to foreign investors

There are generally no restrictions on the access of foreign-controlled companies to local private-sector financing in Brazil and on their ability to invest in government securities and in listed companies.

A foreign investor has access to the Brazilian securities market through registered Brazilian investment funds. See "Portfolio investments" in Chapter 16 for further details.



## Chapter 8

# Exporting to Brazil

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## Tips for exporters

- Import duties are set according to the government's interest in promoting or protecting the local market and its foreign-trade balance.
- Trade barriers used to be wide-reaching, but are now being relaxed gradually.
- Exporters to Brazil should seek advice from local trade and tax consultants before shipment.
- Having a local agent is advisable in order to obtain quicker customs clearance.
- Related-party sales may need special attention with regard to pricing.
- Duty deferrals are available by using customs bonded warehouses/special tax regimes.
- Customs valuation assessments have increased in recent years.

## Import restrictions

For many years Brazil's foreign-trade policy was to reduce imports and encourage exports. Therefore, certain classes of imports are subject to high import duties and/or import quotas. However, the government is slowly reducing trade barriers and import duties.

In addition to customs requirements, imports are also subject to the laws and regulations of other government agencies with which the Customs authorities cooperate in enforcement. These may, for example, prohibit or limit entry to certain ports, restrict routing, storage or use, or require treatment, labelling or processing as a condition of release. Customs clearance is given only if these additional requirements are met. This applies to all types of imports.

Foreign exporters should make certain that the Brazilian importer has provided proper information to the Custom Authorities in order to permit the verification of said information in relation to the products actually shipped and authorise the entry of the merchandise into Brazil.

Prohibited imports include certain narcotics, obscene, immoral and seditious matter, and certain herbicides.

A few goods are subject to import licenses or permits. Import licenses are controlled by DECEX, the Brazilian Foreign-Trade Department, and the respective government body. Imports are not normally limited by absolute annual quotas, except for certain goods; however, actual imports are monitored against those authorised.

## Import duties

### Customs duties

Import duty (“imposto de importação” - II) is generally levied on an ad valorem basis on the CIF value of the product. The invoice value is usually taken as the basis for determining the normal price, but in order to protect local products or to tax nonessentials heavily the Tariff Policy Council may establish minimum import values or base prices or apply specific tax rates. The maximum import duty is currently 35 percent. The essentiality of goods is the main criteria used to set the ad valorem rates.

Overall, the import tariff schedules contain 21 sections and 99 chapters, comprising more than 10,000 classifications. Tables classifying the goods subject to duties and tariffs are established by decrees and are published in the Common External Tariff (TEC). Changes are frequent.

Exemptions or reductions in import duties are granted from time to time to certain industries or enterprises considered of particular importance to the Brazilian economy, depending on the region where they are established, the nature of the goods, the resultant increase in the utilisation of locally produced material, etc. Duties may also be suspended on goods imported for re-export, for further processing prior to export or for use in preparing other products for export.

Exemptions or reductions are also granted temporarily when there are shortages of food products and essential raw materials or local prices are deemed to be abusive.

Mail-order imports of up to USD 3,000 are subject to a 60-percent import duty. Exemptions are granted in the case of medicine and imports under USD 50, provided they are between individuals or are for the individual’s own use. Alcoholic beverages and smoking products do not benefit from this import scheme.

Import duties must be paid before customs clearance is given.

Manaus, in the Amazon region, is the largest free-trade zone currently authorised in Brazil, and imports into this area are duty-free provided they are consumed within the zone or exported (see Chapter 4).

Export processing zones and special free-trade areas have been created to develop certain less-developed and frontier regions, but to date most of them are not operational (also see Chapter 4).

See also “Overseas trade relations” in Chapter 2 for details of membership in trade blocs.

### Other taxes and duties

In calculating import costs it should be noted that, with a few exceptions, federal value-added excise tax (IPI) and contributions (PIS and COFINS) are levied on imports. The state value-added sales and services tax (ICMS) is also payable on imports. For details of these taxes see Chapter 22. A further import cost is the AFRMM charge, which is levied at 25% based on the amounts paid for international ocean freight, the proceeds of which are to be used for the renewal of the Brazilian merchant marine.

Port and dock taxes and charges are high by international standards.



## Documentation procedures

All importers must be registered at SECEX and the tax authorities in order to be able to operate in Brazil. Some products may require special import licenses. If a license is required, automatic licensing may be obtained for certain products as well as under the drawback scheme. Non-automatic licensing is required for imports of used goods, imports under special concessions, goods subject to governmental control or tax incentives and others. Imports may be performed either through fully prepaid letters of credit, which can be financed by local banks, or through credit arrangements. Terms longer than 360 days are subject to special procedures associated with documents attached to the import process.

The following is a brief summary of the documentation procedures:

- Filing of the application for a non-automatic import license, when applicable, before the goods' shipment, which should include the required general information concerning the importer, exporter, manufacturer, country and port of origin, port of unloading, description of the merchandise, FOB price in foreign currency, and supplementary documents as required (these documents do not have to be filed in advance for automatic import licenses and imports which do not require licenses).
- Payment of the application fee.
- Issue of the import license.
- Completion of the import declaration, which is the base document for customs clearance, containing all data related to the respective import, including duties and taxes incurred. This should be done after arrival of the merchandise but before customs inspection.
- The inspection procedures are determined by the type of inspection defined by the customs authority's system (green, yellow, red or grey channel). For instance, the green channel requires no inspection, the yellow channel requires only documentary inspection, the red channel requires physical and documentary inspection and the grey channel requires physical and documental inspection, as well as special customs procedures, including price control.

Customs clearance then finally takes place.

Other formalities may be required in certain cases, mainly for imports which are granted special concessions or tax incentives. Transport in Brazilian vessels may also be required.

## Customs and storage

Although customs and storage facilities could be improved, in general they are secure.

## Port of entry and inland transport

Generally, the port of entry chosen by the importer is honoured. Inland transport is mainly carried out by lorries and HGVs and may pose problems at times of seasonal activity.

## Special Customs Schemes

Drawback incentives may be in the form of suspension, exemption or refund of duties and taxes levied on imported items that are subsequently re-exported. The refund of taxes varies, depending on the circumstances. All re-exports are regulated by SECEX. The addition of a certain percentage of local content is necessary.

## Other Tax Programmes

Brazil has several special customs schemes intended to boost exports. These tax programmes provide benefits in the form of exemption, suspension and refund of taxes levied on imported products or on locally purchased products, provided the goods are subsequently exported.

Brazil's special customs regimes include: Drawback, Temporary Import, Bonded Warehouse and Temporary Export etc.

A special program called Blue Line is also available, based on the international concepts of the AEO – Authorised Economic Operator. This program promotes voluntary compliance with customs obligations by offering preferential treatment in customs clearance procedures for import, export and transit transactions.

## Anti-dumping measures

Law 9019/95 and Decree 1602/95 lay down the anti-dumping measures. Dumping is defined as the entry of a product into the local market (including under drawbacks) at a price lower than its normal price. If entry is considered a threat to the local market, anti-dumping measures are employed.

## Local representation

### Market surveys

Before initiating significant exports to Brazil, it is advisable to survey existing and potential markets for the particular product or service.

### Local agents

Due to the bureaucratic documentation procedures and the language barrier frequently encountered, it is recommended to use a local customs agent or broker. They are particularly useful in dealing with the Customs and Tax authorities.

### Employees/salespersons

There are generally no problems in retaining the services of employees or sales staff, provided they do not hold binding powers (see immediately below).

### **Sales agents or subsidiaries**

As discussed under “Imports” in Chapter 16, products shipped to Brazil and invoiced directly by the foreign supplier to its customer in Brazil are only subject to Brazilian corporate income tax, if the sales agent or representative domiciled in Brazil, who acts as an intermediary, has the authority to bind the overseas seller contractually. However, if the agent does have such binding powers income taxes are calculated on the deemed profit, based on a percentage of gross income (which varies depending on the activity), plus an additional surcharge of 20 percent. It is accordingly advisable for the formal representation agreement to expressly preclude the sales agent or representative from contractually binding the overseas principal in any sales contract.

A sales subsidiary in Brazil may be established and is subject to the same taxes as any other local company.

### **Sources of information**

Commercial departments of Brazilian embassies and consulates abroad may provide information and assistance.

In Brazil, the following organisations provide assistance:

- The Commercial Promotion Section (“Seção de Promoção Comercial”) of the Ministry of Foreign Affairs, in Brasília.
- Chambers of commerce.
- Industry associations.

# Chapter 9

# Business entities

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## Business entity guide

### Choice of entity

- The most common corporate forms used by local and foreign investors to set up a legal entity are the corporation (“sociedade por ações”) and the private limited-liability company (“sociedade limitada”), usually called a “limitada”.

### Capital requirements

- In general, corporations and limitadas may be wholly foreign-owned
- All foreign investments must be registered at the Central Bank of Brazil
- There are no legal minimum capital requirements except for financial institutions, and certain other legal entities with specific business purposes. There is no upper limit.

### Founders' requirements

- The number of quotaholders for a limitada may not be less than two (legal entities or individuals), which may be Brazilian or foreign. Corporations may have just one shareholder, as long as the sole shareholder is a Brazilian legal entity (incorporated under the laws of Brazil). In the event the corporation has more than one shareholder, they may be Brazilian or foreign (legal entities or individuals). In the event of a foreign quotaholder or shareholder, a representative domiciled in Brazil (individual) must be appointed in order to receive court summons, subpoenas and/or notifications of their behalf.
- It is usually more complex to form and run a corporation than a limitada.

### Foreign ownership participation in management

- Ownership, management control and transfer are more flexible in a corporation.
- There are no nationality requirements for management, but a foreigner must hold a permanent visa and be domiciled in Brazil.
- Union and employee participation in management is an increasing practice.

### Repatriation of funds

- Dividends remitted to non-resident shareholders or quotaholders are not subject to any withholding tax. However, distributions from earnings or profits related to periods previous to December 31, 1995 are subject to withholding income tax at the rate of 25 percent or 15 percent, depending on the year they refer to.
- The withholding tax rate on interest and certain other remittances is generally 15 percent or lower rate determined in treaties.
- The withholding tax rate on the remittance of service fees is generally 15 percent.
- The initial investment may be repatriated upon sale of shares or quotas to a resident free of tax. Capital gains, however, are subject to taxation.
- Capital gains on the sale of shares or quotas may also be remitted abroad, subject to payment of income and/or capital gains taxes, normally at the rate of 15 percent.
- Payments to a beneficiary resident in a country or location considered to be a tax haven are generally subject to 25 percent withholding income tax.

### Liquidating an investment

- A foreign shareholder or quotaholder may liquidate their investment at any time by selling their shares or quotas or upon liquidation. It should be noted that in order to repatriate investment upon liquidation, the local company must register the corporate dissolution act at the Board of Trade previously. It must present debt clearance certificates to this registry relating to labour/employment, tax and social security liabilities.

### Tax considerations

- All legal entities are treated equally for tax purposes.
- Basic income tax rates are the same for local and foreign-owned companies.
- Tax losses including the prior year's accumulated tax losses may be carried forward indefinitely. However, the use of tax losses is limited to 30 percent of each year's taxable income and there is no carry-back.

### Professional advice

- It is advisable to retain professional advice at an early stage to ensure a smooth set-up and regulatory compliance.

- Statutory audits are only required for publicly traded corporations, entities operating in the banking and financial sector, insurance companies, and for closed-capital corporations and limitadas considered to be “large companies” (“sociedade de grande porte”), under the terms of law (company or group of companies under common control with total assets worth more than R\$ 240,000,000.00 or annual gross revenue higher than R\$ 300,000,000.00).

Detailed checklists of considerations in setting up in Brazil and in structuring an investment are given in Appendices XIV and XV, respectively.

## Corporate forms for business enterprises

The corporate forms for business enterprises, as well as those adopted by legal entities that provide professional services, are governed by the Civil Code. The only exceptions are corporations, incorporated partnerships (“sociedade em comandita por ações”) and mixed corporations (“sociedades de economia mista”), which are governed by corporate legislation (Law 6404/76). On a subsidiary basis, the Civil Code governs corporations and incorporated partnerships.

The corporate forms in which a business may be conducted are:

### 1. Corporations (publicly held or closely held):

This legal entity (“sociedade por ações”), commonly known as an S.A., most closely resembles a corporation in the United States and other countries and a public limited company (PLC) in the United Kingdom. It is the only corporate form that can have its stock publicly traded.

### 2. Limited-liability companies:

A private limited-liability company (“sociedade limitada”), commonly known as a “limitada” (Ltda.), resembles a closely held company in the United States and a private limited-liability company in the United Kingdom.

### 3. Mixed-capital companies:

This legal entity (“sociedade de economia mista”) is owned by the government as well as investors from the private sector, with the government having the controlling interest; it takes the form of a corporation.

#### 4. Partnerships:

##### a. General partnerships:

This type of partnership (“sociedade em nome coletivo”) and those referred to below, except for regulated professional partnerships, are formed for business purposes. All partners (individuals only) have unlimited-liability and may take part in management. Only the partnership can be declared bankrupt.

##### b. Special partnerships:

This type of partnership (“sociedade em conta de participação”) is formed to carry out one or more specific business ventures. The special partnership is an unincorporated entity and thus has no legal identity. It is in effect a participation account registered in the books of one of the partners (the partner who represents the partnership before third parties).

##### c. Limited partnerships:

This type of partnership (“sociedade em comandita simples”) comprises two or more partners of two types: quotaholders with unlimited (active) and limited (passive) liability. The partners with unlimited-liability may only be individuals.

##### d. Incorporated partnerships:

This partnership (“sociedade em comandita por ações”) comprises at least one managing shareholder who has unlimited-liability and limited shareholders whose liability is limited to the invested capital, regardless of whether it has been paid up. This partnership is governed by a special provision in corporate legislation.

##### e. Regulated professional partnerships:

This entity (“sociedade simples”) is a partnership formed by certain qualified professionals to render professional services. It is normally used by doctors, dentists and accountants.

#### 5. Joint ventures:

A joint venture may be set up in several ways, but is always incorporated under one of the corporate forms set out in item 4 above.

#### 6. Branches of a foreign company:

Due to the extremely bureaucratic requirements associated with the creation and maintenance of a branch of a foreign company, only a very limited number of multinationals operate in Brazil under this structure.



## Foreign enterprise entities

One of the first decisions encountered by foreign enterprise entities undertaking direct investment in Brazil is whether to incorporate the business as a corporation (“sociedade por ações”) or a private limited-liability company (“limitada”); and whether to operate as a subsidiary of the foreign parent company or as a branch. The overwhelming majority of direct foreign investors choose the subsidiary form of operation based primarily on the insulating effect that incorporation has on the liability of the foreign parent company for the subsidiary’s acts. The need to obtain local financing may also influence the decision to operate as a subsidiary.

The tax considerations of subsidiary versus branch operations are discussed in Chapter 16.

## Corporation

### Organisation and incorporation procedures

A corporation (“sociedade por ações”, usually abbreviated to “S.A.”) whether publicly or closely held, is organised and incorporated in accordance with Law 6404/76. If the corporation is or becomes a publicly traded corporation it is also subject to Law 6385/76 and the normative rulings enacted by the Brazilian Securities Commission (“Comissão de Valores Mobiliários – CVM”). A corporation may have authorised capital. An authorised capital corporation may increase its capital up to the limit established in its bylaws, by resolution of the board of directors, without complying with the formalities normally required, such as an amendment to its bylaws.

- Approval of bylaws

An inaugural meeting of prospective shareholders must be held to approve the bylaws, which enumerate the corporation’s core activities and elects management, confirms the capital, registered office and distribution of shares (as per the subscription list), amongst others. The incorporation of a corporation depends on compliance with the following preliminary requisites.

- Subscription of all the shares into which the corporate capital stock is divided according to the bylaws. The initial subscribers must be at least two individuals or legal entities that are considered to be founders.
- Payment of at least 10 percent of the issuance price of the shares subscribed in cash, unless specific legislation requires a higher percentage, and deposit thereof at a bank within five days of receipt. This deposit is released when the corporation has been registered at the Board of Trade (“Junta Comercial”) or after six months if no registration is made.

- Private subscription

Corporations are incorporated by private subscription and can subsequently have their securities publicly traded. Incorporation by private subscription and subsequent transformation into publicly held corporations requires the following:

- Registration of the corporation as a publicly held corporation at the Brazilian Securities Commission (“CVM”).
- Registration of the proposed issuance of shares or share trading at the Brazilian Securities Commission (“CVM”).
- Intermediation of a financial institution for the issuance or trading of shares.

In recent years, the initial public offerings (“IPOs”) of Brazilian corporations have played an important role in business financing, and have been responsible for the growth and consolidation of the Brazilian capital market.

- General meeting of subscribers

When all the corporate capital has been subscribed, the founders must call a general meeting to:

- Procure the appraisal of any assets contributed by shareholders as payment of subscribed capital.
- Approve the incorporation.

A quorum of subscribers of at least one half of the capital is required for the meeting to approve the incorporation of a corporation. If this quorum is not reached, a second meeting may be held before any number of subscribers. At either of these meetings the bank deposit receipt relating to payment of 10 percent or more of the shares’ issuance price must be read out and the proposed bylaws discussed and voted on, where each share entitles the holder thereof to one vote, regardless of share class or type. The majority is not entitled to amend the proposed bylaws and the corporation will not be incorporated if they are not accepted.

- Election of management bodies

Upon approval of the bylaws the shareholders shall elect the members of the management bodies. At the end of the meeting, the minutes should be read out for the subscribers’ approval. After being read and approved, the meeting minutes must be signed by all subscribers in attendance or by the number required to validate the resolutions. The minutes must be kept at the corporation (recorded in the Corporate Shareholders’ Meetings Minutes Book), and a copy certified by the chairman and/or the secretary of the meeting must be filed at the Board of Trade.

- Formalities

A newly incorporated corporation acquires legal existence upon filing its incorporation documents at the Board of Trade and the subsequent publishing of this meeting’s minutes in a newspaper published in the location of its registered office and in the Official Gazette (“Diário Oficial”). The certificate issued by the Board of Trade confirming the filing of the incorporation documents serves as a legal document for the transfer of assets used to pay in the capital and becomes a matter of public record.

The first officers elected at the inaugural meeting are legally responsible for the new corporation from its inaugural meeting until the required documents have been filed. They are also liable to the corporation for losses caused by late performance of the incorporation formalities. The corporation is not liable for the conduct of its initial officers until all required formalities have been complied with, unless the minutes of the first general meeting stipulate otherwise.

A minimum of thirty days would be required to complete the incorporation by private subscription. Corporations are not incorporated directly as publicly held entities. The normal practice is to apply for listing after the corporation has started doing business.

Based on the complexity of the statutes and capital structure, the cost for organising and incorporating a corporation varies, but for a closely held entity the related costs would not be less than USD 10,000.

### Capital structure

- Share capital

There is no minimum share capital requirement for a corporation, except for financial institutions and insurance companies. Share capital must be stated in local currency and may be paid in cash or by credit assignment and/or any type of asset. The monetary value of an asset should be based on an appraisal report which must indicate the criteria and comparative data used to formulate its conclusions, to be approved by the shareholders at a general meeting. Shareholders using assets to pay in capital may accept or reject the amount approved by the other shareholders.

All shares are nominative and may be issued with or without par value. The issuance of common shares with no par value would not preclude the issuance of one or more classes of preferred shares with a par value. However, when common shares are assigned with a par value, all classes of shares must have the same par value. The shares of a publicly held corporation may not be issued at a price below their assigned par value and the minimum value established by the CVM.

In general, corporations have at least two shareholders. The CVM may require a minimum number of shareholders in order to award listed status and may also establish a minimum par value. There is no statutory maximum number of shareholders.

Both common and preferred shares must be nominative and evidenced in the registered book (book-entry shares). The issuance of bearer shares is prohibited. The right to conversion between types depends on the bylaws.

Share ownership and transfer can be evidenced by:

1. Recording the name of the shareholder in the Nominative Shares' Register Corporate Book; or
2. Registration of the shareholder's name by a financial institution that renders services of keeping and custody of the Nominative Shares' Register Corporate Book and Corporate Nominative Shares' Transfer Book.
3. In both cases, the shares are legally classified as being registered (book-entry share).

- Share classes

A corporation's capital may consist of common and preferred shares. Corporate law also provides for the issuance of founders' shares ("partes beneficiárias", best translated as profit sharing rights), since they carry the right to participate in net income without forming part of the capital.

The law permits closed-capital corporations to create more than one class of common shares. These may be distinguished by the following:

- The right to be converted from common into preferred shares.
- The requirement that the shareholders should have Brazilian nationality.
- Special voting rights for election to certain management positions.

The law requires the unanimous approval of all shareholders affected by any modification to classes of shares, unless the bylaws provides otherwise.

- Receipt of dividends and reimbursement of capital

Privileges, generally priority in the receipt of dividends and reimbursement of capital with or without premiums, and restrictions attached to preferred shares must be specified in the bylaws and follow corporate law. For example:.

1. Dividends, including fixed and cumulative dividends, may not be distributed in detriment to the corporate capital, unless this is expressly stated in the bylaws in the event of the corporation's liquidation. However, the law does allow the bylaws to authorise preferred shareholders to receive cumulative dividends paid out of capital reserves arising from:
  - a. Premiums on issuances of shares and debentures.
  - b. Proceeds from the sale of subscription rights and founders' shares ("partes beneficiárias").
2. Except for those entitled to fixed dividends, preferred shareholders cannot be precluded from participating in capital increases arising from the capitalisation of retained earnings or reserves.
3. Preferred shares cannot be created or have their existing rights altered in detriment to the rights of convertible debenture holders without the prior consent of the debenture holders.
4. Preferred shares with restricted or no voting rights cannot exceed half of the total outstanding stock.
5. Preferred dividends are not cumulative, unless the bylaws specifically provide otherwise. Shares entitled to fixed dividends are not entitled to any further profit shares, unless stipulated otherwise in the bylaws. Shares entitled to a minimum dividend are entitled to the same profit shares as the common shares after the latter have attributed a dividend equal to the minimum preferred dividend.

6. Preferred shareholders may be given the right to elect one or more representatives to each corporation's management body (Executive Board and/or Board of Directors) and to veto amendments to the bylaws.
7. Preferred shares are entitled to a profit share of at least 10% higher than the amount attributed to the common shares.

- Founders' shares

Founders' shares ("partes beneficiárias") may only be issued by closely held corporations, if the bylaws so provide. These securities have no par value and can be issued in one class only. They entitle the holders thereof to a share of net income (plus the reserve for their redemption, if applicable) that may not exceed 10 percent of annual net income after offsetting prior-year losses.

A closely held corporation may sell founders' shares or issue them for free to its founders, shareholders or third parties as remuneration for services rendered. When given free of charge, these securities are valid for only ten years. Those that are sold may be issued for a specific period, which must be established in the bylaws.

If the bylaws provide that founders' shares can be redeemed, the corporation should make a special reserve for this purpose. The bylaws may also establish that founders' shares may be converted into capital stock by capitalizing a specific reserve for this purpose.

- Debentures

Corporations may issue debentures that afford credit rights to their holders in accordance with the terms of the debenture deed and debenture certificate. The law regulating debentures issuance and the rights of debenture holders is extensive and may be summarised as follows.

1. Debentures issuances and the details thereof must be authorised by the shareholders at a general meeting.
2. A formal debenture deed must be drawn up and a trustee nominated (in the event of a public issuance).
3. With certain exceptions:
  - a. Unless the debentures have no priority in claiming the corporation's assets, the total outstanding debentures may not exceed the corporate capital
  - b. When there is a specific claim, outstanding debentures may not exceed 80 percent of the value of assets pledged
  - c. When there is a floating charge, outstanding debentures may not exceed 70 percent of the book value of assets less secured liabilities.

4. Debentures must be issued in local currency except when they are issued overseas with Central Bank of Brazil approval.
5. Interest may be fixed or variable, and holders may be entitled to profit shares.
6. Redemption may occur on a stipulated date or be conditional on the occurrence of specific events. Provisions may be made for prepayments.
7. Convertible debentures may be issued, but debenture holders must vote on any resolutions that would affect conversion rights.
8. The trustee must report annually to the debenture holders and is liable to them for any losses that may result from negligence or failure to carry out duties, which cannot be restricted by the debenture deed.
9. Debenture holders may meet at any time to consider matters of interest.
  - Capital increases

The bylaws may authorise the board of directors to increase capital within specified limits without the need to call a shareholders' meeting. In this event, the corporation is required by law to elect a board of directors and the bylaws should specify the following:

1. The authorised capital, i.e. the amount of capital and the series and classes of shares that may be issued.
2. The body authorised to approve the increase.
3. Conditions to which the issuances are subject
4. Circumstances in which the shareholders would have pre-emptive subscription rights.

Capital increases not authorised in the bylaws require the approval of shareholders in a general meeting. These increases generally result from one or more of the following.

1. Conversions of debentures or founders' shares into common or preferred shares.
2. Conversion of debt into equity.
3. Exercising of rights acquired to subscribe shares.
4. Exercising of an option to purchase shares.
5. Capitalisation of profits and/or reserves.

Capital increases from public or private share subscriptions may occur only after 75 percent of the total capital has been paid in. Capital increases from the capitalisation of profits and/or reserves must be made so that shareholders' proportional interests remain unchanged.

Shareholders have a proportional pre-emptive right to subscribe additional shares in the event of a capital increase. The period for exercising this right cannot be inferior to 30 days and is established by the shareholders at the general meeting if it is not established in the bylaws.

Unless the bylaws state otherwise, there are no limits to the amount of financing that can be used to strengthen a corporation's capital structure

- Capital reduction

Capital may be reduced for the following reasons:

1. If the capital is considered by the shareholders to be excessive
2. If the shares issued are not fully subscribed
3. To offset accumulated losses
4. To redeem shares
5. To reimburse shares to dissenting shareholders.

Upon redemption, shares are either withdrawn from circulation with a corresponding capital reduction or are offset against reserves and retained earnings, in which case the par value of the remaining shares is adjusted accordingly. Shares reimbursed to shareholders may be held as treasury stock, provided the reimbursement is made from reserves (except legal reserves) or retained earnings.

In the event of a reduction of capital deemed to be excessive or redemption of shares, the reduction only becomes effective 60 days after the publication of the minutes of the meeting at which the decision to reduce the capital was made. During this period, secondary creditors for securities issued prior to the date the minutes are published may oppose the capital reduction. The law further provides that if debentures issued by the corporation are in circulation, the capital reduction may only be made with the prior approval of the majority of debenture holders at an extraordinary general meeting.

- Other

Amounts subscribed in excess of the par value of shares issued must be classified as capital reserves, which can be used only for specific purposes (see Provisions and reserves in Chapter 12). When the shares do not have par value, part of the share's issuance price can be assigned as capital payment and part as capital reserve.

Shares are generally freely transferable by the shareholders, but caution must be exercised in regard to any liens and encumbrances attached to the shares, as well as when there are nationality requirements, e.g., in the banking sector.

The shareholders' liability is limited to their investment in the corporation (amount subscribed).

### **Relationship of shareholders, directors and officers**

- Executive board, board of directors and audit committee

With regard to the responsibilities of officers and directors and those of other oversight bodies, a corporation's bylaws should establish who is responsible for managing it. This management may be carried out either by the executive board (officers) and a board of directors or by the executive board only. The board of directors is a mandatory requirement in the case of publicly held and closely held corporations with authorised capital.

The board of directors is responsible for defining corporate policy and appointing officers and independent auditors. The board does not play an executive role, and the representation of the corporation is the sole competence of the executive officers. The board must have a minimum of three members, who must be individuals and shareholders. The members of the board of directors need not be resident in Brazil, although in this case an attorney-in-fact must be appointed for a term equal to the member's term of office, plus three years. This attorney-in-fact must have specific powers that allow full representation of the board member.

The board of directors elects a chairman from one of its members; the quorum for passing resolutions is generally equal to the majority of the directors in office.

The executive board is composed of two or more individuals, all of whom must be resident in Brazil, regardless of whether they are shareholders. The executive officers are elected by the board of directors or by the shareholders, as the case may be. Up to one-third of the executive officers may also serve on the board of directors. There is no requirement for employees to be represented on the board of directors or in management.

The most important duties of the executive board are to represent the corporation before third parties and public agencies, undertaking obligations and exercising rights on its interest and behalf.

Corporations may have a permanent audit committee ("conselho fiscal"), responsible for overseeing the board of directors and the executive board, with sweeping powers and authority. The bylaws should determine whether the audit committee will have permanent status or whether it will operate only when convened by the shareholders. Generally, this committee has a non-permanent status. The audit committee must have a minimum of three members and a maximum of five, with equal numbers of substitutes, all residents in Brazil, shareholders or not, and elected at the shareholders' meeting.

The remuneration of the executive officers, the board of directors' members and the audit committee must be established by the shareholders. The remuneration may be established as an overall amount or amount per individual.

Executive officers are not personally liable for the obligations they undertake in the name of the corporation and in the normal course of business. However, they are liable for losses and damages caused by negligent or fraudulent conduct or by violating the law or the corporation's bylaws.

Executive officers are appointed by the board of directors (or the shareholders' meeting, as the case may be) and serve the specified term (no longer than 3 years). They derive their authority from the corporation's bylaws or from the board of directors' resolutions.



- Call notices

As a general rule, it is incumbent upon the board of directors to call the shareholders' meetings. However, the executive officers, audit committee, shareholders and debenture holders may call shareholders' meetings, provided the following rules are observed:

- In corporations that do not have a board of directors, it is incumbent upon the executive officers to call the meetings.
- The audit committee may call a meeting if there is any matter requiring urgent resolution or if the board of directors or the executive officers delay the calling of the annual shareholders' meeting by more than one month.
- Any shareholder may call the meeting if the board of directors or the executive officers delay the calling thereof for more than 60 days
- Shareholders representing at least 5 percent of the capital may call a shareholders' meeting when such a request has not been performed by the board of directors or the executive officers after eight days.
- Shareholders representing at least 5 percent of the voting capital or 5 percent of the non-voting capital may also call the meeting to convene the audit committee, when management has failed to do so within eight days of being requested.

Meetings must normally be called by publishing an appropriate announcement at least three times in the Official Gazette ("Diário Oficial") and in a newspaper of large circulation in the place where the corporation's registered office is located. Shareholders must be informed in advance of any change, in the newspaper in which the call notice has been published. If all shareholders are in attendance at a meeting of a closely held corporation, the notice and publication requirements may be waived. Closely held corporations with less than 20 shareholders may call a meeting by personally delivered announcement, with acknowledgment of receipt, provided the net worth of the corporation is less than R\$ 1 million.

Resolutions of shareholders' meetings must be recorded in the minutes, which may be published in summarised form. Subsequently, the minutes must be transcribed in the appropriate register and filed at the Board of Trade.

- Types of meeting

Shareholders' meetings called and held in accordance with the law and the bylaws should decide all matters related to corporate business and take whatever resolutions are considered necessary for the corporation's protection and development. There are three types of corporate meetings:

- Inaugural meetings:

See "Organisation and incorporation procedures" above.

- Annual shareholders' meetings:

Must be held within four months of the end of the corporate financial year to:

- Approve the annual financial statements and the management report
- Approve the proposed distribution of net income for the year
- Elect the executive officers or the board of directors' members, in addition to the audit committee members, if applicable, and approve the authorised capital, minimum or fixed dividends and premiums on reimbursements, if applicable.

Any other matters requiring the shareholders' approval must be submitted to an extraordinary shareholders' meeting (see below).

Management must advise shareholders at least one month before the date of the annual meeting as to the availability of:

- Management's report on the corporation's business activities and principal administrative events of the past year
- The annual financial statements
- The opinion of the independent auditors, which is only mandatory for publicly held corporations (or "large companies" – "sociedades de grande porte"), banking and financial institutions, insurance companies and certain companies that have been given tax incentives.

A representative of the independent auditors must attend the meeting to answer questions.

Unrestricted approval of the report and financial statements submitted to shareholders frees the executive officers, directors and audit committee members from responsibility, except in the case of error, bad faith or fraud, for which they remain responsible for two years from the date of the meeting that approved the documents.

If the financial statements are modified by the shareholders' meeting or the shareholders modify the corporation's net income for the year or its liabilities, management must republish the amended financial statements within 30 days. If the proposed distribution of net income is not approved by the shareholders, the modifications they approve must be included in the minutes of the meeting, but republication is not required.

3. Extraordinary shareholders' meetings:

The various matters that can only be dealt with at an extraordinary meeting include the following:

- a. Amendments to the bylaws
- b. Authorisation to issue debentures and founders' shares
- c. Approval of corporate conversion, amalgamation, mergers, or spin-off transactions, dissolution or liquidation, and election of liquidators and approval of their accounts
- d. Authorisation for the executive officers to declare bankruptcy or to request an arrangement with creditors ("recuperação judicial").

Annual and extraordinary meetings may be called and held at the same place, date and time and be documented in the same minutes. In practice, annual and extraordinary meetings are normally held immediately after each other, and the order of such meetings is determined by the matters to be discussed.

- Voting procedures and quorums

Except for meetings called to amend a corporation's bylaws, which require at the first call the attendance of shareholders representing at least two-thirds of the voting capital, other general meetings can proceed at the first call with the attendance of shareholders representing one-quarter of the voting capital. At a second calling, meetings may be held with any number of shareholders in attendance.

Shareholders may be represented at meetings by proxy holders, who must be shareholders, executive officers or directors of the corporation or lawyers. In the case of publicly held corporations, financial institutions may hold proxies.

In general, the resolutions at general meetings are passed by an absolute majority of the shareholders in attendance, unless the law or the corporation's bylaws provide otherwise. If an absolute majority is not obtained or if the vote is tied, final resolution by arbitration is permitted if specified in the bylaws. If not, a new meeting must be called to reconsider the matter. In the extreme case where a decision has not yet been taken even after a second meeting, the matter must be referred to the courts.

Approval by shareholders representing at least half the voting capital is necessary for certain matters unless the bylaws, in the case of a closely held corporation, require a higher quorum. These matters relate mainly to amendments in capital structure, profit distributions and reorganisations. When a certain majority is required, a tied vote is deemed to be non-approval of the matter under consideration, and resorting to arbitration would not be allowed to change this result.

Each common share is entitled to one vote, except for electing the members of the board of directors, when multiple voting may be used. For this purpose, shareholders representing a minimum of 10 percent of the voting capital may use multiple voting, regardless of whether this is authorised by the bylaws, by attributing to each share a number of votes equal to the number of board members to be elected. These votes may be used to support a single candidate or be divided between various candidates.

Any resolution voted on by a shareholder whose interests conflict with the corporation's may be annulled. Furthermore, such shareholder is responsible for damages caused and must transfer any advantages obtained to the corporation.

Preferred shareholders may have restricted voting rights or none at all. Preferred shareholders may acquire voting rights in a corporation that fails to pay fixed or minimum preferred dividends for three consecutive years. These voting rights continue until all dividends in arrears have been paid.

Unless the bylaws provide to the contrary, pledging a share does not affect its voting rights. Creditors guaranteed by pledge or share deposit cannot exercise voting rights. Debtors may exercise voting rights if provided for in the pledge contract.

Minority shareholders have the following rights.

- If they represent 5 percent of the capital, they may call a general meeting if the officers or directors fail to do so within eight days of a properly formulated request.
- If they represent 10 percent of the voting capital, they may elect a member of the audit committee and may use multiple votes to elect members of the board of directors.
- If they represent 10 percent of the common shares or 5 percent of the preferred shares without voting rights, they may require the appointment of the audit committee.
- If they represent 5 percent of total capital, they may request to view the corporation's books through a court petition.
- Bylaws may establish whether conflicts between controlling shareholders and minority shareholders may be settled through arbitration.
- The approval and dismissal of independent auditors shall be subject to the veto of the directors appointed by minority shareholders.

Shareholders' agreements are binding on third parties for specific performance when filed at the corporation's registered office. They may regulate the following:

- Purchase and sale of shares
- Pre-emptive rights under a share acquisition
- Exercising of voting rights or control power.

In the annual management report a publicly held corporation must inform the shareholders of the provisions of all shareholders' agreements regulating the distribution of dividends and reinvestment of earnings.

- **Withdrawal**

Shareholders dissenting from decisions on fundamental issues have the right to withdraw from the corporation and have the value of their shares reimbursed by the corporation at a price that cannot be less than the net worth of the shares as based on the latest balance sheet approved by the shareholders at an annual general meeting, unless the bylaws state that the price shall be calculated based on the corporation's market value to be assessed by appraisal. Should the latest balance sheet have been prepared over 60 days ago, the dissenting shareholder may require a special balance sheet. These fundamental issues include the following.

1. Creation of preferred shares or increase in any class of existing shares out of proportion to the others, unless already provided for in the bylaws.
2. Changes to the terms attached to preferred shares or the creation of a more favoured class.
3. Alteration of the corporation's core activities.
4. Decrease in the mandatory dividend.
5. Merger of the corporation or amalgamation into another.
6. Acquisition by a publicly held corporation of control of another entity for an amount greater than that established by the law.
7. Transformation of a corporation into a private limited-liability company ("limitada").
8. Transfer of control of the corporation to a mixed-capital company through expropriation.

The law allows a corporation to reconsider or rectify resolutions that provoke dissension of shareholders whenever the related share reimbursement payments could jeopardise its financial stability.

To exercise the right of withdrawal a dissenting shareholder must claim reimbursement of shares within 30 days of the publication of the minutes of the shareholders' meeting during which the offending resolution was approved.

- **Dividend payments**

Dividends may be paid out of the net income for the current year or prior years and from profit reserves. In any event, they can only be paid out of a surplus. Preferred dividends may be paid out of certain capital reserves, subject to authorisation in the bylaws. Shareholders have the right to receive the mandatory dividend established in the bylaws or, if the bylaws are silent, half of annual net income. The mandatory dividend may not be less than 25 percent of net income for the year unless stipulated otherwise in the bylaws. The mandatory dividend may not be paid by a closely held corporation when there is unanimous agreement of the shareholders in this regard, and may not be paid when payment would be incompatible with the financial situation, regardless of whether the corporation is publicly or closely held. Net income retained for the latter reason must be transferred to a special reserve and, if not absorbed by subsequent losses, be paid out as dividends as soon as the corporation's financial situation permits. Capitalisation of this special reserve is prohibited.

## Transformation

A corporation may be converted into a “limitada” or vice-versa (or into any other corporate form). If conversion is not provided for in the bylaws, unanimous approval must be obtained from the shareholders. Thus, dissenting shareholders are entitled to exercise their right to withdraw from the corporation (see above). Creditors are not jeopardised by transformations, as their rights remain unchanged.

## Liquidation and Creditor’s agreement

A corporation retains its corporate personality throughout the liquidation process until its legal existence is terminated. Normal liquidation occurs in the following circumstances:

1. By termination of the corporation’s existence in the circumstances provided for in the bylaws.
2. By shareholder resolution.
3. By cancellation of the authorisation to operate.
4. In the event the corporation is left with a single shareholder, if the minimum of two shareholders is not restored by the following year’s shareholders’ meeting and the corporation is not declared a sole-shareholder subsidiary (“subsidiária integral”).

Judicial dissolution may occur in the following circumstances:

1. When the incorporation of the corporation is annulled by an action brought by any shareholder.
2. When an action brought by shareholders representing 5 percent or more of the corporate capital confirms that the corporation cannot achieve its business objectives.
3. As a result of bankruptcy in a judicial liquidation.

A temporary voluntary creditors agreement, called “recuperação extrajudicial” is available when a corporation is in financial strife and negotiates better terms with a pool of creditors to liquidate its debts, in such a way that it does not stop producing, does not lay off employees and maintains its core activities.

Liquidation may also occur in special cases by decision of the administrative authorities, pursuant to the appropriate applicable legislation.

Shareholders’ resolutions for corporations undergoing liquidation require the approval of holders of at least 50 percent of all outstanding shares, regardless of voting rights.

The liquidator has the same responsibilities as an executive officer or a director of the corporation. The duties of the executive officers, directors, audit committee members and shareholders remain in force until the corporation has been dissolved.

After all creditors have been paid, the shareholders may, to the extent that the assets have been realised, approve a distribution to themselves before completion of the liquidation. Specific assets may be distributed to shareholders if this is not harmful to the creditors or the minority shareholders' rights. When all liabilities have been settled and the remaining assets distributed, the liquidator must call a shareholders' meeting for a final rendering of accounts. Upon approval of these accounts, the liquidation is considered to be completed and the corporation is automatically dissolved.

Corporations also become dissolved upon transformation, merger, amalgamation or spin-off, with all equity assigned to other companies.

### **Books and records**

The books and records that must be kept are informed in Chapter 11.

All books may be required to be disclosed by court order when requested by shareholders representing at least 5 percent of the capital, when there has been a violation of law or the bylaws or if there is suspicion of serious irregularities on the part of any of the corporation's management bodies.

### **Statutory audit**

Except for publicly held corporations, "large companies" ("sociedades de grande porte"), banks, insurance companies and other financial institutions, corporations are not required to be audited by chartered independent public accountants (see Chapter 11).

## **Limited-liability companies and partnerships**

### **Incorporation procedures**

A private limited-liability company (commonly known as a "limitada") and all the types of partnerships described at the beginning of this chapter are formed by signing a public or private deed (articles of association - "contrato social") which defines the basic governing provisions and the relationship between the quotaholders/partners. The deed (articles of association) is equivalent to a corporation's bylaws and should contain clear provisions on voting rights, management powers and transfer of capital quotas. In the case of a private limited-liability company, its name must be followed by the word "limitada" or its abbreviation "Ltda". In the case of partnerships, the name must generally include the names of the managing partners (with unlimited liability).

If the articles of association are silent, the civil code applies to limitadas and partnerships. Corporation law also applied if provided for in the deed.

The articles of association and any subsequent amendments to the provisions governing the entity, including transfers of capital quotas, must be filed at the Board of Trade, whereupon they become a matter of public record. There are no further disclosure requirements.

A limitada and any type of partnership can generally be formed in about 30 days.

## Capital structure

There is no minimum capital requirement for a “limitada” or a partnership and no deposit is necessary for their incorporation, with a few exceptions, such as having a foreign officer, among others. There is no ceiling on the number of quotaholders or partners each entity may have, although there must be at least two quotaholders or partners. There are no statutory provisions regarding time limits for the paying in of capital, but the articles of association must stipulate the term.

Capital is divided into quotas of equal or unequal value, as specified in the articles of association (“contrato social”). The capital is usually divided into quotas of equal par value. The number of quotas and corresponding amount held by each of the quotaholders thereof must be clearly stated. Quotas are not issued and therefore bearer quotas are also not permitted.

Increases and decreases in capital are made through amendments to the articles of association.

Provided the articles of association permit, quotas may be transferred between quotaholders or to third parties by means of amendments to the articles of association. The liability of quotaholders of a “limitada” is limited to the value of their quotas, when fully paid in and secondarily to the total capital when not paid in. Partners in general have unlimited-liability for the partnership’s debts.

## Relationship of quotaholders, partners and managers

The management of a “limitada” may be entrusted to one or more quotaholders or non-quotaholders (individuals), resident in Brazil, and the articles of association (or a specific agreement) must state their names and the extent/limits of their powers. The management of partnerships generally follows similar rules.

The responsibilities and duties of an executive officer of a “limitada” are similar to those of a corporation. Thus, in general they are only personally liable for deceit, unlawful acts or when exceeding their powers (as per the articles of association).

Within the four months subsequent to the end of the financial year, the quotaholders of a limitada must hold a general meeting (if there are more than 10 quotaholders), or pass a written resolution, to approve the management accounts and financial statements, to decide on the allocation of profits and to elect new managers, if applicable.

Limitadas must also maintain corporate books, similar to those of a corporation (except for the Nominative Shares’ Registration Corporate Book).

Limitadas and partnerships are not required to publish financial statements.

There are no specific legal provisions on profit distribution, although dividends may only be paid out of the profits (surplus) legally available for distribution. A “limitada’s” quotas can have unequal profit distribution entitlements.

As noted earlier, a “limitada” may be transformed into a corporation or vice-versa (or into any other corporate form).



### **Liquidation and creditors agreement**

“Limitadas” and partnerships may go into liquidation as a result of provisions in the articles of association, or agreement between the quotaholders/partners, due to only having a single quotaholder/partner, end of term, expiry of operating license or by court order. Bankruptcy declared in a judicial liquidation is also a reason for liquidation. The conditions for withdrawal, as well as the basis and timing for repaying quotas/partners, must be clearly established in the articles of association.

A creditors agreement (“recuperação extrajudicial”) is also applicable to limitadas and commercial partnerships.

### **Books and records**

See Chapter 11 for requirements about books and records.

### **Statutory audit**

There are no statutory audit requirements, except in the case of “large companies” (“sociedades de grande porte”).

### **Joint venture**

A joint venture may be implemented by a capital association through the incorporation of any chosen corporate form (legal entity), usually a corporation or a “limitada”. The formalities for entering into a joint venture agreement and disclosure requirements depend on the corporate form chosen. Foreign companies and individuals may form a joint venture with or without local participation.

A joint venture may also be implemented through a special partnership (“sociedade em conta de participação” - see above) or through the formation of a consortium, which is neither a legal entity nor a form of capital association. A consortium is used mainly with major contracts for the rendering of services or for the supply of equipment. It is actually a contract, the essential feature of which is the association of two or more enterprises for the joint accomplishment of one specific undertaking. Each associate maintains its respective structure and there is no capital association.

There are no special statutory audit requirements for joint ventures. However, the aforesaid rules applicable to corporations and limited-liability companies – large companies – are to be obeyed.

## Branches of foreign companies

In order to operate a branch, a foreign company must apply for permission from the federal government. Approval must also be obtained for any change in the branch's organisation as a result of an amendment to the bylaws of the head office or for any other reason. The competence for authorising the setting up of branches is currently held by the Ministry of Development, Industry and Foreign Trade, by delegation.

The branch must operate under the name its head office uses in the country of origin and may add the words do Brasil ("of Brazil") or para o Brasil ("for Brazil"). Subsequent nationalisation of branches, i.e. conversion into a Brazilian legal entity, is provided for in the law, subject to the federal government's authorisation (see above).

The authorisation decree and other official notices are published in the Official Gazette. These should be filed at the Board of Trade of the state where the branch will be located.

An amount of capital must be assigned and paid in, in advance. However, the liability for debts and claims on the branch is not limited to that amount but rather the head office's capital. No minimum has been established for branch capital.

A branch is considered an extension - the Brazilian operations - of the head office. Furthermore, the head office is liable for the branch's operations. Sweeping powers of administration and representation must be given to the permanent legal representative, who must be permanently resident in Brazil. No annual meeting is required.

A branch is normally closed by the decision of the head office.

The books and records are kept in the same manner as for corporations (see above and Chapter 11). The foreign company must publish its financial reports in the Official Gazette as in its country of origin, as well as the branch's financial reports, under pain of forfeiting its authorisation.

For the tax implications to a foreign investor see Chapter 16.

There are no statutory audit requirements.

## Mixed-capital companies

The Brazilian government has a controlling interest in this type of company, which takes the form of a corporation, and the other stockholders are private investors. These companies are subject to corporate law and also specific federal laws. They are restricted to the activities specified in the law authorising their formation.

## Entrepreneurs

An entrepreneur is an individual who is professionally engaged in an organised economic activity involving the production of goods or the rendering of services. The entrepreneur must have civil qualifications and be registered at the Public Register before beginning activities. By operating in this form, all of the entrepreneur's assets, personal or business, are liable for the debts incurred by the business activity.

There are no statutory audit requirements. However, the Tax authorities require that adequate books and records be maintained, which is also mandatory by law, in order to reflect the taxable income and transactions clearly. The owner of a sole proprietorship is taxed as an individual.

## Chapter 10

# Labor relations and social security

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## Investor considerations

- The labour markets are regulated in Brazil.
- An adequate and growing work force is available but is mainly semiskilled and unskilled.
- Labour disputes are mainly resolved through collective bargaining but government influence is significant.
- Labour legislation is notoriously favourable to employees.
- Trade unions are quite active.
- All employees must be paid an additional month's salary each year as a compulsory bonus.
- Employers must contribute to various federal social security and welfare institutions.
- The social security system covers main employee risks but employers may need to increase certain benefits for middle and senior management.
- Discrimination at work is prohibited.
- Applications to bring in foreign personnel are scrutinised by the federal authorities.
- Employee dismissal is regulated by the federal government.

## Industrial relations

### Availability of labour

The labour force stands at approximately 106.5 million, or 58 percent of the total population, with about 19 percent employed in agriculture, 20 percent in industry, 17 percent in commerce and 45 percent in services. Women comprised about 42 percent of this workforce in 2002. A significant part of the work force is not formally registered.

In general, adequate labour is available. Semiskilled and unskilled labour is fairly abundant, recognised as hard-working and willing to learn, and is relatively mobile. Skilled labour tends to be in short supply. Personnel with proven technical, professional or management skills are growing as company in-house training and other courses take effect, and are highly sought after.

## Employer/employee relations

Extensive social security laws and labour regulations govern employer/employee relations. However, foreign investors have not experienced much difficulty in the way of labour problems, principally because they follow local standards and practices.

Employer/employee relations are dealt with principally in the consolidation of labour laws (CLT) enacted in 1943 and subsequent legislation. The labour laws are applicable to all employees in regular registered jobs, except for public employees and civil servants, who have separate regulations. The labour laws make no distinction between skilled and unskilled workers or between blue-collar and white-collar workers. Therefore, all types of workers are generally referred to as employees. A change in the legal structure or ownership of an employer does not affect the rights acquired by employees under the labour laws.

All registered employees, including foreigners, are required to hold a work card (carteira de trabalho) which must state their terms of employment. Employers must keep official registers or cards containing detailed information about each employee, and every year they must submit returns to the local office of the Ministry of Labour listing all employees, and also reporting the number of foreigners and minors on their books.

In general, terms of employment may not be altered except by mutual consent, but there are exceptions, including the following:

- An employee may be withdrawn from a position of trust and responsibility without compensation, provided the status previously held is restored.
- Employees may not normally be transferred from one place of work to another if this involves a change of residence, unless the employee holds a position of trust and responsibility or the transfer results from the closing down of an establishment.
- Notwithstanding the above, an employee who is not in a position of trust and responsibility may be transferred if this is justified by the requirements of the employer. A 25 percent pay rise must be given upon transfer and all expenses incidental to the transfer must be paid by the employer.

Lockouts are mentioned in the labour laws as acts subject to penalties if undertaken without prior legal authorisation or if they are ruled to be abusive by the judicial labour courts.

Employees who take leave to fulfil military or civic duty must be permitted to return to their former position with the benefits corresponding to the position that would otherwise have been attained. Employees must notify their employer of their intent to return within 30 days following the termination of the outside activity.

Employees whose terms of service are interrupted by illness are entitled to social security allowances and upon recovery may return to their former position and obtain all accrued benefits.

Special regulations exist for the protection of minors aged 14 to 18. Apprentices must be between 14 and 18 years of age and must be undergoing occupational training. All minors must be given enough time to attend educational classes.

All industrial enterprises are required to employ apprentices and register them in National Apprentice Services. Their number may not be less than 5 percent or more than 15 percent of the total skilled workers.

## Unions

Trade unions are active and are a force to be reckoned with in the metallurgy, automobile, banking and transport sectors.

The right to strike is recognised and regulated in law. The labour laws legislate for the formation of trade unions on the basis of a similarity of business interests or occupations. They may be organised on a citywide or merely a district basis. They may also be combined so as to form state-wide federations or nationwide confederations. As a rule, their membership must represent at least one-third of all persons engaged in the activity or occupation concerned. Membership in a trade union is not obligatory.

Amongst the prerogatives of trade unions are the rights to:

- Engage in collective bargaining, whereby they may sign contracts on behalf of all employees occupied in the activities they represent, whether union members or not.
- Receive contributions from all employed in the occupation they represent, whether union members or not.
- Receive monthly dues from union members.
- Operate employment agencies.
- Cooperate with the government in studies and research involving the activities they represent.

Unions are regulated by the Ministry of Labour. The results of collective bargaining are subject to the decision or approval of the labour courts.

Union representation at places of work with more than 200 employees is required by the Constitution.

## Employee training programmes

Government-sponsored training to improve labour standards includes the following.

- Serviço Nacional de Aprendizagem Industrial (SENAI): SENAI is concerned with all aspects of industrial training under the supervision of the National Confederation of Industry.
- Serviço Nacional de Aprendizagem Comercial (SENAC): SENAC organises and administers commercial training under the supervision of the National Confederation of Commerce.

SENAI and SENAC are funded by a payroll levy of 1 percent of gross payroll. Companies that have more than 500 employees are liable to an additional contribution to SENAI of 0.2% of the gross payroll.

Employers in many sectors provide specific training schemes for their employees, mostly in-house, but are also using outside consultants and/or vocational and educational programmes offered by various schools.

## Workers' councils

For employers with more than 200 employees, an employee representative must be elected for the exclusive purpose of ensuring direct employer/employee agreements.

## Profit sharing

Law 10101/00 allows companies to distribute part of their annual net income to employees. Profit sharing must be negotiated on a company-by-company basis and disputes settled by arbitration. Amounts distributed are deductible for corporate income tax purposes and not subject to labour and social security contributions, but the beneficiaries are taxed.

## Working conditions

### Wages and salaries

All work of equal value must be remunerated at the same rate, irrespective of the employee's nationality, age, sex or marital status, although differences are allowed for employees working in the same position for two consecutive years more than their colleagues.

A minimum wage is established by law and adjusted annually, which currently stands at approximately USD 293 per month. It should be noted that the minimum wage serves mainly as a base index for adjusting wages and certain prices. In practice, it is paid only to certain rural, unskilled and migrant workers.

The main labour law provisions concerning wages and salaries are as follows.

- National Salary Policy

The National Salary Policy used to change periodically. Currently it is based on free collective negotiations.

- Deductions and reductions

Employers are not permitted to make any deductions from employees' remuneration other than those resulting from advances, legal and collective bargaining agreements, and withholding income tax and social security contributions on payroll.

Remuneration may only be reduced in the extraordinary circumstances established by law.



- Overtime

When paid under a collective bargaining or private agreement, the overtime rate must be stipulated. The additional pay for overtime work cannot be less than 50 percent of the regular wage rate. There are limits on the number of overtime hours that can be worked each day. If overtime is incurred as an emergency measure, payment may not be less than the regular wage, provided this emergency was a contingency beyond the employer's control. Managers are not entitled to overtime pay.

- Night work

For work between 10:00 p.m. and 5:00 a.m., remuneration must be at least 20 percent higher than similar daytime work. Each hour of night work is deemed to last 52.5 minutes.

- Payment

Payment must be made in local currency within the first five working days of the month. Gaps exceeding one month between successive payment dates are not permissible. The remuneration of foreign technicians hired directly overseas (not through a technical service agreement between a national and a foreign company) on a temporary basis to render specialised services may be stipulated in foreign currency, but payment must be made in local currency.

- Obligatory annual bonus

Employers must pay an annual bonus, known as the 13th month salary. This bonus is equal to the normal remuneration for December and is paid in two parts: part one when the employee takes their holidays or before November 30 and part two in early December. Employers' contributions to the Employee Severance Indemnity Fund (see "Termination of employment" below) and to social security funds are also payable on this bonus.

- Family allowance

The INSS (National Institute of Social Security) pays a small supplementary monthly allowance for all offspring under 14 years of age, for employees on a wage of less than USD 459 per month.

### **Fringe benefits**

Voluntary fringe benefits normally constitute a significant additional employment cost. Some employers provide medical care, meals and transport. Other fringe benefits are also given, depending on the nature of the enterprise and the category of the employee. Income tax incentives exist for meals provided under approved schemes. Many companies have private pension schemes for which there is special legislation. Group life insurance schemes may also be available.

All employers are obliged to make reasonable provisions for the comfort and convenience of their employees. Appropriate canteen facilities must be provided on the premises if the headcount exceeds 300. The authorities may require that other special facilities be made available where unusual conditions exist. No industrial enterprise may commence operations until working conditions have been inspected and approved by the authorities.

Employers must also supply transport vouchers to employees, which entitle them to free transport to and from work. Employees contribute to the cost at up to 6 percent of their monthly pay.

Some companies also provide meal vouchers which employees may use in certain restaurants and other eating establishments.

If the above benefits are not stipulated by labour law, the respective amounts are considered as earnings and subject to payroll charges.

The social security benefits are discussed below.

### **Hours worked**

The statutory working week may not exceed 8 hours daily or 44 hours weekly. In the case of employers with continuous working shifts, the working day may not exceed 6 hours. In both cases, this requirement can be resolved by means of a collective bargaining agreement. Unions are attempting to cut the working week to 40 hours, with some success, and many companies are now working a five-day week of eight hours a day.

Work periods in excess of 6 hours must be interrupted by a break/lunch period of one to two hours, but this break may be reduced to less than one hour for enterprises that provide adequate canteen facilities. If the work period is six hours or less, a 15-minute break must be given after the first four hours. Office employees on continuous work, such as typing, calculating and bookkeeping, must be permitted a 10-minute break after every 90 minutes of work. Other rest periods have to be given for special kinds of work.

The above provisions do not apply to managers and other employees in positions of trust and responsibility.

### **Paid holidays**

Paid bank holidays are listed in “Tips for business visitors” at the end of Chapter 1.

Upon completion of every 12 months of service, employees are entitled to paid holidays of 30 consecutive days to be taken during the next 12-month period. Employees are entitled to an additional one-third of their monthly pay when taking annual holidays. If holidays are not granted in this period, employees must receive double their remuneration. Up to one-third of the holiday entitlement may be paid in cash instead, if the employee so desires. In addition, employees are entitled to receive 50 percent of their 13th month salary (see “Obligatory annual bonus” above) at the beginning of their holidays.

### **Equal opportunities**

This is not an important factor in industrial relations yet.

### **Health and safety**

Various regulations cover health and safety issues in dangerous and unhealthy activities. Many companies have a training and education system designed to reduce the number of health and safety hazards in the work place.

It should also be noted that the activities listed as dangerous or unhealthy to employees have special provisions in terms of salaries, breaks and other matters.

## Termination of employment

All employers must contribute to the Employee Severance Indemnity Fund (FGTS) an amount equivalent to 8 percent of the gross monthly remuneration of each employee.

Contributions are credited to bank accounts in the name of each employee and accrue interest at the Reference Rate (Taxa Referencial – TR), plus 3 percent per year. These contributions are deductible expenses for corporate income tax purposes. The balances in these bank accounts may be withdrawn by employees upon termination of employment under the following circumstances:

- Dismissal without cause, or where the employer and employee are considered to be mutually at fault. In the case of dismissal without fair cause, the employer is obliged to pay the employee an additional penalty equal to 40 percent of the accumulated balance in the employee's FGTS bank account, and 10 percent to a government social fund. If employer and employee are mutually at fault, the additional amount payable is 20 percent of the FGTS balance.
- Liquidation of the enterprise or termination of operations resulting in cancellation of the employment contract.
- Retirement in accordance with the social security regulations.
- An employer may insist on retirement when an employee reaches 70 years of age.
- Death of the employee, in which case the balance in the FGTS account is included in the deceased's estate.

Employees may use their FGTS balance at any time to purchase a personal residence under a government-approved housing financing scheme.

Normally, both employer and employee are obliged to give 30 days' notice of their intention to terminate employment. If the service is terminated by the employer without such notice, compensation corresponding to the period of notice must be paid. For all employees with more than one year of service, the settlement of an employee's termination rights under the labour laws must be signed by the employee in the presence of a representative of the labour authorities or union. After notice has been given by the employer, the employee must be granted two hours' leave per day for the purpose of finding another job.

Accrued holiday pay is also due upon termination of employment, even if the employee has not completed 12 months service.

## Social security

### Social security system

The social security system is regulated by the Consolidation of Social Security Laws - CLPS. The system provides benefits like pensions, sickness and maternity assistance and accident insurance. In practice, many employers supplement benefits by making contributions to private medical, dental and hospital plans with a view to upgrading the services provided by the government.

There is an official unemployment insurance program.

### Coverage

All persons in gainful employment and their dependents are covered by the social security system, provided contributions have been paid. Foreign personnel cannot choose to forgo coverage. Contributions are forfeited if a foreigner leaves the country before qualifying for a pension or after twelve months from the moment contributions are discontinued, provided that the minimum period was reached. The self-employed pay social security taxes for their own future benefit.

### Contributions

Employees contribute monthly to the social security system at the rate of 8 to 11 percent of a progressive-scale base salary with a maximum monthly contribution of USD216. These contributions are withheld from payroll. Employer monthly contributions are made at 20 percent of the gross payroll. The contribution of financial institutions and insurance companies is 2.5% higher. In addition, employers are required to make monthly contributions to other funds, which could currently amount to as much as 8.8% percent of gross payroll. Such contributions may be increased or reduced according to the number of work-related accidents suffered by the company. Employees and employers' contributions are deductible for income tax purposes. For further details see Appendix XII.

Certificates showing that employers are up-to-date with their contributions are required before they can engage in certain business activities, such as public bids, real estate mortgages or sales, capital reductions, mergers and spin-offs, amongst others.

The unemployment insurance program is funded by proceeds from the Social Integration Program tax (PIS/PASEP).

### Benefits

All social security system benefits are calculated on the basis of what is known as the benefit wage ("salário de benefício"). This is generally computed on the base salary used for contributions made during various periods prior to the date of claims, according to the kind of benefit. For further details see Appendix XII.

The main benefits are as follows:

- Old-age pensions

Old-age pensions are available from the age of 65 for men (60 for women) providing at least 180 monthly contributions have been made.

The company may, at its own discretion, retire employees aged over 70.

- Retirement pensions

Retirement pensions are normally available if an employee has worked for 35 years for men (30 for women). The qualifying period of service is shorter for certain types of work, e.g. dangerous, unhealthy or fatiguing work, provided contributions have been made for at least fifteen years. Employees entitled to receive retirement pensions may continue to work for the same or a different employer.

- Invalid pensions

The invalid pension replaces the sickness benefit and accident insurance benefit, subject to formal approval of the government social security fund.

- Sickness benefits

The sickness benefit is payable if the insured is unable to work for a period of more than 15 days and continues for the duration of the infirmity. It can be replaced by the invalid pension.

- Accident insurance benefits

When incapacitated by an accident, employees receive full pay for the first 15 days' absence and then a certain amount monthly. If it is determined that the accident victim has been left permanently incapable of working, the accident insurance payments are replaced by the invalid pension.

- Maternity leave

The period of maternity leave is 120 days at full pay. Spouses are allowed paternity leave of 5 days at full pay.

Companies that apply for a special Government Program called "Empresa Ciudadã" may guarantee an additional 60 full pay days and deduct the corresponding payment for corporate income tax purposes.

- Other benefits

Other social security benefits include pensions for the dependents of deceased beneficiaries, assistance for the dependents of insured prisoners, birth grants, maternity assistance, funeral grants, and the family allowance for offspring under 14 years of age.

All benefits are adjusted annually on the basis of official inflation indexes.

### Unemployment relief

Unemployment benefit is granted under certain conditions to employees under an employment contract and domestic employees, amongst others. The respective amount is paid in up to 5 instalments. Unemployment pay, as a general rule, is not granted to those dismissed from work for misconduct, those who stopped working without reason or those unable or unwilling to work.

### Totalisation agreements

Agreements with other countries regarding the coordination of social security systems are listed in Appendix V.

## Payroll costs

Labour costs (wages, salaries, fringe benefits, severance payments, payroll taxes, social security and welfare contributions, etc.) comprise a significant portion of overall production costs, as they have risen considerably as successive governments have increased contributions and benefits. As a percentage of overall production costs, labour costs are generally lower in Brazil than in North America and most European countries but are higher than in many Asian countries.

## Expatriate personnel in Brazil

### Work permits

There are two types of visas that allow foreigners to work in Brazil:

- Temporary visas:

Provided there is an employment contract with a Brazilian company, the holder is entitled to work in Brazil for two years, renewable for as long as the contract regarding the holder's permanence in the country is valid. Foreigners are deemed employees of the Brazilian company and are entitled to all labour rights and are subject to the Brazilian Social Security System.

Without the contract, the visa is issued for foreign individuals involved in specific projects that lead to the effective transfer of know-how/technology to Brazil and the remuneration must be paid through foreign sources. The foreigners are not considered employees of the Brazilian company and are not entitled to labour rights and/or subject to the Brazilian Social Security System.

- Permanent visas:

These visas may be granted to those hired to work in Brazil for an indefinite period and are generally issued to senior executives (directors) of foreign companies being transferred to Brazil and individuals with specialist skills not readily available in Brazil.

The Brazilian authorities require minimum foreign investment of USD 200,000 per expatriate worker, duly registered at the Central Bank of Brazil. The investment can be reduced to USD 50,000 if the company generates at least 10 direct jobs during the period of two years following the foreigner's appointment in the Bylaws/Articles of Association of the Brazilian company. In this case, the individuals are usually not entitled to labour rights but are subject to the Brazilian Social Security System.

These visas can also be granted to individuals marrying Brazilians or who have Brazilian-born offspring. In other circumstances it is difficult to obtain a permanent visa. In this case, the individual is deemed to be a Brazilian national.

Foreigners not in possession of one of the above visas may not work in Brazil. It is advisable to apply for any type of visa well in advance. Note that holders of business visas will only be able to enter Brazil to attend meetings, workshops and visit clients. These visas are valid for a maximum stay of 90 days and up to 180 days per year. These visa holders cannot be registered as employees of a Brazilian entity.

Permanent visas are valid for up to 5 years.

### **Special arrangements or concessions**

Social security benefits are the same for all employees, regardless of their nationality. Contributions to the social security fund are not refunded if an employee leaves the country. Those working under a temporary residence visa are also entitled to annual holidays, standard working hours, accident insurance and social security benefits.

Foreigners arriving on permanent visas may bring otherwise dutiable household goods without paying duty. Duties may be imposed if these goods are sold inside Brazil before certain time limits have expired. The same applies for holders of temporary residence visas, except that they are required to repatriate all otherwise dutiable household goods when they leave.

### **Restrictions on employment**

All employers, with a few exceptions, are required to employ Brazilians at the proportion of at least two-thirds of their overall staff, both in terms of numbers and total remuneration. Exceptions may be made for skilled workers and technicians. Foreigners resident in Brazil for ten years or more or those with a Brazilian spouse or child born in the country qualify as Brazilians for this purpose. In the event employees have to be made redundant as a result of downsizing, Brazilians carrying out the same duties as foreigners must be given preference as regards retention.

### **Living conditions**

In general, living conditions in the major urban areas are similar to those in the United States or Europe, although personal security is more of an issue. High-standard accommodation is available, in both houses and apartment buildings. There is still considerable reliance on domestic help although the use of household appliances is high. There are no restrictions on a family accompanying foreign personnel into Brazil, although this is not necessarily so for domestic servants. Most major urban areas have adequate education facilities for the children of foreign personnel through to comprehensive school level.

Domestic help and food are relatively inexpensive by international standards. Housing costs vary from city to city but, depending on the location and quality, may well be higher than in most developed countries.

In most areas of the country an automobile is necessary for transport around the neighbourhood, shopping and going to and from work. Supermarkets, delicatessens and drug stores stay open most evenings.

Chapter 11

# Audit requirements and practices

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## Investor considerations

- “S.A.” corporations are required to publish their annual financial statements.
- The annual financial statements of all listed companies and all “large companies” (entities with total assets of over R\$ 240 million or annual revenue over R\$ 300 million) must be audited by an independent auditor registered at the Brazilian Securities Commission (CVM).
- Financial institutions and other entities under the jurisdiction of the Central Bank, as well as insurance companies, are required to publish annual and semi-annual audited financial statements.
- The quarterly financial information of listed corporations and financial institutions must be filed with the respective regulator (CVM or Central Bank) and reviewed by an independent auditor.

## Statutory requirements

### Digital books and records

In January 2007, Federal Decree 6022 instituted the Public Digital Bookkeeping System – SPED, a tool that unifies the activities of receipt, validation, storage and authentication of documents and books that integrate the taxpayer’s commercial and fiscal bookkeeping, through a single, computerised flow of information and the use of digital certification.

SPED is an integrated initiative of the federal financial administration for three different areas: the Digital Fiscal Bookkeeping (Escrituração Fiscal Digital - EFD), Digital Accounting Bookkeeping (Escrituração Contábil Digital - ECD) and the Electronic Invoice (Nota Fiscal Eletrônica - NF-e).

The Accounting SPED – ECD tool is intended to replace the issuance of hardcopy accounting books with softcopies. The general journal (livro diário), general ledger (livro razão), auxiliary books and the trial balances and balance sheets will be generated as part of a set of digital documents. The project includes the presentation of information for the federal, state and, hereafter, municipal tax authorities, as well as for the National Registration Department of Commerce (Departamento Nacional de Registro de Comércio), the Central Bank (BACEN), SUSEP and the Securities Commission (CVM). These accounting books must be delivered on the current deadlines.

### **Audited financial statements**

The annual financial statements of the following entities must be audited by independent auditors registered at the CVM, Central Bank and other government agencies, as applicable:

- Listed corporations
- “Large companies”, as defined above
- Financial institutions and other entities under the jurisdiction of the Central Bank
- Investment funds
- Stock exchanges
- Insurance companies, and
- Private pension funds.

Financial institutions and insurance companies must also have their semi-annual financial statements audited. The quarterly financial reports of listed entities supervised by the Brazilian Securities Commission must be reviewed by independent auditors.

When a closely held corporation does not have independent auditors, the company’s audit committee (conselho fiscal) may appoint them at the corporation’s expense if it is believed that this is necessary for the proper fulfilment of its responsibilities.

Even when not required by regulation or bylaws, banks and other financiers frequently require audited financial statements from borrowers.

The tax authorities do not require audited financial statements.

Internal auditors cannot be used as statutory auditors.

## Audit reports

The auditors' conclusions on the independent audit's findings are documented in the "Independent Auditors' Report," often referred to as an audit opinion. The report presents the auditors' conclusions regarding whether the limitations, if any, placed on the audit scope have hindered the ability to form a conclusion, and whether the financial statements are presented fairly in accordance with the applicable accounting framework, such as accounting practices adopted in Brazil. If there are no significant limitations on the audit scope, and the financial statements are presented fairly, the auditors' report is unqualified. If limitations were imposed on the scope of the audit procedures, the auditors' report will either be qualified (in material but not severe circumstances) or contain a disclaimer of opinion (in severe circumstances), indicating that the auditors could not form an opinion on the financial statements taken as a whole. If the auditors detect significant deviations from the accounting framework that management has not rectified, the report will either be qualified (for material but not pervasive deviations) or adverse (for pervasive deviations), indicating that the financial statements are not presented fairly.

## The accounting profession

### Professional requirements

There are two classes of accountants in Brazil:

- Contadores (accountants): Accounting graduates who are permitted to engage in all types of professional work.
- Técnicos de contabilidade (accounting technicians): Non-graduates whose field of professional activity is restricted.

Holders of non-Brazilian university degrees in accountancy may apply to have them revalidated in order to practice in Brazil. This requires sitting examinations on subjects that the state or federal universities consider as not having been covered in the courses taken outside Brazil.

Accountants may practice until their qualifications have been recognised and registered by the appropriate Regional Accounting Council (CRC). Only contadores may work as auditors.

Auditors are required to pass a technical qualification exam before working as auditors. There is a national registration of independent auditors (Cadastro Nacional de Auditores Independentes or CNAI) which is managed by the Federal Accounting Council (CFC) in order to assess the competence and skills of accounting professionals who wish to work as auditors. Additionally, all auditors of entities regulated by the Central Bank, CVM and the Private Insurance Regulator – (SUSEP) must pass the respective additional exams.

Independent auditors (individuals or firms) of listed companies in Brazil are subject to peer review, a quadrennial review of policies and specific engagements by another independent auditor under a program managed by members of the CFC and the Institute of Independent Auditors of Brazil (IBRACON).

#### Federal Accounting Council and Regional Accounting Council

The accounting profession is regulated by an authority called the Federal Accounting Council (CFC) which is composed of members elected by representatives of the various Regional Accounting Councils (CRCs). The elected members of the CFC then elect their president.

The CFC is a supervisory body, interpreting how the law governing the profession is to be applied and overseeing its enforcement. The CFC is called upon to resolve any disagreement at the regional level. Both the Federal and Regional Councils pass judgment on ethical matters. The CFC may submit proposed changes in the relevant legislation to Congress through the Ministry of Labour or it may be called upon to present its recommendations.

#### **Institute of Independent Auditors**

The Institute of Independent Auditors (IBRACON) is a private institution founded to complement, but not substitute, the CFC, primarily for technical matters. Preparing auditing pronouncements is one of its activities. IBRACON also had initiatives to prepare accounting pronouncements until 2007, but those activities are now the responsibility of the Accounting Pronouncements Committee (CPC).

#### **Accounting Pronouncements Committee**

The Accounting Pronouncements Committee (CPC) was created under the auspices of Federal Law 11638, which authorised the CVM, the Central Bank and other regulatory bodies and agencies to enter into an agreement with an entity for the purpose of studying and disclosing accounting and auditing principles, rules and standards and, as part of their regular activities, to fully or partly adopt that entity's pronouncements and other technical guidelines.

The CPC is mostly composed of accountants and also includes, on an equitable basis, representatives of entities that prepare financial statements, entities that audit and analyse financial statements, the CFC and universities or research institutes with renowned expertise in the accounting and capital market areas.

## Auditing standards

Financial statements and the accounting principles reflected therein are representations of management. The independent auditors confirm whether the financial statements conform to published accounting principles. To do so, they must examine the financial statements in accordance with approved Brazilian auditing standards.

The Brazilian Convergence Committee was created in October 2005 to identify and monitor the initiatives to be implemented to make possible the convergence of Brazilian accounting and auditing standards with the International Financial Reporting Standards (IFRS) issued by the IASB and International Standards on Auditing (ISAs) issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB).

The accounting standards convergence process is described in Chapter 12. With respect to auditing standards, this process resulted in the CFC adopting the IFAC's international auditing and assurance standards, issued after the "clarity project" (1). CFC accordingly issued thirty-seven auditing and assurance standards in Brazil in 2009. These new standards apply to the audits of financial statements for periods ending on or after December 31, 2010.

In this process of adopting international auditing standards, the original IFAC numbering system was maintained to facilitate the subsequent updates or reviews. Despite the maintenance of the numbering system, the structure of Brazilian standards is classified as professional (includes the code of ethics ) and technical (ISAs, ISAEs, ISRSs, ISREs). For example, instead of ISA 210 as issued by IFAC, this standard will be numbered TA 210; instead of ISRE 2400 this standard will be numbered NBC TR 2400.

The text above is not a comprehensive source for assessing and understanding audit requirements and practices. We strongly advise you seek help from your accounting consultants when assessing these matters.

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(1) At the beginning of 2009, the International Auditing and Assurance Standards Board (IAASB) completed the clarified version of ISAs (International Standards on Auditing). The ISA Clarity project aimed to clarify the objectives and responsibilities of independent auditors, to eliminate ambiguities and to facilitate the implementation of the international standards. In Brazil, the new NBC TAs are being issued according to the new version of ISAs, after the aforesaid ISA Clarity project.

## Chapter 12

# Accounting principles and practices

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## Investor considerations

- Law 11638, enacted in 2007, has modified the Brazilian Corporate Law and legislation regarding the Brazilian securities market and the Brazilian Securities Commission (CVM). Although the accounting professionals, standard setters and regulators were already committed to seeking convergence with International Financial Reporting Standards (IFRS), these modifications to Brazilian Corporate Law were necessary to provide the flexibility and agility to move forward in that direction.
- Although the convergence process is underway and several new Brazilian accounting pronouncements have been issued to that end, full convergence with IFRS has not yet been achieved. Several differences remain for the 2010 calendar year, as described in the following section.
- Listed companies, financial institutions and insurance companies must prepare their 2010 consolidated financial statements in full compliance with IFRS as issued by the IASB. Their stand-alone unconsolidated financial statements, however, will still be prepared in accordance with accounting practices adopted in Brazil. Other companies are not required to adopt IFRS and may prepare their financial statements in accordance with accounting practices adopted in Brazil.
- In order to facilitate an analysis by potential foreign investors, we have summarised below the requirements of the Brazilian accounting practices and compared them with international requirements, i.e. IFRS.

## Summary of the Accounting Practices adopted in Brazil

The Accounting Practices adopted in Brazil (BR GAAP) are founded upon Brazilian Corporate Law. At the end of 2007 a new law (Law 11638) modified the Brazilian Corporate Law, effective in 2008.

This law was an important step towards making BR GAAP equivalent to International IFRS, although several differences still remain. The local standard setter, the Accounting Pronouncements Committee (CPC), was established in 2007 and is responsible for issuing new Brazilian accounting standards, which must then be endorsed by the applicable regulators, such as the CVM, the Central Bank or the Private Insurance Regulator (SUSEP). Representatives of the regulators usually attend CPC meetings as observers, so they are familiar with the new standards and can approve them soon after they have been finalised by the CPC.

The CVM, the Central Bank and SUSEP have each issued regulations requiring that the entities regulated by them prepare consolidated financial statements in accordance with IFRS for the 2010 calendar year. These regulated entities will still prepare their stand-alone financial statements in accordance with BR GAAP. Please refer to the section "Mandatory Adoption of the CPCs" below.

Except for the consolidated financial statements mentioned in the previous paragraph, all legal entities in Brazil shall prepare their individual or stand-alone financial statements in accordance with BR GAAP. Individual financial statements differ conceptually from separate financial statements in IFRS. In the individual financial statements, the investments in subsidiaries, associates and joint ventures are accounted for using the equity method, while IFRS would require them at cost or fair value in separate financial statements.

From 2008 to the end of 2009, the CPC issued numerous new standards, referred to as CPCs, that were essentially translations of the respective IFRS standards. Only the following IFRS standards had not yet been converted into CPCs as of December 31, 2009:



IFRS Standard	Comments
IFRS 6 – Exploration for and Evaluation of Mineral Resources	Not relevant since the current industry practice in Brazil is acceptable under IFRS 6.
IAS 26 – Accounting and Reporting by Retirement Benefit Plans	Specific to a particular class of entities. Adoption in Brazil will require coordination with the pensions regulator.
IAS 29 – Financial Reporting in Hyperinflationary Economies	Not significant, since Brazil has not been considered a hyperinflationary economy since 1998. The CPC is also discussing with the IASB Brazil’s approach to hyperinflationary accounting before issuing the equivalent standard.
IAS 33 – Earnings per Share (EPS)	Although EPS is an important benchmark abroad, it is not widely used in the Brazilian capital markets, and the CPC and the CVM have decided not to require this standard for 2010. However, in the first quarter of 2010, the CPC and the CVM issued an exposure draft for comments. The standard will therefore probably be issued and become effective from 2011 onwards.

Although not all IFRS interpretations by the IFRIC/SIC have been converted to CPC Interpretations (ICPCs), the CPC believes this is not an issue due to the nature of the interpretation. If an issue arises for which there is no ICPC, but an IFRIC interpretation is available, it is likely management will follow the available IFRIC guidance, in accordance with CPC 23 (equivalent to IAS 8).

The CPCs are more restrictive than IFRS in that they do not permit some alternatives that are allowed by IFRS such as:

- Revaluation of fixed assets and intangibles.
- Presentation of the Statement of Income and the Statement of Comprehensive Income in a single statement.

The initial adoption of IFRS in Brazil in 2010 is covered by CPC 37, and the initial adoption of the new CPCs is covered by CPC 43. Companies that adopted IFRS before 2010 followed IFRS 1 instead of CPC 37. The basic difference between CPC 37 and IFRS 1 is that some of the exemptions in IFRS 1 are not available for adoption in Brazil in 2010:

<u>Exemption not available</u>	<u>Explanation</u>
Share-based payment transactions	This exemption was eliminated because a CPC equivalent to IFRS 2 became effective in 2008.
Employee benefits	This exemption was eliminated because a similar standard in BR GAAP has been in effect since 2002.
Leases	This exemption was eliminated because a CPC equivalent to IAS 17 became effective in 2008.
Cumulative translation differences	This exemption was eliminated because a CPC equivalent to IAS 21 became effective in 2008.
Investments in subsidiaries, jointly controlled entities and associates	This exemption is not relevant in Brazil, since it applies only to separate financial statements, and not individual financial statements, as described earlier.
Designation of previously recognised financial instruments	This exemption was eliminated because a CPC dealing with categories of financial instruments categories became effective in 2008.
Fair value measurement of financial assets or financial liabilities at initial recognition	This exemption was eliminated because a CPC dealing with measurement of financial instruments became effective in 2008.
Borrowing costs	This exemption was eliminated because there was a similar standard in BR GAAP.

In accordance with the Statement of Best Practice that deals with the relationship between the IASB and the other Accounting Standard Setters, the addition of disclosure requirements or the removal of optional procedures is not viewed as non-compliance with IFRS.

According to the CPC, CPC 37 and CPC 43 were issued with the intention of not creating any differences between the individual financial statements (under BR GAAP) and consolidated financial statements (under IFRS), with respect to total assets, total liabilities, equity and profit or loss for the year, except for the following:

- a) BR GAAP allowed companies to maintain pre-existing deferred charges (as of December 31, 2007) in the balance sheet, provided that they are amortised over the original planned period (usually between 5 and 10 years) and that new expenditure is recognised in profit or loss prospectively.
- b) In the individual financial statements under BR GAAP investments in subsidiaries, associates and joint ventures are recorded under the equity method.

Although the new CPCs are in line with the equivalent IFRS standards, other differences in opening balances may arise, considering that:

- i. the new CPCs are being implemented in two phases in 2008 and 2010.
- ii. CPC 37 has removed some of the initial adoption alternatives, such as those discussed above.
- iii. some companies may initially adopt IFRS and the new CPCs at different transition dates.

CPC 37 states that when more than one alternative exists for a transaction, the financial statements prepared under IFRS and BR GAAP shall use the same alternative.

CPC is working diligently to eliminate these differences as quickly as possible by reviewing the current text of the issued IFRS standards. This approach is in line with the Memorandum of Understanding between the IASB, the Brazilian Federal Accounting Council (CFC), and the CPC, which states that “the goal by the end of 2010 is to eliminate the remaining differences between Brazilian GAAP and IFRS and engage efforts to obtain the necessary regulatory endorsement to converged GAAP.”

## Mandatory adoption of the CPCs

The CPCs are issued by the Brazilian Accounting Pronouncements Committee (CPC), and their adoption is required for all companies once the applicable regulators have approved them. Please see below a summary of the enforcement of the new CPCs and IFRS by the relevant regulators:

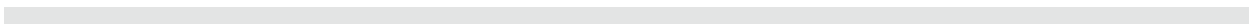
Companies	Regulator	Status
Listed companies	CVM	<ul style="list-style-type: none"> <li>Consolidated financial statements in accordance with IFRS beginning in 2010, with early adoption allowed</li> <li>Individual financial statements in accordance with BR GAAP.</li> </ul> <p>All CPCs have been approved by the CVM. The CPC exposure draft process of new standards occurs simultaneously with the CVM's process.</p>
Financial institutions	Central Bank	<ul style="list-style-type: none"> <li>Consolidated financial statements in accordance with IFRS for 2010, with early adoption allowed</li> <li>Individual financial statements in accordance with BR GAAP.</li> </ul> <p>Although the Central Bank participates in CPC meetings and the convergence process in general, in practice only a few CPCs have been approved by this regulator. Consequently, there might be material differences between the Individual financial statements prepared under BR GAAP and the Consolidated financial statements prepared under IFRS.</p>
Insurance companies	SUSEP	Similar to financial institutions
All other companies	CFC	<ul style="list-style-type: none"> <li>Consolidated and individual F/S prepared in accordance with BR GAAP, which reflect the new CPCs</li> <li>The CPC has adopted a standard equivalent to IFRS for Small and Medium Entities (SME), which is already effective in Brazil for all companies except: <ul style="list-style-type: none"> <li>Listed companies</li> <li>Large companies (total assets of over R\$ 300 million or total revenue greater than R\$ 240 million)</li> <li>Financial institutions</li> <li>Other entities with relevant public accountability</li> </ul> </li> </ul>

Companies are following the CVM guidelines, if listed, or the CFC guidelines for certain rate-regulated activities. In addition, it may be necessary to prepare another set of financial statements specifically for regulatory purposes.

The text above should not be your only source when assessing and obtaining an understanding of the differences between BR GAAP and IFRS. We strongly advise you to seek the assistance of your accounting consultants when assessing the differences.

## Chapter 13

# Tax system



## Investor considerations

- Corporate income tax is computed on the basis of taxable income at a single tax rate, with a surcharge on income over a certain level.
- Net income distributed to shareholders is not taxed at source.
- Foreign profits/income/gains of any kind are subject to Brazilian income tax.
- Individual taxpayers, including resident foreigners, are taxed on worldwide income at progressive rates.
- Non-residents are taxed only on Brazilian-source income.

## Principal taxes

The principal federal, state and municipal taxes are as follows.

### Federal:

- Income tax (IR).
- Social contribution on net income (CSLL).
- Excise tax (IPI).
- Import tax (II).
- Export tax (IE).
- Tax on financial transactions (IOF).
- Social contribution on billing (COFINS).
- Contribution to the Social Integration Program (PIS/PASEP).
- Contribution for Intervention in the Economic Domain (CIDE).
- Rural property tax (ITR).

### State:

- Value-added tax on sales and services (ICMS).
- Inheritance and gift transfer tax (ITCMD).
- Road tax (IPVA).

### Municipal:

- Service tax (ISS).
- Property taxes (IPTU and ITBI).

For details of the principal indirect taxes see Chapter 22.

## Tax guarantees

Tax guarantees do not exist under the Brazilian tax system.

## Legislative framework

### Statute law

The Brazilian tax system is primarily governed by the Federal Constitution and by the National Tax Code (“Código Tributário Nacional - CTN”), which was consolidated in 1966. This basic legislation contains all general provisions, definitions, competences, procedures, and limitations concerning the tax system. The CTN is universal and must be observed by all tax authorities in the country: federal, state and municipal. Legislation is frequently introduced and changed by laws and provisional measures, but retroactive legislation is not permitted, except when it benefits the taxpayer and when the taxable event has not been completed. Within the executive branch, the Ministry of Finance has the responsibility of implementing the tax statutes. This function is specifically carried out by the Brazilian Revenue Service (“Receita Federal do Brasil - RFB”), whose duties are to interpret the statutes in accordance with the intent of the CTN and to enforce them.

The interpretative duties of the Ministry of Finance and RFB range from the general to the specific. Regulations are written in broad, general terms to explain and illustrate the provisions of the CTN. However, revenue rulings interpret the CTN only with respect to specific facts. Revenue procedures are issued to announce administrative practices that the RFB follows.

### Case law

Judicial interpretations provide varying degrees of precedent, depending on the nature of the matter and the jurisdictional authority of the court that delivered the opinion. In situations where the statutory authority alone does not provide a definite solution for a particular tax issue, the taxpayer must consult legal counsel as well as the administrative authorities in order to resolve the matter. In spite of the absence of the binding precedent concept as understood in countries with a common law tradition, case law usually exerts a tangible influence over other comparable cases as well as the decisions of the tax authorities.

Records of disputes in the legislature, as well as leading professional and academic opinions, are important sources of interpretation. Opinions issued by persons of excellent professional repute help develop arguments in support of specific cases, mainly in contentious areas.

### Anti-avoidance

Current anti-avoidance legislation is found in Decree 2730/98. Several provisions in the National Tax Code prevent taxpayers from availing themselves of beneficial provisions of the law in situations where the main reasons, or one of the primary reasons, for their actions is to avoid tax.

It should be noted that the anti-avoidance provisions generally pertain to specific transactions. In general, it is the court's attitude that taxpayers have the right to arrange their affairs in such a manner as to keep their taxes as low as possible, as long as the methods employed are legal.



### **Form versus substance**

The general focus of the law and the attitude of the courts are that substance takes precedence over form. This is evident, for example, in the area of related-party transactions. However, it is possible to obtain alternative tax results from a given transaction through proper tax planning. This opportunity exists only because the law contains specific provisions authorising the use of alternative accounting methods and tax treatments for what in substance are arguably the same transactions.

It is important to note that Complementary Law 104/2001 (still pending regulation) allows administrative authorities to “disregard legal acts or transactions effected with the objective of dissimulating the occurrence of a taxable event or the nature of the elements that constitute the tax obligation, with due observation of the procedures to be established by ordinary law”.

More recently, Provisional Measure 472/2009 has limited the deductibility for local corporate income tax purposes of amounts remitted to tax haven jurisdictions (as stated in Brazilian legislation), to cases where operational substance can be allocated abroad (e.g. identification of the effective beneficiary of the amounts remitted, proof of operational capacity of the individual/legal entity and gathering of documentation related to the payment of the respective price and receipt of goods, services and rights).

### **Clearance procedures**

It is not necessary to obtain advance approval from the tax authorities before entering into significant transactions. However, in most business with the public sector a tax clearance certificate (“Certidão Negativa de Débito – CND”) is required.

### **Public Digital Bookkeeping System – SPED**

Brazil is currently implementing a new public digital bookkeeping system known as SPED, which aims at gradually replacing hard copies of invoices and tax records for soft copies.

Comprised of three pillars (electronic invoices, digital fiscal bookkeeping and digital accounting bookkeeping), the implementation of SPED requires changes in the relationship with tax authorities, clients, suppliers and, mainly, in the internal operational processes, which will demand an integrated action from different areas (tax, accounting, IT, supplies, production, commercial, and others). Furthermore, occasional inconsistencies in databases, as well as operational errors related to tax and accounting information to be generated, usually unknown to the companies’ administration, will be subject to increased visibility and monitoring by the Brazilian tax authorities.

The pillars are being implemented in steps. The main objectives of the new system are to: (i) promote the integration of tax bureaus (federal, state and municipal) by means of standardising and sharing tax and accounting information through computer systems (ii) rationalise and standardise auxiliary obligations for taxpayers and (iii) improve tax assessment procedures. SPED will be compulsory for all taxpayers in the (near) future. For the time being, it is being implemented gradually and taxpayers are obliged to issue documents according to SPED as per different criteria for the different SPED modules.

The files relating to the different SPED modules must generally have their digital certification approved/validated by a specific program generated by the Brazilian Revenue Service. The issuance of invoices by electronic means has already been implemented (in addition to the electronic invoice, a document named DANFE – “Documento Auxiliar da Nota Fiscal Eletrônica” – must be issued, in a single copy, and sent along with the merchandise in order to indicate the respective electronic invoice).

## Income tax

### **Concepts of income taxation**

Corporate taxable income is taxable under a unitary system whereby a single tax rate is applied. This rate is currently 15 percent with a surcharge of 10 percent on taxable income over a certain level (see Appendix I). Tax must be calculated and paid on a monthly or quarterly basis.

As to the relationship between companies and shareholders, Brazil follows a system in which corporate taxable income is taxed to the company and distributions of net income to shareholders are not subject to withholding income tax.

For individual taxpayers the progressive rates of income tax are 0, 7.5, 15, 22.5 and 27.5 percent (see Appendix VI for details).

### **Social Contribution on Net Income**

The Social Contribution on Net Income (CSL) was created with the purpose of financing the social security system. This contribution is levied at the rate of 9% on the net income for the financial year, before certain legal adjustments (additions and exclusions).

## Transitional Tax Scheme - RTT

As commented in Chapter 12, Law 11638/2007 introduced new rules to adapt Brazilian accounting practices to international accounting standards. In response to such changes, Law 11941/2009 guaranteed fiscal neutrality, i.e. no adverse tax consequences should arise from the adoption of the new accounting criteria regarding the recognition of revenue, costs and expenses used to determine net income. To achieve this result, Brazilian taxpayers had the option to elect a Transitional Tax Scheme (“Regime Tributário de Transição” – RTT), under which, for tax purposes only, taxpayers are allowed to calculate corporate income tax and follow the applicable accounting criteria before the enactment of Law 11638/2007.

The transitional tax scheme was optional for the 2008 and 2009 calendar years (mandatory as from 2010) and shall remain in force until a new law is enacted setting forth the tax effects (if any) stemming from the new accounting methods and criteria.

It should be noted that electing the RTT for Corporate Income Tax (IRPJ) results in the tax scheme also being adopted for social contribution purposes (CSLL, PIS and COFINS).

## Taxpayer classes

The main groups of taxpayers are:

- Resident corporate entities, such as corporations, private limited-liability companies (“limitadas”), branches of foreign companies, and partnerships.
- Resident individuals.
- Non-resident corporate entities and individuals.

## Taxable income

An individual’s taxable income is gross income minus deductions. In general, gross income is defined as a taxpayer’s entire income minus certain classes of income specifically excluded by tax legislation. The term gross income includes net business income, dividends, interest, gains on the sale of property, and other accretions of wealth realised by the taxpayer. However, a gain is not generally taxable until it is realised. Mere appreciation in the value of an asset is not income until it is realised by sale, exchange or other conversion. Similarly, a loss from a decline in the value of an asset is not generally tax deductible until realised.

Deductions are allowed only if specified in the laws and regulations. Business expenses are ordinarily deductible.

Certain non-business expenses are also deductible within certain limits.

Corporate entities are subject to tax on all Brazilian and foreign-source income. Corporate dividend income is excluded from gross income in the computation of taxable income.

Resident individuals’ taxable income is computed on a worldwide basis. Tax is normally deducted at source on remuneration, earnings and gains, including capital gains, on a monthly basis. However, at the end of April each year an annual tax return must be filed stating the income of the previous calendar year, whereupon any discrepancy between the annual amount payable and amounts deducted or paid at source is calculated and paid.

Income obtained from Brazil by non-resident legal entities or individuals is subject to withholding tax of 15 or 25 percent, depending on its nature.

**Tax year**

The tax year (base year) is the calendar year, but tax is due and payable on a monthly basis (monthly tax periods). For tax purposes the corporate year end (Corporate balance sheet) is irrelevant, but in practice most companies close their annual accounts as at December 31. Companies may elect to have their corporate tax determined and paid on a quarterly basis.

Except for some special cases, no tax rate increases or new taxes can be levied in the course of a tax year. However, there have been exceptions in the past.

**Tax-free zones**

There is a major, long-established federal tax-free zone in Manaus and the Western Amazon area.

States and municipalities grant local tax concessions in order to attract new businesses.

**Tax holidays**

A few tax holidays are offered by the federal government to attract new business projects in certain areas (see Chapter 4 for further details). Some states and municipalities that seek foreign investment compete for it by offering incentives such as property tax holidays and favourable financing. For further information, a PricewaterhouseCoopers Brazil office in or near the location of interest should be contacted for details.

**Capital taxation**

Property transfer taxes are payable at state and municipal levels by companies and individuals (see Chapter 22 for further details).

**Companies**

No tax is payable at the federal level on the value of a company at incorporation, on the issuance of shares or on annual net assets.

**Individuals**

A wealth tax is provided for in the 1988 Constitution, but legislation has not yet been drafted.

## International matters

### **Foreign operations**

Brazilian resident companies are taxed on worldwide income. Both foreign branch and subsidiaries' profits are taxed as earned. Double taxation is avoided by means of foreign tax credits.

Resident individuals are subject to tax on all income from abroad but are allowed to take credit for the foreign tax paid thereon, provided reciprocal treatment is accorded to Brazilian-source income in the country from which the income is received.

Foreign airlines and shipping companies are exempt from Brazilian income tax on their operations within Brazil, provided equivalent exemption is available to similar Brazilian companies in the countries concerned.

Brazil has signed various treaties for the avoidance of double taxation. For further details see Chapter 23.

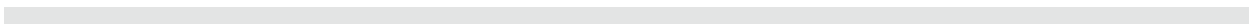
Fees and other related expenses paid in Brazil for services rendered abroad are subject to withholding tax of 15 percent or lower treaty rate.

### **International financial centre operations**

There are no tax breaks to encourage the location of multinational companies' headquarters and administrative offices in Brazil and/or the use of Brazil as a base for offshore financial operations.

Chapter 14

# Tax administration



## Investor considerations

- Tax administration is generally based on self-assessment.
- Taxes are withheld at source on most income payments.
- Corporate income tax is calculated and paid monthly or quarterly. An annual tax return is usually filed in June of the subsequent calendar year-end.
- Consolidated tax returns and/or group relief are not allowed.
- Individual income tax is also calculated and paid monthly, and annual returns are due within four months of the calendar year-end.
- Joint returns for married taxpayers are allowed.
- Penalties are imposed for failure or delinquency in filing returns or paying tax.

## Administration of the tax system

The income tax laws were consolidated by Decree 3000/99 (Regulamento do Imposto de Renda). The federal government department responsible for income tax administration is the Receita Federal do Brasil (RFB- Federal Revenue Service) under the Ministry of Finance, with branches in all states and major cities. The RFB is also responsible for enforcing the law, including the collection of taxes, performance of audits and advocacy in tax disputes leading to litigation. Supplementary regulations are frequently issued by the tax authorities through ordinances, instructions and normative rulings.

State and local governments are responsible for the administration and collection of those taxes under their jurisdiction.

## Corporate taxpayers

### Tax returns

With a few exceptions, all corporate entities including those that are foreign-controlled calculate and pay tax on a monthly basis and file an annual adjusting tax return consolidating the monthly results of the previous calendar year. This annual return must typically be filed by the end of June. The forms to be used are prescribed annually and generally include all financial information required by the authorities.

In the case of late submission, penalties may be charged.

A Company's tax returns must be signed by a chartered accountant, who need not be independent. Many companies submit their tax returns for the review of professional consultants before filing them with the authorities. It is not required to attach financial statements or other data, either audited or unaudited.

Supporting documentation must be retained for at least five years.

### Assessments

Corporate income tax is self-assessed and returns must be filed in the taxpayer's domicile. At the time of filing, all tax returns are subject to a summary check of the tax calculation and of the deductions made. They may subsequently undergo an audit. Tax is deemed assessed at the moment the return is filed. Provisional assessments are not made.

The authorities may assess taxes when the following events occur.

- No return is filed.
- The taxpayer files an incorrect return.
- The taxpayer fails to furnish information requested by tax inspectors or does not present it satisfactorily.
- Proper accounting records have not been kept by the taxpayer. In this event, the authorities may disregard the accounting records in extreme situations and conduct an arbitrary assessment based on gross revenue, asset values or other available data.



## Appeals

Upon receiving any additional assessment notification, a taxpayer has 30 days in which to file an appeal to the local RFB branch. This initial appeal is submitted to the authority that issued the additional assessment. In the event of an unfavourable decision, a second appeal may be made to the Taxpayers' Council ("Conselho Administrativo de Recursos Fiscais- CARF"), a federal administrative tax court in Brasília, whose decision normally terminates the administrative process. Thereafter, a taxpayer may enter into judicial proceedings to contest the assessment.

Claims for recovery of overpaid taxes may be filed no later than five years after the date of overpayment.

## Payment and collection

Self-assessment, monthly payments, estimated payments and withholding taxes are the principal methods by which the federal government collects corporate taxes.

Self-assessments are generally based on the monthly tax returns as filed.

If a company has difficulties in determining its monthly earnings, it can opt for monthly payments of tax on the presumed taxable income basis. However, the utilisation of the presumed basis would not dispense with the later calculation of the annual taxable income and presentation of the annual tax return.

## Withholding taxes

Withholding tax rates are set out in Appendix IV. Withholding taxes, including those on employees' wages and salaries, are subject to monthly payments. Such withholding tax is the responsibility of the employer or the payer.

## Tax audits

Although all income tax returns are checked for mathematical accuracy, only a relatively small number are selected for further examination. Returns are selected for audit either manually or by computer, according to various criteria, including type of business, unusually large or small amounts of income or deductions and random sampling.

No corporate entity, whether a taxpayer or not, is excused from furnishing information or explanations required by the tax authorities. Furthermore, in certain circumstances government agencies and other entities are obliged to disclose information to them (financial institutions, for example).

When audits are conducted on the premises of taxpayers, tax inspectors have broad powers to inspect books and documents and to request information and any data deemed necessary. This is generally disrupting and in practice every effort is made to expedite the conclusion of these audits.

Whenever a violation is determined during a tax audit, the inspectors must draw up an infringement notification which starts the administrative procedure for additional tax assessments.

**Penalties**

A fine ranging from 75% to 225% of the tax due is imposed for any irregularities detected by the tax authorities' audits.

Some irregularities are considered to be of a criminal nature and can lead to imprisonment.

Interest on the amount of tax in arrears is payable based on the monthly SELIC rate, which is presently around 1 percent, together with a fine of 0.33% per day with a limit of 20%.

When overdue taxes have been negotiated with the tax authorities to be paid in instalments and an instalment is not paid before the next one is due, the balance of the tax payable, including outstanding instalments, is considered as payable immediately.

**Statute of limitations**

The tax authorities may generally audit taxpayers up to five years after the close of the tax year.

**Community property/Spouse**

As a general rule, each spouse files his/her own tax return, including his/her income and fifty percent of the income produced by common rights.

However, a joint tax return is also permitted, in which the individual includes all income. The income is therefore taxed jointly, as a single person. The head of the household may, accordingly, treat the other spouse as dependent.

**Foreign personnel**

Foreigners working in Brazil who hold temporary or permanent visas are taxed as residents on their worldwide income. There are no special rules for foreign personnel who hold a permanent visa.

### **Exit permits**

A foreigner or a Brazilian who leaves the country permanently is required to obtain tax clearance. This permits official repatriation of funds and the sending back of other assets. A Brazilian leaving the country on a permanent basis must also obtain a tax clearance.

### **Trusts, partnerships and joint ventures**

The common law concept of trust does not exist in Brazil.

The procedures for the taxation of partnerships and joint ventures are similar to those for corporate taxpayers.

Chapter 15

# Corporate taxation

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## Investor considerations

- Corporate income tax is calculated and paid monthly or quarterly on the basis of worldwide taxable income.
- There is a surcharge on taxable income over a certain level.
- There is no distinction in terms of the tax burden between local and foreign-owned companies.
- Dividends generated as from January 1, 1996 distributed to resident or non-resident beneficiaries (individuals and/or corporate entities) are not subject to withholding income tax.
- Dividend payments are not tax deductible by the distributor.
- Dividends received from local entities are excluded from taxable income.
- Interest may be paid to shareholders based on a company's net equity and is deductible for income tax purposes.
- Interest paid on loans to foreign shareholders is generally deductible for tax purposes on an accrual basis, provided that the loan agreement has been registered at the Central Bank of Brazil (otherwise, the deductibility is limited to LIBOR rate for U.S. dollar six-month deposits plus a 3% annual spread), and the debt: equity ratio is observed.
- Thin capitalisation rules have been introduced in Brazil, as from December 16, 2009, limiting the deductibility of interest paid or credited by a Brazilian entity to a related party (individual or legal entity) or to an individual or legal entity (whether related or not) that is resident or domiciled in a tax haven jurisdiction (For further details see Chapter 16).
- Exchange losses on foreign loans may be deducted on a cash basis. Nonetheless, the taxpayer may elect to recognize the exchange gain/loss on an accrual basis.
- Inter-company transactions are subject to transfer pricing rules
- Consolidated tax returns are not permitted.
- Accounting records, as a general rule, shall observe the accrual basis method.

## Corporate tax system

Corporate net income is taxed at the corporate level.

### Taxable entities

Corporations, limitadas (private limited-liability partnerships), other partnerships (except for regulated professional partnerships), and branches organised in accordance with Brazilian laws are subject to corporate income tax. Non-profit entities that comply with certain registration and filing requirements are generally exempt.

### Territoriality

A legal entity is considered resident in Brazil and subject to local taxation if it has been incorporated in Brazil.

The territorial concept for Brazilian corporate income tax payers was abolished in January 1996. Corporate taxpayers are now taxed on the basis of their worldwide income. For further details see Chapter 18.

### Accounting period

Corporate income tax is generally computed on the basis of annual taxable income. Although companies may elect to compute tax on a quarterly basis, for tax purposes a company's year-end is December 31. A different year-end for corporate purposes is irrelevant for tax purposes.

### Accounting methods

All companies are required to determine net income in accordance with the accounting principles established in Law 6404/76 (see Chapter 12). In general, the accrual basis is required for both accounting and taxation purposes. However, profits on long-term contracts may be computed on the percentage-of-completion basis, except in the case of contracts with the government or government-owned companies, for which the profit may be recognised on a cash basis for tax purposes. Special tax-accounting methods also apply in other areas and are discussed below.

Please refer to Chapters 12 and 13 for further details on the new accounting practices effective in Brazil as from 2008 and the corresponding transitional tax scheme currently applicable.

### Business profits

For tax purposes, business profits are computed on the basis of net income, as reported in the statement of income (profit and loss account), adjusted for non-taxable income and non-deductible expenses.

## Inter-company transactions

### Transfer Pricing Rules

Brazil's transfer pricing rules, which became effective on January 1, 1997, do not adopt the internationally accepted arm's length principle. Instead, Brazil's transfer pricing rules define maximum price ceilings for deductible expenses on inter-company import transactions and minimum gross-income floors for inter-company export transactions.

The rules address imports and exports of products, services and rights charged between related parties, inter-company financing transactions not registered at the Central Bank of Brazil, as well as all import and export transactions between Brazilian residents (individual or legal entity) and residents in either low-tax jurisdictions (as defined in the Brazilian legislation) or jurisdictions with internal legislation that call for secrecy relating to corporate ownership, regardless of any relation.

The rules require that a Brazilian company substantiate its inter-company import and export prices on an annual basis by comparing the actual transfer price with a benchmark price determined under any one of the Brazilian equivalents of the OECD's comparable uncontrolled price method (CUP method), resale price method (RPM) or cost plus method (CP method). Taxpayers are required to apply the same method, which they elect, for each product or type of transaction consistently throughout the respective financial year. However, taxpayers are not required to apply the same method for different products and services.

### Rules regarding imports of goods, services or rights

Deductible import prices relating to the acquisition of property, services and rights from foreign related parties should be determined under one of the following three Brazilian equivalents of the OECD's traditional transaction methods:

#### Comparable independent price method (PIC)

This Brazilian equivalent of the CUP method is defined as the weighted average price for the year of identical or similar property, services or rights obtained either in Brazil or abroad in buy-sell transactions on similar payment terms. For this purpose, only buy-sell transactions conducted by unrelated parties may be used.

#### Resale price less profit method (PRL)

This Brazilian equivalent of the RPM was originally defined as the weighted average price for the year of the resale of property, services or rights minus unconditional discounts, taxes and contributions on sales, commission and a gross profit margin of 20% calculated based on the resale price (minus unconditional discounts). If value is added before resale, the margin profit is increased to 60%, calculated based on the percentage of the value imported over the final resale price. In applying the PRL, a Brazilian taxpayer may use their own prices (wholesale or retail), established with unrelated parties.

It is important to mention that a Provisional Measure (PM) published on December 29, 2009 proposed an amendment to the Brazilian transfer pricing legislation, in order to change the PRL Method. This change should be in effect as of January 1, 2010. Under the new provision, the resale minus method would apply the same way for imports of products for resale or for consumables to be used in a manufacturing process. The new Sales Minus Method (PVL) should be calculated considering a margin of 35%, as opposed to the previous 20% applicable to products for resale and the 60% applicable to consumables. By the date this Chapter had been reviewed the proposed changes had not been analyzed by the Brazilian Congress, which should take place before June 1, 2010.

### **Production cost plus profit method (CPL)**

This Brazilian equivalent of the CP method is defined as the weighted average cost incurred for the year to produce identical or similar property, services or rights in the country where they were originally produced, grossed up for taxes and duties imposed by that country on export plus a gross profit margin of 20%, calculated based on the obtained cost. Production costs for the purpose of the CPL are limited to the costs of goods, services or rights sold. Operating expenses, such as research and development (R&D) and selling and administrative expenses, may not be included in the production costs of goods sold to Brazil.

In the event that more than one method is used, the method that provides the highest value for imported products is considered by the Brazilian tax authorities as the appropriate import price. This is intended to provide taxpayers with the flexibility to choose the method most suitable to them. The Brazilian rules require that each import transaction be tested by the benchmark price determined using one of the three methods, as applicable to the type of transaction (this also applies to export transactions).

If the import sales price of a specific inter-company transaction is equal to or less than the benchmark price determined by one of the methods, no adjustment is required. On the other hand, if the import sales price exceeds the determined benchmark price, the taxpayer is required to make an adjustment to the calculation basis of income tax and social contribution.

The aforementioned excess must be accounted for in the retained earnings account (debit) against the asset account or against the corresponding cost or expense if the good, service or right has already been charged to the income statement.



### **Rules regarding exports of goods, services and rights**

In the case of export sales, the regulations provide a safe harbour whereby a taxpayer is deemed to have an appropriate transfer price with respect to export sales when the average export sales price is at least 90% of the average domestic sales price of the same property, services or intangible rights in the Brazilian market during the same period under similar payment terms. When a company does not conduct sales transactions in the Brazilian market, the determination of the average price is based on data obtained from other companies that sell identical or similar property, services, or intangible rights in the Brazilian market. When it is determined that the export sales price is less than 90% of the average sales price in the Brazilian market, the Brazilian company is required to substantiate its export transfer prices, based on the benchmark obtained using one of the following Brazilian equivalents of the OECD's traditional transaction methods:

#### **Export sales price method (PVEx)**

This Brazilian equivalent of the CUP method is defined as the weighted average of the export sales price charged by the company to other customers or other national exporters of identical or similar property, services or rights during the same tax year on similar payment terms.

### **Resale price methods**

The Brazilian versions of the RPM for export transactions are defined as the weighted average price of identical or similar property, services or rights in the country of destination on similar payment terms reducing by the taxes included in the price imposed by that country and a profit margin of either:

- 15%, calculated according to the wholesale price in the country of destination (wholesale price in country of destination less profit method, or PVA).
- 30%, calculated according to the retail price in the country of destination (retail price in country of destination less profit method, or PVV).

### **Purchase or production cost plus taxes and profit method (CAP)**

This Brazilian equivalent of the CP method is defined as the weighted average cost of acquisition or production of exported property, services or rights increased for taxes and duties imposed by Brazil plus a profit margin of 15%, calculated based on the sum of the costs, taxes and duties.

In the event that the export sales price of a specific inter-company transaction is equal to or more than the transfer price determined by one of these methods, no adjustment is required to be made. On the other hand, if the export sales price of a specific inter-company export transaction is less than the determined transfer price, the taxpayer is required to make an adjustment to the income tax and social contribution calculation bases.

### **Rules regarding interest on debt paid to an overseas related party**

The statutory rules provide that interest on related-party loans that are duly registered at the Central Bank of Brazil will not be subject to transfer pricing adjustments. However, interest paid on loans issued to a related party that is not registered at the Central Bank of Brazil is deductible only to the extent that the interest rate equals the LIBOR dollar rate for six-month loans plus 3% per year (adjusted to the contract's term). The actual amount of the interest paid on the loan in excess of this limitation will not be deductible for income tax and social contribution purposes.

Similarly, loans extended by a Brazilian company to an overseas related party that are not registered at the Central Bank of Brazil must charge interest at least equal to the LIBOR dollar rate for six-month loans plus 3%.

### **Rules regarding royalties and technical assistance**

The statutory rules expressly exclude royalties and technical, scientific, administrative or similar assistance remittances from the scope of the transfer pricing legislation. Accordingly, provisions of the Brazilian income tax law established before the Brazilian transfer pricing rules came into effect still regulate the remittances and deductibility of inter-company payments for royalties and technical assistance fees.

### **Definition of related parties**

Brazil's transfer pricing rules provide a much broader definition of related parties than do internationally accepted transfer-pricing principles. As described further on, the regulations go so far as to characterise overseas parties as being related when such parties are located in low-tax jurisdictions, regardless of whether a relationship exists between them.

Under the statutory rules, a foreign company and a Brazilian company may be considered related if the foreign company owns as little as 10% of the Brazilian company, or when at least 10% of the capital of each of them is owned by the same person.

Additionally, regardless of any underlying relationship, the Brazilian definition of related parties considers a foreign party to be related to a Brazilian company if, in the case of export transactions, the foreign party operates as an exclusive agent of the Brazilian company or, in the case of import transactions, the Brazilian company operates as an exclusive agent of the foreign party. For these purposes, exclusivity is evidenced by a formal written contract, or in the absence of one, by the practice of commercial operations relating to a specific product, service or right that are carried out exclusively between the two companies or exclusively via the intermediation of one of them.

### **Companies located in low-tax jurisdictions or jurisdictions that allow secrecy in regard to corporate ownership**

Under the regulations, the transfer pricing rules apply to transactions conducted with a foreign resident, even if unrelated, that is domiciled in a country that does not tax income or that taxes income at a rate of less than 20% or in a jurisdiction with internal legislation does not allow access to information relating to corporate ownership and/or access to information relating to the actual beneficiary of earnings attributed to non-Brazilian residents. For these purposes, the tax legislation of the referred country applicable to individuals or legal entities is considered, depending on the nature of the party with which the transaction was carried out.

As from January 1 , 2009, the provisions regarding prices, costs and interest rates related to transfer pricing regulations are also applied to transactions performed in privileged tax regime, between individuals or legal entities resident or domiciled in Brazil and any individuals or legal entities, even if not related, resident or domiciled abroad, according to Law 11727/2008.

### **Current documentation requirements**

Transfer pricing information must be provided to the tax authorities on an annual basis, as part of the information contained in the income tax return (Declaração de Informações Econômico-Fiscais da Pessoa Jurídica, or DIPJ). As a result, taxpayers have to make a detailed disclosure of their inter-company import and export transactions, the method applied to test the inter-company price for the 49 largest import and export transactions, and the amount of any adjustments to income resulting from the application of the method to a specific transaction during the financial year in question.

### **Divergence margin**

For inter-company import and export transactions, even if the actual price is above the determined transfer price (for import transactions) or below the determined transfer price (for export transactions), no adjustment is required as long as the actual import price does not exceed the determined transfer price by more than 5% (i.e. as long as the actual export price is not inferior to the calculated transfer price by more than 5%).

### Relief of proof rule for inter-company export transactions

In addition to the statutory 90% safe harbour rule for inter-company export transactions, there is a secondary compliance rule (herein referred to as the 'relief of proof rule') whereby a taxpayer may be relieved of the obligation to substantiate the export sales price to overseas related parties using one of the statutory methods if it can demonstrate either of the following:

1. the net income derived from inter-company export sales, taking into account the annual average for the calculation period and the two preceding years, excluding companies in low-tax jurisdictions and transactions for which the taxpayer is permitted to use different fixed margins, is at least 5% of the revenue from such sales, or
2. net export revenue does not exceed 5% of the taxpayer's total net revenue in the corresponding financial year.

If a taxpayer can satisfy the relief of proof rule, the taxpayer is able to prove that the export sales prices charged to related overseas parties are adequate for Brazilian tax purposes by only using the export documents related to those transactions.

### Inventory valuation

Inventories must be valued at the lower of cost or market value. The average purchase or production cost is normally used. Tax rulings have been made to the effect that LIFO is not an acceptable valuation method and that standard costs must be reverted to actual cost at least quarterly. Provisions for inventory obsolescence or loss of value are not allowable deductions until the corresponding items have been disposed of or destroyed. A certificate must be obtained to substantiate the destruction. Manufacturing costs to be inventoried include all direct costs (material, labour and overhead).

Special valuation methods are available for farmers, securities dealers and certain other taxpayers. Most importantly, valuation methods must clearly reflect income and conform as nearly as possible to the best accounting practice in the trade or business.

There must be conformity between book and tax reporting.

Further tax regulation on this subject is expected in view of the new Brazilian accounting standards laid down by the new Corporate Law and other related provisions.

### Capital gains/losses

Capital gains are taxed as ordinary income. The cash basis may be used to compute profits on certain long-term sales of permanent assets.

Capital losses may only be offset by capital gains. Unused capital losses are treated similarly to income tax losses with regard to limits on use and carry forward period (see deductions – losses further on in this Chapter).

## Financial income

Financial income is taxed at the following rates:

	Prepayment of income tax	Year-end Calculation (income tax and social contribution tax)
Net capital gains on equities traded on the stock exchange	15%	Income: 34%  Losses: carried forward to be compensated against future gains of the same nature.
Net capital gains on futures, options or forwards, traded in the Futures Stock and Commodities Exchange, similar markets; or capital gains on flexible options, out of the exchanges	22.5% = investment period <180 days  20% = 181 < investment period <360 days  17.5% = 361 < investment period <720 days  15% = investment period >721 days	Income: 34%  Losses: carried forward to be compensated against future gains of the same nature.
Investment in Variable Investment Funds	15%	Income: 34%  Losses: tax deductible
Swap Transactions	22.5% = investment period <180 days  20% = 181 < investment period < 360 days  17.5% = 361 < investment period <720 days  15% = investment period > 721 days  (for contracts signed before 31/12/2004 = 20%)	Income: 34%  Losses: tax deductible under certain conditions

Capital gains and interest on fixed-income investments including fixed-income investment funds, whose average portfolio term is shorter than 360 days	20% semi-annual + positive difference between effective income tax rate depending on the holding period, if any:  22.5% = investment period <180 days  20% = 181 < application period < 360 days	Income: 34%  Losses: tax deductible
Day Trade	20%	Income: 34%  Losses: tax deductible
Capital gains and interest on fixed-income investments including fixed-income investment funds, with an average term in excess of 360 days	15% semi-annual + positive difference between effective income tax rate depending on the holding period, if any:  22.5% = investment period <180 days  20% = 181 < investment period < 360 days  17.5% = 361 < investment period < 720 days  15% = investment period > 721 days	Income: 34%  Losses: tax deductible

At the year-end, gains compose the operational income basket and prepayments or withholdings are offset against the final tax due. Losses on variable income transactions (equity, options, futures and forwards) are temporarily not tax deductible but may be carried forward to be offset against gains of the same kind (shares and derivatives). Day trade transactions have a special tax treatment.

Gains from the sale of depreciable property are treated as ordinary non-operating income and not as capital gains.

Financial income is not subject to the PIS/PASEP and COFINS taxes. Nevertheless, income from hedge operations and from interest on net equity is subject to the PIS/PASEP and COFINS taxes at the rates of 1.65% and 7.6%, respectively.

Please note that financial institutions are generally not subject to withholding income taxes on capital gains and income yielded by investments in the financial and capital markets. Nevertheless, these earnings are counted for the purpose of determining corporate income tax. Moreover, financial income is also subject to the PIS/PASEP and COFINS taxes at the rates of 0.65% and 4%, respectively.

## **Interest**

Interest income is taxable on the accrual basis.

## **Dividends/Inter-company dividends**

Dividends received from other local companies including subsidiaries and affiliates are not subject to corporate income tax.

## **Stock dividends**

Dividends are not subject to withholding income tax and the recipient is not subject to corporate income tax.

## **Dividends in kind**

The payment of dividends in kind is not prohibited by corporate law, provided that specific rules and terms are clearly defined in the Articles of Association or the payment is approved at the Annual Shareholders' Meeting.

## **Royalties and service fees**

Royalties and service fees received by Brazilian residents are taxable on an accrual basis.

## **Exchange gains and losses**

Corporate taxpayers may elect to include exchange gains and losses in their taxable income, on an accrual basis or when realised.

## **Non-taxable income**

The following types of income are non-taxable for corporations (Sociedades Anônimas – S/A):

- Credits arising from the equity pick-up method of accounting for investments in subsidiary and associated companies (same tax treatment for all companies).
- Premiums on the issuance of shares and debentures.
- Proceeds from the sale of participation and subscription rights.
- Profit on the sale of Treasury stock.
- Subventions received for capital investments.

## Deductions

### Business expenses

In general, all ordinary and necessary expenses paid or incurred in the course of business are deductible. Minor expenditure on capital assets or any expenditure on capital assets with a useful life of less than one year is also deductible. Territorial limits are not in themselves a factor in determining the deductibility of expenses. There are no prohibitions against payments to affiliates if they involve an arm's-length charge. Such payments may be subject to Transfer Pricing rules (see "Non-deductible items" below).

The following costs/expenses are generally deductible for tax purposes: lease and rental expenses; depreciation and amortisation; maintenance and repair; taxes and related fees/contributions; insurance premiums; any other costs or expenses not effectively and directly connected with the production or sale of goods, products or services, may not be considered deductible for tax purposes.

### Depreciation and amortisation

Except for land, which is not depreciable, the depreciation incurred on property, plant and equipment is an allowable deduction. The regulations do not establish depreciation methods, but the annual straight-line rates listed in Appendix II can be considered as normally acceptable for tax purposes. However, in special cases when the rates listed do not reflect the real depreciation period it is possible to obtain different rates provided evidence that these rates are incompatible is presented, such as reports prepared by specialised technical entities. If assets are not used in the production or sale of products or services, the depreciation or amortisation thereof would not be deductible for tax purposes.

Amortisation of goodwill that arises as a result of accounting for investments in subsidiary and associated entities by the equity pick-up method is deferred for taxation purposes until the related investment has been realised. However, under certain requirements, goodwill paid upon the acquisition of the shares or quotas of a permanent investment may be amortised before this realisation occurs. It is important to note that, although still applicable for tax purposes (until further regulation is issued), the amortisation of goodwill is no longer accepted under Brazil's new accounting practices.

Amortisation of patents, trademarks and copyrights, based on their legal limited life, is a deductible expense within approved limits.

### Formation, start-up, pre-operating and expansion expenses

As a general rule, for tax purposes these expenses may be deferred and amortised on the straight-line basis over a period of not less than five years, beginning the month in which the business starts operating.

### Leasing agreements

A leasing company is considered to be a financial institution and is authorised to operate by the Central Bank. Only financial leases are applicable. Lease payments are treated as an operating expense by the lessee and are generally deductible for tax purposes if the leased assets are used in the ordinary course of business.



## Depletion

Depletion allowances may be made for natural resources on a useful-life basis. Special incentive depletion allowances based on gross revenue are granted for mining operations, except for those commencing after December 1987.

## Interest and financial charges

All interest and financial charges paid or accrued in the taxable year are generally deductible, including those paid or accrued to a local or foreign affiliated company. Interest credited to the beneficiary on foreign loans is generally subject to 15 percent withholding tax at source and the deductibility thereof is subject to the new thin capitalisation rules introduced in December 16, 2009, as mentioned previously. Interest on the financing of property, plant and equipment incurred in the pre-operational stages of a business venture may be deferred for future amortisation, and should normally be deferred for income tax purposes.

## Interest on net equity

Since January 1996 companies have been able to pay interest to shareholders based on the company's net equity. This interest, which may not exceed 50% of the annual profits or retained earnings, is deductible for income tax and corporate social contribution purposes, and is generally subject to 15% withholding income tax (both for beneficiaries resident in Brazil or abroad), rising to 25% if the non-resident beneficiary is resident/domiciled in a low-tax jurisdiction, according to Brazilian legislation. It is calculated on the pro rata tempore basis and

up to a given rate is known as the long-term interest rate. Whenever the beneficiary is a corporate entity subject to normal income tax in Brazil, the tax withheld at source may be taken as a tax credit against the normal corporate income tax due. Alternatively, this tax credit can be offset against income tax due at source on interest payments. This interest is not subject to further tax if the beneficiary is a Brazilian resident individual.

## Royalties and service fees

For tax deduction purposes, royalties, license fees, technical assistance and similar charges, together with the amortisation of patent costs, may not in total exceed certain percentages of net sales revenue of the related products. Except in cases covered by specific tax incentives, the highest total deductible charge permitted for certain industries only is 5 percent. The maximum payment for the use of trademarks and trade names is 1 percent of the corresponding net sales. Formal agreements must be registered at the National Institute of Industrial Property (Instituto Nacional de Propriedade Industrial - INPI) in support of all such charges.

Registration with the Central Bank of Brazil is also necessary for the remittance of foreign currency.

Royalty fees for license agreements without INPI approval are not deductible.

Royalties payable to a foreign company with a direct or indirect controlling interest in a Brazilian company are deductible for tax purposes, provided the contract has been duly registered by the INPI.

There is no withholding tax on royalties and service fees etc, paid to resident parties. However, payments of royalties and technical assistance service fees to foreign recipients are subject to 15 percent withholding income tax, rising to 25% if the non-resident beneficiary is resident/domiciled in a low-tax jurisdiction, as defined by Brazilian legislation. In addition, remittances of royalties and service fees are subject to the Contribution for Intervention in the Economic Domain (CIDE), at the rate of 10% based on the amounts credited/paid. CIDE is levied on the local entity's cost and is not therefore creditable to non-residents.

Depending on the nature of the remittance to the foreign beneficiary, the respective payment/credit may fall under one of the services subject to the Municipal Services Tax - ISS. Under the prevailing legislation, ISS is not levied on the licensing of patents and copyrights. Nevertheless, as stated in Complementary Law 116/2003, licenses to use/exploit trademarks and software have been subject to ISS since August 2003. The Brazilian entity is responsible (on behalf of the non-resident) for withholding and paying the tax to the municipal authorities, at rates ranging from 2% to 5%.

In general, remittances of royalties are not subject to the PIS and COFINS taxes, as these social contributions apply to the import of goods and services (since May 2004). Nevertheless, once characterised as a service for ISS purposes (e.g. software licensing), the federal tax authorities may also demand payment of the PIS and COFINS taxes, at the rates of 1.65% and 7.6% respectively.

Lastly, remittances of royalties/technical assistance service fees abroad (i.e. foreign exchange transactions) are subject to the Tax on Financial Transactions – IOF, at the rate of 0.38%.

It should be noted that operations involving royalty agreements are not subject to transfer pricing rules if the related contract has been registered at the Central Bank and the INPI. For information about service fees paid to associated foreign companies, please refer to our comments on transfer pricing regulations above.

### **Employee remuneration**

Employees' wages and salaries and related social security contributions are fully deductible and no restrictions or limitations specifically apply to foreign personnel. Monthly contributions to the Employee Severance Indemnity Fund (FGTS) are deductible, as are expenses related to group medical care and health insurance programmes for employees, contributions to private supplementary pension schemes and meals supplied to all employees indistinctly. Schooling expenses of employees' children are deductible if this benefit is given to all employees or considered as a benefit.

Directors and Officers' remuneration is also deductible, although payments made at the discretion of the employer are not considered as remuneration, and are not therefore deductible.

### **Insurance premiums**

There are no limits for income tax purposes. However, insurance cannot be placed with overseas companies unless specifically authorised by the government agency which deals with the insurance industry. Self-insurance reserves are not deductible.

### **Inter-company charges**

In general, inter-company charges are deductible when they correspond to actual services rendered and to the extent they are deemed necessary to the Brazilian company's activities. Such charges must be established on an arm's length basis. Amounts paid to foreign associates are subject to exchange control regulations and transfer pricing rules.

It should be noted that charges by foreign associates for management, general and administrative expenses are subject to close scrutiny by the Tax and Exchange Control authorities, and remittance permission may be challenged by the relevant authorities.

### **Travel**

Travel expenses in general are deductible, provided they are duly documented and substantiated. However, meals of share/quotaholders and/or senior management are generally not deductible (see non-deductible items further on).

### **Doubtful accounts receivable**

Deductions relating to doubtful accounts receivable must follow specific procedures connected to the value of the credits, outstanding periods, whether there is a guarantee or not, the debtor's solvency situation and the existence of judicial procedures. In general terms there is no problem relating to deductibility, provided that complete supporting documentation is available.

### **Taxes and contributions**

All taxes (except corporate income tax and the social contribution on net income), compulsory contributions and related costs, such as interest on arrears, are deductible for tax purposes on an accrual basis. This rule does not apply to taxes/contributions being or to be contested by the taxpayer, at any level of litigation, which are deductible for tax purposes only on a cash basis. Taxes and other charges on assets not used in the production or sale of goods, products or services are also not considered deductible.

Withholding tax on income paid to non-residents, which is assumed by the payer, is deductible if the underlying payment itself is deductible. Punitive tax/contribution penalties are not deductible.

### **Charitable donations**

Donations are deductible up to certain limits if the recipients are registered as charitable institutions.

### Deferred compensation

Contributions to qualified deferred employee compensation plans may be deductible, within limits, in the year of contribution.

### Repairs

Expenditure on repairs that result in an increase of more than one year in the estimated useful life of related assets is not deductible and should normally be capitalised in order to support future depreciation.

### Professional fees

Professional fees are deductible, subject to proof the services have actually been rendered, as well as compliance with the general deductibility rules.

### Advertising

Advertising is deductible on the accrual basis. The cost of free samples is not deductible.

### Research and development

At the option of the company and for tax purposes, research and development expenditure may be deducted when incurred or deferred until the end of the project and then amortised over a period of not less than five years.

In 2005 Brazilian legislation introduced tax incentives for projects geared towards technological innovation.

### Non-deductible items

As a general rule and except for the specific items listed immediately below, amounts paid or credited for the furtherance of business activities are considered deductible.

- Meals (food) expenses incurred or paid on behalf of partners, share/quotaholders and senior management
- Noncompulsory contributions and donations (with very few exceptions).
- Gifts in general.

Where the beneficiary or nature of a transaction is unidentified, the related payments are also subject to a 35 percent withholding tax at source, which is in effect a penalty tax.

Disguised profit distributions are non-deductible expenses and recipients are required to pay tax thereon. In general, disguised profit distributions arise as a result of failing to conduct transactions with shareholders (whether corporate entities or individuals), directors, officers and their relatives on an arm's-length basis.

Provisions in general are not deductible, except those for holiday pay and 13th month salaries. The technical reserves of insurance and capitalisation companies, however, are deductible under certain special conditions.

### Equity investments

Provisions for probable losses on the realisation of equity investments are not considered deductible.

## Losses

Tax losses may be carried forward indefinitely. However, tax loss offsetting is restricted to 30 percent of taxable income in each subsequent year. For this purpose a loss is defined as an accounting loss adjusted for tax purposes. Tax losses may not be carried back. Certain forms of tax losses may be cancelled, such as those resulting from mergers and spin-offs, and may not be used by the survivor and/or successor.

Additionally, tax losses may be cancelled when a company simultaneously undergoes a change in control and business activity.

Nonoperating losses may only be offset against profits of the same kind, up to the limit of 30 percent of such annual profits.

## Tax computation

### Net income

Taxable income is computed by adjusting net book income for non-taxable income and non-deductible expenses. A sample corporate tax computation can be seen in Appendix III.

### Tax rates

The single federal income tax rate for corporate taxable income is 15 percent, but there is a surcharge of 10 percent on annual taxable income above R\$ 240,000 (approximately USD 140,000) (see Appendix I).

## Presumed profits

Corporate taxpayers with gross annual revenue not exceeding R\$ 48 million (approximately USD 27 million) may opt to pay tax on a presumed-profit basis. Under this method, income is calculated on a quarterly basis and shall correspond to certain percentages applied over gross revenue, adjusted as determined by the prevailing legislation. Such percentages vary depending on the entity's activities.

The corporate income tax rate of 15 percent, plus a surcharge of 10 percent on quarterly taxable income above R\$ 60,000 (approximately USD 34,000), is levied on the product resulting from applying the percentages and related adjustments. For further details see Appendix III.

The annual adjusting corporate tax return for presumed profits must be filed by the same date the regular income tax return is due; normally by the end of June of the subsequent year.

## Arbitrary profits

The Tax authorities may assess tax based on arbitrary profits (profits discretionally assumed to exist) if a taxpayer fails to comply with the rules and regulations for keeping records and/or computing taxable income. The taxable income basis would be arbitrated based on the presumed percentage of profits attributable to each type of activity, ranging from 1.92 % to 38.4 % of gross monthly revenue. The amount of tax determined would then be grossed up by 20 percent (45 percent for financial institutions). When the gross revenue is unknown, the federal tax authority uses several other methods to determine the taxable income (e.g. based on the latest adjusted financial statements, adjusted capital and others).

**Tax credits**

Foreign tax credits are available subject to certain limits. There are no other specific tax credits.

**Consolidation - Group relief**

Consolidated income tax returns are not permitted in Brazil.

**Other taxes****Social Contribution on Net Income**

Monthly corporate net income, before income tax and after some deductions, is subject to the social contribution on net income at the rate of 9 percent, except in the case of insurance and financial institutions, which are subject to a 15% rate (for further details see Appendix III).

**Social Integration Program - PIS/PASEP**

This contribution is levied at the rate of 1.65 percent on gross income, considered to be the sum of the company's total revenue, minus taxes not grossed up in the sales invoice, such as Excise Tax - IPI, unconditional discounts, cancelled sales, goods and service exports revenue and other legal deductions. Based on the non-cumulative basis, companies may appropriate credits by applying the same rate to certain costs and expenses deriving from the acquisition of certain consumables. Companies electing the presumed-profit basis and those engaged in certain sectors such as telecommunications and finance, are subject to the PIS/PASEP taxes at the rate of 0.65 percent, but cannot offset credits (cumulative basis). Special rates apply to specific sectors such as automobiles, pharmaceuticals, beverages and petroleum products. The contribution is also levied on import transactions.

**Social Contribution on Billing - COFINS**

This contribution is currently levied at the rate of 7.6% and has the same taxable basis and credit regime as the PIS tax mentioned above. Companies under the cumulative basis are subject to COFINS at the rate of 3.0 percent. The contribution is also levied on import transactions.

- For further details see Chapter 22.

For a detailed description of all significant indirect taxes see Chapter 22.

## Branches versus subsidiaries

The advantages and disadvantages of operating in Brazil as a subsidiary versus a branch are discussed in Chapter 16. Very few branches of foreign entities are operating in Brazil.

### **Special industries**

There are a number of corporate categories for which the income tax regulations provide special treatment, the most important of which are as follows.

#### **Insurance**

Insurance companies are allowed to make a special deduction for the technical reserves required by law.

#### **Real estate**

In the case of instalment sales, taxable income may be determined on the cash basis.

#### **Leasing**

Leasing companies are regulated by the Central Bank of Brazil, and optional accounting and tax methods are applicable.

#### **Agricultural enterprises**

These enterprises may take a deduction from taxable income for certain specified investments in land improvements, plant and equipment.

#### **Mutual and investment funds**

Generally, investors may pool their funds in order to obtain investment diversity and proportional investment advice from the funds' administrators. Tax is payable at source only at varying rates.

## Holding companies

There are no special rules for holding companies, and they are taxed in the same manner as other corporate taxpayers. They are required to account for their material investments by the equity pick-up method. Dividend income received from other local corporate entities is non-taxable. Any income received from foreign affiliates is taxable.

## Corporate tax planning strategies

### Subsidiaries versus branches

Foreign investors are advised to incorporate operations in Brazil instead of setting up branches, as in the latter case non-residents must file an application to the Ministry of Commerce, Industry and Development to obtain authorisation to operate in Brazil.

### Joint ventures

There are no tax advantages or disadvantages for joint ventures in Brazil.

### Holding companies

There is no legislation that favours foreign shareholders or holding companies.

Special industry companies/Special-use companies

Companies participating in certain sectors, such as banking, insurance, leasing, etc., are subject to special tax rules.

### Location/Industry

Tax holidays are offered by governments for certain industries installed in specific areas (see Chapter 4).

### Reorganisations, mergers and acquisitions

Companies can be reorganised tax free under certain conditions. Further tax regulation on this subject is expected in view of the new Brazilian accounting standards laid down by the new Corporate Law and other related provisions (see Chapter 13 for details).

The tax basis of assets can be stepped up through acquisitions under certain conditions.

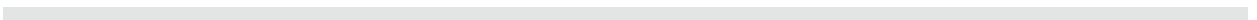
Both buyer and seller must allocate costs in asset purchases or deemed asset purchases.

### Tax treaties

Relief from double taxation is applicable. See Appendices IV and V for details.

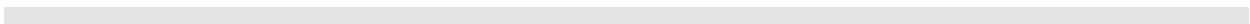
See Appendices XIV and XV for other points to consider when setting up, structuring or acquiring an investment in Brazil.





Chapter 16

# Taxation of foreign corporations



## Investor considerations

- Subsidiaries of foreign corporations receive the same tax treatment as local companies.
- Dividends payable by subsidiaries of foreign corporations to foreign shareholders are not subject to withholding income tax.
- Foreign corporations are not normally subject to tax on income arising from their export sales to Brazil.
- Local salesmen/agents with authority to enter into binding contracts may increase the tax exposure of exporters in Brazil.
- Administrative and similar service charges from overseas head offices or affiliates to Brazilian subsidiaries should be considered necessary, actually incurred and properly documented for tax purposes and remittance procedures must be carried out based on Central Bank of Brazil regulations.

## Tax concepts

The basic taxation principle for foreign corporations is that only income from Brazilian sources is taxable in Brazil. A foreign corporation is only therefore subject to Brazilian tax when it directly derives income from Brazilian sources. A foreign corporation exporting goods to Brazil would not be liable for income tax on the export income, although the resale of the merchandise inside Brazil would be a taxable transaction under the conditions described further on under “Imports”.

There is no difference between income tax payable on net income earned by Brazilian companies, whether held locally or by foreigners. There is no withholding income tax on distributions of profits to either local or foreign shareholders.

No foreign corporation may carry out permanent activities in Brazil other than through a registered subsidiary, branch or permanent establishment.

## Imports

No income tax liability will normally arise on the sale of goods shipped to Brazil by a foreign corporation and billed directly to the customer, provided that ownership passes directly to the customer and provided that any local agent involved in the sale (corporate or individual, related or unrelated) does not have the power to bind the overseas principal contractually. If the local agent has such power, income tax is calculated on a deemed-profit basis, based on gross income plus an additional surcharge of 20 percent (see "Sales agents or subsidiaries" in Chapter 8). Any tax assessed would be charged to and collected from the local agent.

### **Imports without agents**

There are no tax implications.

### **Unrelated agents**

Agents are normally entitled to commission and as such are subject to Brazilian income tax and service tax. However, there are no tax implications for foreign exporters.

### **Sole or exclusive agents**

The implications are the same as for unrelated agents. However, sole or exclusive agents may not hold binding powers.

### **Employees/sales staff**

There are no tax implications, provided that binding powers are not held.

### **Sales subsidiaries**

Sales subsidiaries are subject to the same Brazilian taxes as any other local company.

## Branch operations

The profits of a foreign corporation's branch are taxable in the same way as those of a local company, regardless of the branch's business objectives. They are not subject to an annual branch withholding tax.

## Income from subsidiaries

### Dividends

Since January 1, 1996, dividends paid out of the subsidiaries' profits to local or foreign shareholders have not been subject to withholding income tax.

### Interest

Withholding income tax at the rate of 15 percent (25 percent, if the beneficiary is located in a low-tax jurisdiction, as defined under Brazilian legislation) or a lower treaty rate (see Appendix IV), is payable on interest that a foreign corporation may receive from its Brazilian subsidiary. Exemption of withholding tax may be obtained in the case of certain types of export financing.

On December 16, 2009, Brazil's Executive Branch published Provisional Measure (PM) 472 which, among other provisions, includes new thin capitalisation rules that can be summarised as follows:

Interest paid or credited by a Brazilian entity to a related party (individual or legal entity), not resident or domiciled in a tax haven jurisdiction or subject to a privileged tax scheme, may only be deducted for income tax purposes if the interest expense is viewed as essential to the local entity's activities and the amount of debt granted by

the related party does not exceed twice the amount of its interest in the Brazilian entity's net equity. A second test also needs to be performed including the total amount of debts with any foreign related party. If a 2:1 ratio is exceeded under a "debt/equity" test, the portion of interest related to the excess debt will not be deductible for Brazilian income tax purposes.

Similar provisions also apply to interest paid or credited by a Brazilian entity to an individual or legal entity (related party or otherwise) resident or domiciled in a tax haven or favourable tax jurisdiction or subject to a privileged tax scheme. In these cases, the interest expense will only be deductible for Brazilian income tax purposes if the expense is viewed as necessary and the debt amount does not exceed 30% of the Brazilian entity's net equity. A second test also needs to be performed including the total debt to any foreign party resident or domiciled in a tax haven jurisdiction. If under either "debt/equity" test the 30% of net equity threshold is exceeded, the excess interest will not be deductible for Brazilian income tax purposes.

The two aforesaid rules also apply to cases where a guarantor, representative or any other intervening party is a related party or resident of a tax haven jurisdiction (respectively).

**Royalties, capital gains, service/management fees, rent, etc.**

Withholding income tax at the rate of 15 percent (25 percent, if the beneficiary is located in a low-tax jurisdiction, as defined by Brazilian legislation) or a lower treaty rate, is also payable on royalties and service fees received by a foreign corporation from its Brazilian subsidiary.

It should also be noted that transfer pricing rules apply to the export and import of services to or from related companies, except for operations involving royalty agreements.

Furthermore, the Brazilian entities may be subject to the Contribution for Intervention in the Economic Domain at the rate of 10 percent (see chapter 15 – “Taxation of Corporations” under “Royalties and service fees”).

**Payments made to tax haven jurisdictions**

Provisional Measure 472 also states that amounts directly or indirectly paid, credited, delivered or remitted under any title to individuals or legal entities residing in tax haven jurisdictions (as defined by Brazilian legislation) or subject to a privileged tax scheme should not be considered deductible for income tax and social contribution purposes, unless operational substance can be allocated abroad (e.g. identification of the effective beneficiary of the amounts remitted, proof of operational capacity of the individual/legal entity and gathering of documentation related to the payment of the respective price and receipt of goods, services and rights).

It is important to note that although PM 472 has already come into force, the Brazilian Congress has 60 days to veto, modify, or convert the provisions into law. If Congress does not act within this initial 60-day period, the PM expires unless it is extended for an additional 60-day period.

## Foreign portfolio investments

The direct investment of foreign capital in the Brazilian capital market must be made through a special foreign-investment account under Central Bank of Brazil rules. The main features of these funds are as follows:

- IOF - Tax on Financial Transactions - taxation on the inflow of resources (currently 2%). Outflow of resources are currently tax exempt.
- The investment fund's income is not subject to Brazilian corporate income tax at the fund level. Withholding income tax may apply, depending on the type of fund, up to 15%.
- Capital gains arising from transactions in the Brazilian exchanges and similar markets are tax exempt (equity and derivative funds).
- Capital gains on variable-income transactions out of the exchanges or in variable-income funds are subject to withholding income tax at rates varying from 10% to 15%.
- Capital gains and interest on fixed transactions or investment funds are subject to withholding income tax at a rate of 15%.
- Foreign investors resident in tax havens are subject to higher taxation, as applicable to Brazilian residents.

The rules for the formation and administration of foreign-investment accounts are contained in National Monetary Council Resolutions and must be previously approved by the Securities Commission and administered by authorised Brazilian financial institutions. The incoming foreign capital must be registered at the Central Bank of Brazil.

The investment accounts are taxed in the portfolio provided that there is no further taxation on outbound capital.

### **IOF levied on other foreign transactions**

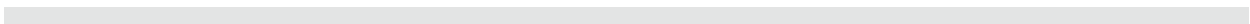
IOF is a federal tax levied primarily on transactions involving foreign exchange, insurance, loans or financing and on securities transactions. The applicable rate varies depending on the transaction (generally 0.38% - e.g. exchange operations relating to the payment of imported services and inflow of funds as capital contributions). IOF is charged at the rate of 5.38% on foreign loans, if the loan is repaid within 90 days. The rate is reduced to zero for exchange transactions relating to the inflow and outflow of capital in and from Brazil, stemming from foreign loans and financing obtained from October 23, 2008 (repaid after an average 90 days). The 0% IOF rate also applies to exchange transactions relating to the inflow of revenue into Brazil deriving from the export of goods and services.

## International financial centres

There are no concessions available to foreign corporations for using Brazil as an international financial centre.

## Chapter 17

# Taxation of shareholders or quotaholders





## Investor considerations

- Dividends or profits paid, remitted or credited to local or foreign investors are not subject to withholding tax.
- A special type of interest may be payable to shareholders or quotaholders based on the value of a legal entity's net equity (interest on net equity) and is subject to withholding tax (the usual rate is 15%).
- Foreign-source dividend or equity income is subject to Brazilian corporate income taxes.

## Local shareholders or quotaholders

### Dividends or profits

No withholding tax is payable on cash dividends or profits paid or credited to either corporate or individual local shareholders. Brazilian resident beneficiaries are not subject to further income tax.

Foreign-source dividend income is subject to Brazilian income tax.

### Capital gains

Gains on the sale or transfer of shares or quotas are taxed at normal rates.

## Foreign shareholders or quotaholders

### Dividends or profits

Dividends or profits paid, remitted or credited to both corporate and individual foreign shareholders are not subject to withholding tax.

Dividends paid out on stocks held by foreign shareholders are not subject to taxation.

### Capital gains

Capital gains derived from the sale of Brazilian assets (including shares) are subject to withholding tax, (even if both vendor and buyer are domiciled abroad) generally at the rate of 15 percent or a lower treaty rate. The tax rate increases to 25% if the beneficiary is domiciled or resident in a tax haven or subject to a privileged tax scheme.

## Interest on net equity

Companies can pay interest to shareholders based on their net equity interest, subject to withholding tax generally at the rate of 15 percent or a lower treaty rate. The tax rate increases to 25% if the beneficiary is domiciled or resident in a tax haven or subject to a privileged tax scheme.

For details of the calculation basis and restrictions see Chapter 15.

## Reorganisations

### **Incorporations**

No tax consequences arise from converting a non-incorporated business into an incorporated entity or from changing the corporate form, such as from a “limitada” (private limited-liability company) into a corporation.

### **Mergers or amalgamations**

In the case of a merger, the new or surviving company succeeds the taxation and labour rights and obligations of the dissolved company, although it is not entitled to use the dissolved company’s tax-loss carry forwards. For tax purposes, mergers may be accounted for on the basis of book or market values. If accounted for at market value, the taxable gain or tax-deductible loss is computed as follows.

**Taxable gain** - A taxable gain is the excess of the value at which the net assets received are accounted for over the book value of the investment that they have replaced. Gains earned by local investor companies as a result of the merger or amalgamation of their local investee companies are subject to the Brazilian Income taxes (IRPJ and CSLL) at a combined rate of 34%. Capital gains earned by non-resident shareholders due to merger and amalgamation transactions involving Brazilian companies are subject to withholding income tax generally at the rate of 15 percent or a lower treaty rate. The tax rate increases to 25% if the beneficiary is domiciled or resident in a tax haven or subject to a privileged tax scheme.

Provided the merger is conducted at market value, the negative difference between the net assets received and the book value of the investment is treated as a deductible capital loss.

## Reorganisations

The legislation permits spin-offs, split-offs or split-ups whereby a company transfers all or part of its net assets to one or more existing companies or companies specifically set up for that purpose. The tax considerations described above for mergers or amalgamations also apply to reorganisations.

## Liquidations

There are no special tax rules relating to companies in liquidation. Any net income accruing to corporate shareholders is taxed normally as part of taxable income. With regard to individual shareholders, any gain arising from the redemption of shares or quotas is taxed as a normal capital gain. If the owner is resident overseas, any gain is taxed at source, generally at the rate of 15 percent or a lower treaty rate. The tax rate increases to 25% if the beneficiary is domiciled or resident in a tax haven or subject to a privileged tax scheme.

## Acquisitions

### Asset acquisitions

Acquisitions of assets by a foreign company should preferably be carried out via a locally incorporated company. The assets must be recorded at cost and may be depreciated normally.

### Share or quota acquisitions

In general an acquisition of shares or quotas by a Brazilian resident company would allow the premium/goodwill paid in the acquisition to become deductible, under certain circumstances, following the merger of the acquiring and the acquired company, through either an upstream or downstream merger.

Chapter 18

# Taxation of foreign operations



## Investor considerations

- Foreign-source profits and earnings are subject to tax in Brazil (worldwide income taxation).
- Foreign tax credits are available, subject to certain limits.
- Foreign-source losses cannot be offset against Brazilian-source profits.

## Taxation of foreign income

The territorial concept for corporate income tax purposes was abolished in January 1996 and corporate taxpayers are currently taxed on a worldwide income basis. Foreign-source income/gains of any nature, net of foreign-source losses, are subject to Brazilian income tax, when distributed or made available. Foreign tax credits are available subject to certain limits.

Profits of overseas associated companies, when distributed or made available, are included in the determination of taxable income of the Brazilian company proportionately to its interest based on the financial statements prepared in the country where the associated company is domiciled. As per the legislation in force, the profits of overseas associated companies are considered “available” to the Brazilian controlling company at the time the overseas associated company closes its financial statements at the end of its financial year.

### **Double tax relief**

A Brazilian corporate entity may offset income tax incurred abroad on profits, revenue and capital gains and include it in taxable income up to the limit of the income tax incurred in Brazil on such profits, revenue or capital gain. The income tax to be offset is converted into Reais based on the bank selling rate on the date the tax was paid.

Brazil has double taxation agreements with various countries. See Appendix V for a complete listing.

## Chapter 19

# Consortiums and joint ventures

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## Investor considerations

Among the various forms of association provided for in Brazilian legislation, consortiums have gained in stature.

Upon introducing consortiums Brazilian commercial law intended to facilitate the coming together of companies to leverage a certain purpose without having to incorporate a new legal entity.

A consortium does not constitute a corporate entity and the consortium members only undertake to observe the conditions stipulated in the respective contracts, where each member is liable for their own obligations; there is no joint liability if no such contractual covenant exists.

## Consortiums

See Chapter 9 for the different types of partnerships and their common uses.

### **Entities or conduits**

A consortium cannot be a creditor nor can it undertake obligations alone since it is not a legal entity; only consortium members can be creditors or undertake obligations. A consortium operates through its member companies, usually through one only, appointed as the “Leader Company”.

Creditors of a consortium cannot claim full performance of obligations undertaken by only one of the consortium members, which must be made public by being expressly included in the contract constituting the consortium, duly registered at a trade registry.

As mentioned above, a consortium must be constituted through a contract in writing duly registered at a Trade Registry, containing the minimum requirements established by Law.

### **Taxable income**

There is no specific provision in Brazilian legislation on consortium taxation. Since a consortium is not a legal entity, the results of its operations will only be taxed through the consortium members.

In this respect, each of the legal entities participating in the consortium must individually appropriate their revenue and expenses and file their own separate income tax returns.

However, the Federal Tax Authorities require compulsory registration of the consortium in the General Taxpayers' Register – CNPJ, for earnings subject to withholding income tax or earnings arising from their activities.

Accounting records must also be centralised in a specific book for consortiums to be later transferred to each of the consortium members.

A consortium cannot be a legal entity or undertake obligations, and is not liable for paying the Social Contribution on Gross Revenue – PIS or the Social Contribution on Billing – COFINS. These charges are levied on the consortium members, as the enterprise's earnings are appropriated by each of the consortium members.

### **Joint ventures**

#### **Entities or conduits**

The concept of an unincorporated joint venture as a separate corporate entity does not exist in Brazil.

Accordingly, the parties to an unincorporated joint venture or consortium are taxed individually.

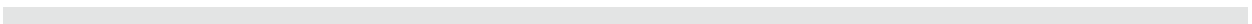
#### **Taxable income**

As stated above, parties to an unincorporated joint venture or consortium are taxed individually. Their tax liability is based on their tax status and their share of the joint venture or consortium's taxable income. Incorporated joint ventures are taxed in the same way as corporate entities.

#### **Taxation of foreign ventures**

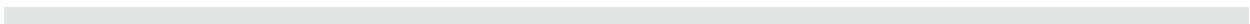
Foreign ventures are subject to withholding tax at the rate applicable to foreign shareholders (see Chapter 17).





## Chapter 20

# Taxation of individuals



## Tax planning for expatriates

### **Resident/non-resident status**

Special visas and work permits are required for any foreigner intending to live and/or work in Brazil, whether for short or long periods. Certain types of visa may be granted in connection with work permits, and each one has a different tax consequence.

Permanent visas are issued to foreign individuals who occupy decision-making positions stipulated in the Bylaws/Articles of Association of a Brazilian company. These foreigners are considered tax residents as from their arrival in Brazil and are subject to income tax on their worldwide income.

Temporary visas for employment contracts with a Brazilian Company may be issued to qualified individuals, including business executives who have an employment relationship with a Brazilian company and who meet certain conditions established by the Brazilian Authorities (experience in the field, post graduation, justification for requiring such staff etc). These temporary visas are valid for up to 2 years and are renewable for the same period. These individuals also become tax residents of Brazil as from their arrival in the country.

Furthermore, foreigners on renewable temporary visas without an employment contract with a Brazilian Company, but under a technical service agreement, which are valid for 1 year, 90 days or 30 days are considered resident, if their stay in Brazil exceeds 183 days (consecutive or not) within any given 12-month period. Such foreigners are not allowed to enter into any local employment agreements. During the first 183 days of their stay in Brazil as non-residents, foreign holders of temporary visas without an employment contract will only be taxed at source on their Brazilian-source income. They become residents for tax purposes as from the 184th day of their stay.

There are no special tax concessions for foreigners working permanently or temporarily in Brazil.

### **Pre and post-assignment periods**

Any amounts payable by a non-Brazilian source to a foreigner who has not yet acquired the status of a Brazilian resident or who has relinquished this status are not subject to Brazilian income tax.

**Job-related activities partially outside Brazil**

Resident status must be considered. Worldwide income is generally subject to Brazilian income tax for Brazilian residents.

**Bonuses and fringe benefits**

Bonuses and most fringe benefits provided by employers are taxable. Tax-exempt fringe benefits include employers' contributions to private social security plans and labour claim payments, as well as specific benefits provided for in the applicable Collective Labour Agreement.

**Special foreign-assignment allowances**

Any special foreign-assignment allowance paid in Brazil is subject to income tax. Allowances paid in the employee's country of origin have to be included in their worldwide income if they have resident status.

**Social security contributions**

Social security contributions are payable by all persons working under a relationship with a Brazilian company, whether as employees or holders of decision-making positions, in accordance with the Brazilian company's Bylaws/ Articles of Association. Amounts paid to the Brazilian Social Security System are deductible from individual taxable income.

**Special tax concessions**

There are no special tax concessions for foreigners working in Brazil.

**Timing of arrival/departure**

Since tax is due monthly, it generally makes no difference whether a foreigner arrives or departs early or late in the year. For tax residents, income received from Brazilian sources is withheld at source and income from foreign sources is payable by the individual. Individuals are obliged to file an annual Income Tax Return to adjust the tax amount paid monthly.

Specific exit procedures have to be filed and tax clearance certificates are needed before tax residents can permanently leave Brazil.

## Territoriality and residence

The underlying principle of individual taxation is that residents are taxed on their worldwide income and non-residents at source only on their Brazilian-source income. The source of income is determined by the place where the income payer is located, irrespective of where the work is performed.

Foreigners holding temporary visas with no local employment agreement are treated as non-residents during the first 183 days (consecutive or not) of their stay and are liable to Brazilian income tax of 25 percent withheld at source on their Brazilian source income only. They do not have to file a tax return. From the 184th day of residence onward, or earlier if a temporary visa is converted into a permanent visa, they become resident for tax purposes.

Foreigners arriving in Brazil on permanent visas or temporary visas with a local employment agreement are considered residents and taxed on worldwide income from the date of their arrival.

On departure, the foreigners (both holders of temporary visas with an employment contract or permanent visas) should notify the tax authorities of their departure and prepare an Individual Income Tax Return relating to the period from January 1 up to the date of departure. The income tax return for the previous tax year will also need to be filed if this has not yet been done. At the same time a Federal Tax Clearance Certificate should also be requested.

After filing the pertinent procedures and requesting the Certificate, the foreigners are no longer considered resident and as of this moment all income earned in Brazil is taxed at source at the rate of 25 percent, except for income or gains on financial investments, which are taxed at the same rates applicable to residents.

Companies are advised to require individuals surrender their visas.

There are no special rules for Brazilians working abroad.

## Special provisions

There are no special favourable provisions applicable to foreigners working in Brazil.

## Gross income

Gross income is the sum of earnings from capital, labour or a combination of both, including allowances, alimony and pensions received in cash, gains of any other nature and any increase in personal wealth not supported by declared income. Income from overseas sources is also included in gross income. Capital gains arising from the disposal of assets or rights of any nature and investment income are generally considered as part of gross income. However, in certain circumstances certain transactions are exempt or are taxed exclusively at source at lower rates.

The annual income tax return is divided into various sections, which serve to classify income by source as follows.

- Taxable income received from companies.
- Taxable income received from individuals and overseas sources.
- Exempt and non-taxable income.
- Income subject to exclusive taxation.

In addition to these income-related sections, all taxpayers with income and/or assets above certain levels must prepare a list of personal assets and rights, and of liabilities at the beginning and end of each calendar year, including those overseas.

Types of income exempt from individual income tax include the following.

- Board, transport and special work uniforms or clothing provided free of charge by the employer, or the difference between the amount charged and the market value.

- Per diem allowances to cover room and board when working outside the county in which the company or office is based or in which the work is normally performed.
- Labour indemnities, limited to the legal amounts, including indemnities for work-related accidents.
- Contributions made by the employer to private social security programmes on behalf of employees.
- Reimbursement of relocation costs when moving to a different area at the request of the employer.

## Employee services

The definition of taxable income arising from employee services is very broad and includes everything that is directly or indirectly connected with the work and/or assignment remuneration package, including salaries, premiums, directors' fees, bonuses, tips and other gratuities, allowances of any kind, 13<sup>th</sup> month salaries, tax reimbursements, club dues and company cars.

Amounts paid under net pay schemes, where an employee receives net income with taxes paid by the employer, are grossed up.

Stock option schemes are not covered by individual tax legislation, but do trigger tax implications in Brazil.

Foreign-source income is taxable, but relief is normally given for foreign taxes paid to foreign jurisdictions if a tax treaty exists or reciprocal treatment is available.

### **Employees' profit sharing**

Workers have the right to share in a company's profits, irrespective of any remuneration received, according to a specific labour law. Any amounts received are not considered as consideration for employee services and are taxed exclusively at source.

### **Capital gains**

In general, capital gains of resident individuals are taxed at the rate of 15 percent. However, gains on sales of assets or rights where the sale price is less than certain thresholds (depending on the asset or right being sold) may be exempt. The exemptions are considered on a monthly basis. In addition, a capital gain on the sale of an individual's principal residence is exempt up to a certain amount.

### **Other income**

Royalties, professional fees, pensions, annuities and alimony are taxable upon receipt and should be included in gross income. Credit is given for tax deducted at source.

Rent on overseas property, including a private home, and dividends and interest from overseas investments, should also be included in gross income.

Amounts paid by employers for group life insurance, medical care, meals, uniforms, transport and per diem expense allowances are not generally taxable for the individual. Employers' contributions to private pension plans and savings and investment plans are also exempt from individual income tax.

Income from short-term investments is taxed only at source, at varying rates.

### **Closely held companies**

There are no special tax rules for shareholders/quotaholders of closely held corporations/limitadas (private limited-liability companies). Care must be taken to ensure that shareholders'/quotaholders' transactions are perceived to be on an arm's-length basis and therefore not deemed to be disguised profit distributions, which would be subject to income tax (see "Non-deductible items" in Chapter 15).

### **Non-residents**

Brazilian-source income and capital gains of non-resident individuals are subject to withholding tax of 25 percent, except for financial income held at bank accounts in Brazil, which may be subject to lower rates. Furthermore, earnings received by non-residents, arising from the rental of real estate located in Brazil, are subject to income tax withheld at source at a flat rate of 15 percent.

The source of income is determined by the place where the income payer is located, irrespective of where the work is performed.

## Deductions

Deductions from the income tax calculation basis (taxable amount) should be listed in the corresponding sections of the annual income tax return. As a general rule, deductions are only allowed when disbursements have been made. Deductions may be summarised as follows.

- Contributions to the Brazilian Social Security System.
- Medical, dental and hospital expenses.
- Amounts paid to private medical schemes.
- Private pension fund contributions.
- Alimony payments.
- Schooling expenses of dependents.
- Expenses of lawsuits related to income earned.

For limitations on amounts deductible and/or deductions from the tax due see Appendix VII.

Business expenses are not deductible.

### **Personal allowances**

Personal allowances are deductible for each dependent. A special allowance applies to elderly taxpayers. For deductible amounts see Appendix VII.

### **Non-residents**

Non-residents do not need to prepare income tax returns. As mentioned previously, their Brazilian-source income is taxed at source only.

### **Double-tax relief**

Relief from double taxation is available if a tax treaty exists between Brazil and the country from which foreign-source income is generated or if reciprocal treatment is applicable. See Chapter 23 and Appendix V for details of tax treaties.



## Tax computation

### **Taxable income**

A sample calculation of individual taxable income is shown in Appendix VIII.

Specific filing categories exist for married people filing jointly or separately and for single taxpayers.

### **Tax rates**

The progressive tax rates are shown in Appendix VI. The current maximum individual tax rate is 27.5 percent.

### **Tax credits**

Tax credits are available (within certain limits) for income tax paid to countries with which Brazil has a ratified tax treaty, or to countries that would render reciprocal treatment in relation to income taxes paid to the Brazilian government.

## Other taxes

### **Local taxes on income**

No state or municipal income taxes are levied on individuals.

Minor amounts are payable annually to the various unions.

### **Wealth and inheritance taxes**

There are presently no wealth or inheritance taxes.

### **Inheritance and gift transfer tax**

The ITCMD (“Imposto de Transmissão Causa Mortis e Doação”) - transfer tax is imposed at state level at different rates.

## Chapter 21

# Taxation of trusts and estates

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## Trusts

The common-law concept of a trust does not exist in Brazil.

## Estates

There is at present no inheritance tax in Brazil. The 1988 Constitution introduced the concept of a wealth tax, although to date no legislation and/or regulations have been issued.

As regards the estate of a deceased person, the executors are required to file income tax returns covering the net income of the estate up to the date of distribution of the available resources. The net income of the estate is taxable in exactly the same way as an individual's net income (see Chapter 20).

The only other tax relating to the dissolution of a deceased's estate is the property transfer tax ("imposto de transmissão causa mortis"), which is payable by the estate (see Chapter 22).

## Chapter 22

# Indirect taxes

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## Investor considerations

- A federal value-added excise tax is payable at varying rates on nearly all sales and transfers of industrialised products. It is also payable on most imported merchandise.
- Import tax is levied at varying rates on most imports.
- Many payroll taxes are levied in addition to social security contributions.
- Financial transactions are subject to a tax on financial transactions at varying rates.
- Companies must contribute to various federal social and welfare funds.
- A state value-added sales and services tax is levied on most sales and imports.
- Service tax is levied by municipalities at varying rates.

## General

All taxes that are complementary to income tax (taxes on occasional gains, dividends and remittances) have been discussed in previous chapters. This chapter refers to the more important indirect taxes that affect businesses and individuals in Brazil. Indirect taxes are also summarised in Appendix XIII.

## Federal indirect taxes

### Value-added excise tax

Excise Tax - IPI (“Imposto sobre Produtos Industrializados”) is levied at various rates on industrialised products when sold or transferred by the industrialising establishment, even though industrialisation may be incomplete, partial or intermediate. There are a few exceptions, including exports and most food products. It is also levied on imports at the same rates as on Brazilian-made products. All related laws and regulations were consolidated in Decree 4544/02.

The tax is payable at the point of production or import. When items are transformed or processed, additional excise tax is payable on the finished product, but credit is allowed for tax paid on the purchase of raw materials or component parts used for production. Tax must also be paid on the price differential of items imported and sold on at a higher price by the importer, and on those repackaged or reoffered for sale at a higher price.

IPI is calculated on selling prices on an ad valorem basis at rates that vary according to the degree of necessity. For example, food products in general are exempt while cigarettes and certain other tobacco products are taxed at over 300 percent. Normally the rate is around 10 to 15 percent. Product specifications can be seen in the Excise Tax Table (TIPI).

Excise tax is passed on to the purchaser as an addition to the sales price of each item shown in the invoice (“nota fiscal”) and related receipt (“fatura”).

Invoices must accompany all items in transit whether they have been sold or are merely being transferred to another location since, as in the case of the state value-added tax on sales and services - ICMS (see below), each plant or location of an entity is considered a separate taxpaying unit. Invoices must always indicate the amount of excise tax and the calculation basis. For companies subject to SPED (see chapter 13), hardcopy invoices are replaced by soft copies.

### **Customs duties**

Import duty - II (“Imposto de Importação”) is generally levied on an ad valorem basis. For details see Chapter 8.

### **Payroll taxes**

Payroll Taxes in the form of social security and other contributions are discussed in Chapter 10. They are also summarised in Appendix XII.

### **Export taxes**

Export Tax - IE (“Imposto de Exportação”) is levied on a very limited number of products (e.g. animal fur and cigarettes) . This tax is applied more as a foreign trade regulator than as a revenue instrument.

### **Tax on financial transactions (IOF)**

The tax on financial transactions - IOF (“Imposto sobre Operações Financeiras”) is levied at varying rates on loans and credit operations, securities transactions, certain foreign-exchange transactions and insurance policies. It is added to the cost of each transaction. This tax is also levied at varying rates on income earned from certain short-term financial investments, where the tax is withheld from the investor by the financial institution. Both companies and individuals are subject to this tax. For further details see Appendix XIII.

### **Rural property tax**

The rural property tax - ITR (“Imposto Territorial Rural”) is normally based on the value of land and buildings assessed for this purpose and the land area and utilisation rates. The tax rate normally ranges from 0.03 percent to 20 percent per annum, depending on the stage of use. Small rural properties are exempt, if the owner or the owner’s family cultivates the land.

### **Corporate social contribution**

Except for non-profit entities legally qualified as social assistance entities, all companies must make monthly/quarterly contributions (“contribuição social”) at the rate of 9 percent on each month or quarter’s profit (depending on the taxation scheme) before income tax, after allowing for certain adjustments. Negative contribution bases may be carried forward for offsetting purposes indefinitely. However, this offsetting is limited to 30% of the contribution basis. Contributions are not deductible for income tax purposes. The federal government applies resources obtained in the Social Welfare System.

### **Social contribution on billing**

All companies, except non-profit entities and those not subject to corporate taxation on the taxable income basis (lucro real), must make monthly contributions to this federal social financing scheme (“Contribuição Social para Financiamento de Seguridade Social” - COFINS) at the rate of 7.6 percent on gross monthly revenue after certain deductions and exclusions. However, it is possible to offset certain credits on consumables and some other expenses, according to the applicable legislation. Companies subject to a basis other than the “taxable income” basis are subject to a lower rate of 3 percent, but cannot deduct credits. Resources are used to finance social security expenses in the areas of health, social welfare and social assistance.

COFINS is also levied at 7.6 percent on the import of goods and services. Credits calculated on the “COFINS Import” paid, and on expenses related to the import of goods and services, according to the applicable legislation, may be offset against the COFINS due on monthly gross revenue.

Additionally, different tax rates apply for certain products which levy occurs only once in the supply chain.

### **Social integration program**

All companies, except those not subject to the “taxable income” basis (lucro real), must make monthly contributions to this federal program (“Programa de Integração Social” - PIS) at the rate of 1.65 percent of gross monthly revenue after certain deductions and exclusions. However, it is possible to offset certain credits on consumables and some other expenses, according to the applicable legislation. Companies subject to a basis other than the “taxable income” basis are subject to a lower rate of 0.65 percent, but cannot deduct credits on consumables. Contributions are used to create a fund for employees that can be used at the time of marriage, retirement, incapacity, or purchase a home, to an extent depending on the employee’s salary level and length of service. Income from the fund attributable to each employee may be withdrawn annually, provided that the beneficiary has been registered as an employee for over five years.

PIS is also levied at 1.65 percent on the import of goods and services. Credits calculated on the “PIS Import” paid, and on expenses related to the import of goods and services, according to the applicable legislation, may be offset against the PIS due on monthly gross revenue.

Additionally, different tax rates apply for certain products which levy occurs only once in the supply chain.

## State indirect taxes

### Valued-added tax on sales and services

Sales and services tax - ICMS (“Imposto sobre Circulação de Mercadorias e Serviços”) is levied on sales or the physical movement of goods, on freight, transport and communications services, and on electricity, normally at the rate of 18 or 19 percent for intrastate transactions and 7 to 12 percent for interstate transactions. In some states certain products are exempt, including food products. This tax is also payable on almost all imports at 7 to 25 percent but most exports are exempt. Each location of a business operation is considered as a separate taxpaying unit. The total tax assessed must be shown separately on the invoice (“nota fiscal”), but is considered an integral part of the sale or transfer amount of each item listed in the invoice. Tax is calculated on monthly operations and payment is due according to the company’s activity code. Payments are generally made the following month.

The regulations contain many requirements for documenting and recording the movement of goods for the purpose of controlling this tax. Heavy penalties are imposed for failure to comply with the regulations.

### Property tax

A property transfer tax - ITCMD (“Imposto de Transmissão Causa Mortis e Doações”) is normally payable at a rate of up to 4 percent on inheritances and donations of real estate properties and rights.

### Tax on Vehicles

The state tax on the ownership of vehicles – IPVA - is payable on a yearly basis on all kinds of vehicles, including motor boats and airplanes. The amount payable is based on the market value of the vehicle at the beginning of each year, when applicable.



## Municipal indirect taxes

### Service tax

A service tax - ISS (“Imposto sobre Serviços”) is normally levied on services rendered, except for those related to freight, certain transport and communications services and electricity, which are subject to the ICMS tax commented on previously. Rates vary from 2 percent up to the maximum rate of 5 percent, (which is more frequently applied), depending on the municipality. It is payable on a monthly basis and is not a VAT tax. For certain professional firms or individuals, these rates are substituted by an annual contribution based on the number of practicing professionals.

ISS is also levied on payments for remuneration of services rendered from abroad (import of services).

### Property taxes

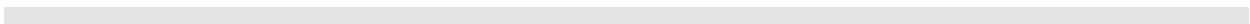
A property tax - IPTU (“Imposto Predial e Territorial Urbano”) is levied annually based on the fair market value of property in urban areas at rates that generally vary between 0.2 to 5 percent according to the municipality and location of the property. Payments can be made in up to 10 monthly instalments. In a few cases it is possible to obtain exemption from this tax.

Another property tax - ITBI (“Imposto de Transmissão de Bens Imóveis Inter Vivos”) is levied at rates of up to 6 percent on sales or transfers of properties and is payable by the acquirer. A reduced rate of 0.5 percent applies to transactions under housing programmes financed by federal government schemes.

Transfers of properties to a corporate entity as a capital subscription are exempt except where the business activity is real estate.

## Chapter 23

# Tax treaties



## Tax treaty policy

Brazil has ratified a number of tax treaties to accomplish the following objectives:

- Income derived from Brazil should be subject to Brazilian income tax only and thus an exemption or foreign tax credit should be granted by the other country.
- The effects of reducing Brazilian taxes should not be compensated by increasing taxes in the other country.
- The establishment of maximum levels of taxation for income deriving from Brazilian sources.
- The reduction of foreign taxes on profits earned abroad by Brazilian enterprises.

In general, the double-tax treaties cover only corporate and individual income tax and remittance taxes and do not affect the payment of capital gains tax (i.e. the treaties do not provide relief as they generally state that capital gains may be taxable in both countries).

Fiscal residence is usually determined in accordance with the tax law prevailing in the country in which an establishment is located. Normally, double-tax treaties contain special provisions for determining the residence of individuals who would otherwise have dual residence. This determination is generally based on the personal and economic interests of the individual.

Brazil is not actively pursuing a wide network of double-tax treaties. Treaties currently in force and those under negotiation are listed in Appendix V. Most treaties follow the OECD model.

## Withholding taxes

The withholding tax on dividends was reduced from 15 percent to zero for profits generated from January 1996. The rate for remittances of interest and royalties was also reduced from 25 percent to 15 percent in January 1996. Treaty rates in excess of 15 percent are automatically reduced.

## Permanent establishment

A branch is considered to be a permanent establishment, as is an agent who has powers to bind an overseas principal contractually (see Chapter 8).

Each double-tax treaty should be consulted for further definition of a permanent establishment.

## Other articles

There are no special tax treaty benefits for industrial and commercial income.

Earnings from properties are generally subject to the tax regulations of the country where they are located.

Shipping and aircraft transport companies are normally taxed only in the country where their head offices are located.

## Elimination of double taxation

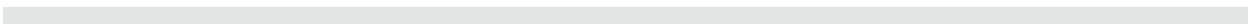
Each double-tax treaty should be consulted to determine the method of eliminating double taxation, tax credit or exemption.

## Exchange of information

Although double-tax treaties provide for an exchange of information on a confidential basis, this does not include disclosure of any trade, business, commercial, industrial or professional secrets.

## Competent authority/Mutual agreement

Any case arising in relation to a double-tax treaty may be submitted to the competent authorities of the country in which the taxpayer is resident. If no satisfactory solution is reached, the competent authorities of both countries will try to settle the case by agreement in order to maintain the spirit of the treaty.

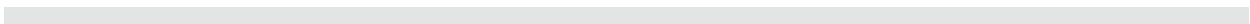


## Appendices

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### Appendix I

# Corporate income tax & Social contribution rates



Rates applicable to taxable income (2010).

	%
Income tax rate	15
Surcharge on taxable income in excess of R\$ 240,000	10
Social contribution (see note 2)	9

Notes:

1. Income tax and social contribution payments can be made on a monthly or quarterly basis. As a general rule, the annual income tax return ("DIPJ") for the previous calendar year is prepared by the last business day of June of the following year and submitted to the authorities, whereupon any further payable or refundable tax is settled. However, monthly payments may also be final.
2. In addition to corporate income tax, all legal entities are subject to a social contribution to the federal government at the rate of 9% (except for insurance and financial institutions, subject to a 15% rate), which is not deductible for corporate income tax purposes. The tax basis is the profit before income tax, after certain adjustments.
3. Accordingly, the current maximum consolidated effective tax rate on taxable income is 34%.
4. The official exchange rate at October 16, 2009 (the deadline for delivery to the tax authorities of the DIPJ relating to the 2008 calendar-year) was USD 1= R\$ 1.71.

## Appendix II

# Tax depreciation rates

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<b>Type of asset</b>	<b>Rate per annum %</b>
Buildings - industrial, office and warehouses	4
Building improvements	4
Machinery and installations, air-conditioning, lifts and equipment	10
Tools and moulds	20
Computer hardware	20
Office installations	10
Office furniture and fittings	10
Automobiles and lorries	20/25
Aircraft, including engines	10

Notes:

1. Rates are applied on the straight-line basis.
2. Rates for machinery and installations, air-conditioning, lifts and equipment are for an 8-hour working shift per day. For double shifts the rates can be increased by 50 percent and for triple shifts by 100 percent.
3. Rates may be decreased or increased if the taxpayer can prove that the asset concerned has a correspondingly longer or shorter life.
4. Leasehold improvements are normally depreciated over the period of the lease.

Further regulation on this subject is expected in view of the new Brazilian accounting standards introduced by the new Corporate Law and other related provisions. Please see Chapter 12 for further information.

## Appendix III

# Corporate tax calculation

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**Year ending December 31, 2009**

	<b>R\$</b>
Net income before income tax and social contributions	11,800,000
Less: Dividends received (Note 2)	1,000,000
Net taxable income	10,800,000
Tax thereon:	
Basic income tax at 15%	1,620,000
Surcharge: 10% from 240,000 to 10,800,000	1,056,000
Total federal income tax	2,676,000

The social contribution calculation is as follows.

	<b>R\$</b>
Net taxable income	10,800,000
Social contribution at 9% (Note 3)	972,000

**Notes:**

1. Dividends received from other Brazilian companies, including affiliated companies, are not subject to withholding income tax and are excluded from the income tax calculation.
2. The income tax/social contribution may be computed in three different ways, as follows:
  - a. On a “presumed taxable income” basis:

Only corporate taxpayers with gross annual revenue of under R\$ 48 million in the preceding year may opt for this income tax computation method. The income tax rate of 25% is imposed on a percentage of gross monthly revenue (from the sale of goods/products/services) plus capital gains and money-market income, less some minor adjustments such as unconditional discounts and cancelled sales. The taxable basis for other diversified activities is determined according to the proportionate amount of gross revenue.

## Taxable basis as a percentage of gross monthly revenue

Type of activity	%
In general	8.0
Oil, gas, lubricants etc. (retail)	1.6
Transport (except cargo)	16.0
Services in general	32.0

The social contribution liability, at the rate of 9%, presumes a taxable basis corresponding to the sum of: (i) the amount equal to 12% of gross monthly revenue (32% for services) and (ii) capital gains and money-market income.

## b. On an “arbitrary” basis

Established solely at the discretion of the tax authorities, should the taxpayer fail to comply with the regulations for keeping records and/or computing taxable income.

## c. On an “actual taxable income” basis

This basis is computed in accordance with the corporate records and adjusted for tax purposes in line with the applicable regulations. Legal entities with the following characteristics/activities must use this method:

- |   |   |
|---|---|
| i. Annual gross revenue in the preceding calendar year of more than R\$48 million                           | iv. Legal entities benefiting from income tax incentives (reduction or exemption)   |
| ii. Financial institutions in general, leasing companies, insurance companies and non-private pension funds | v. Legal entities that have made the monthly payments on an estimated basis during the tax year;  |
| iii. Legal entities that have profits, income or capital gains from abroad                                  | vi. Legal entities that render services related to credit and market assistance, credit management, risks and selection, management of receivables, and payables assistance or factoring. |

These corporate taxpayers estimate their monthly tax payments (income tax and social contribution) by using the computation rules applicable for the presumed taxable income basis. Payments are due on the last working day of the following month. A final balance sheet and statement of income must be drawn up at year-end and the annual tax liability (including the income tax surcharge) computed. At this time, nominal money-market gains as well as gains on transactions in the stock/commodities exchanges and/or futures markets must be considered; taxes withheld at source are treated as tax credits. Any difference between the final tax liability computed at year-end and the amounts estimated and paid in advance or withheld at source will either be paid up to the last working day of the month of March (subject to interest) or claimed as a tax credit. The taxpayer may at any time suspend or reduce the monthly advance payments upon proof that amounts already paid or withheld at source exceed the amount due on actual taxable income for the same period.

Alternatively, the above corporate taxpayers may draw up quarterly financial statements, calculate the appropriate taxable income and pay the income tax (including surcharges) and the social contribution thereon by the last working day of the following month. Taxes paid under this alternative are considered final, and the annual financial statements are not required for tax purposes.

The official exchange rate at October 16, 2009 (the deadline for submitting the DIPJ for 2008 to the tax authorities) was USD 1 = R\$ 1.71.

3. Except for insurance and financial institutions, subject to a 15% rate.
4. As mentioned in Chapter 13, taxpayers which opted for the Transitional Tax Scheme (Regime Tributário de Transição – RTT) for 2008 and 2009 (the scheme is mandatory from FY 2010) must adjust their income tax and social contribution taxable basis as to avoid any adverse tax consequences deriving from the new Brazilian accounting standards implemented from FY 2008.

# Appendix IV

# Withholding taxes



Payments of dividends, interest and royalties are subject to withholding income tax at the following rates.

Recipient	Dividends %	Interest %	Royalties %
Resident:			
Companies	Nil	15-22.5	Nil
Individuals	Nil	Progressive Rate	Progressive Rate
Non-resident companies and individuals:			
Nontreaty (non tax haven)	Nil	15	15
Tax Haven	Nil	25	25
Treaty (Note 1):			
Argentina	Nil	15	15
Austria	15	15	25, 15, 10
Belgium	15, 10	15, 10	20, 15, 10
Canada	15	15, 10	25, 15
Chile	15, 10	15	15
China, P.R.	15	15	25, 15
Czech Republic	15	15, 10	25, 15
Denmark	25	15	25, 15
Ecuador	15	15	25, 15
Finland	10	15	25, 15, 10
France	15	15, 10	25, 15, 10
Hungary	15	15, 10	25, 15
India	15	15	25, 15
Israel	15, 10	15	15, 10
Italy	15	15	25, 15
Japan	12.5	12.5	25, 15, 12.5
Korea, Republic	15, 10	15, 10	25, 15, 10
Luxembourg	25, 15	15, 10	25, 15
Mexico	15, 10	15	15, 10
Netherlands	15	15, 10	25, 15
Norway	15	15	25, 15
Peru	15, 10	15	15
Philippines	25, 15	15, 10	25, 15}
Portugal	15, 10	15	15
Russia (Note 2)	15, 10	15	15
Slovakia	15	15, 10	25, 15
South Africa	15, 10	15	15, 10
Spain	15, 10	15, 10	15, 10
Sweden	25	25	25
Ukraine	15, 10	15	15

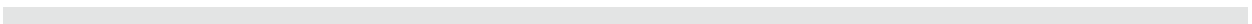
In addition, tax is withheld from other payments as follows.

	%
Repatriated capital in excess of registered amount (Note 3)	15
Gains on sale or transfer of shareholdings by foreign shareholders or assets located in Brazil (Note 3)	15

Notes:

1. Treaty rates in excess of those for nontreaty countries are automatically reduced. As can be seen, dividends paid are not subject to any withholding tax.
2. The double-tax treaty (DTT) between Russia and Brazil is still pending ratification.
3. In the case of residents in tax havens the capital-gains tax rate is increased to 25%.





## Appendix V

# Tax treaties

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## Treaties in effect

<b>Country</b>	<b>Date of treaty</b>		<b>In force since</b>	
Argentina	May	1980	December	1982
Austria	May	1975	July	1976
Belgium	June	1972	July	1973
Canada	June	1984	December	1985
Chile	April	2001	July	2003
China P.R.	August	1991	January	1993
Czech Republic	August	1986	November	1990
Denmark	August	1974	December	1974
Ecuador	May	1983	December	1987
Finland	April	1996	December	1997
France	September	1971	May	1972
Hungary	June	1986	July	1990
India	April	1988	March	1992
Israel	December	2002	September	2005
Italy	October	1978	April	1981
Japan	January	1967	December	1967
Korea, Republic of	March	1989	November	1991
Luxembourg	November	1978	July	1980
Mexico	September	2003	November	2006
Netherlands	March	1990	November	1991
Norway	August	1980	November	1981
Peru	February	2006	August	2009
Philippines	September	1983	October	1991
Portugal	May	2000	October	2001
Slovakia	August	1986	November	1990
South Africa	November	2003	July	2006
Spain	November	1974	December	1975
Sweden	April	1975	December	1975
Ukraine	January	2002	April	2006

The Tax Treaties with Paraguay and Russia, although already signed, are not yet in force.

The provisions included in the tax treaties are normally effective in each signatory country as from the first day of January of the following year.

## Treaties limited to airlines

Brazil is a signatory to the 1944 Convention on International Civil Aviation.

Treaties under negotiation

Treaties are under negotiation with the following countries:

United Kingdom

Romania

Switzerland

Trinidad and Tobago

United States

Venezuela

## Social security totalisation agreements

Agreements have been signed with the following countries.

Argentina

Cape Verde

Chile

Italy

Greece

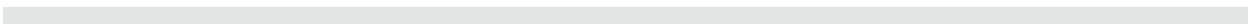
Paraguay

Portugal

Spain

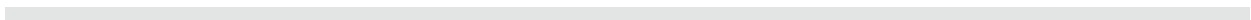
Uruguay

Luxembourg



# Appendix VI

# Individual tax rates



The following tax table is applicable to income tax payable in 2010.

**Net taxable income (1)**

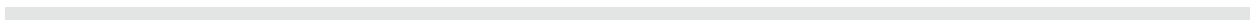
<b>Over</b>	<b>Not over</b>	<b>Tax rate (2)%</b>	<b>Amount to be deducted from (1) times (2)</b>
\$0	R\$ 17,989.80	0%	-
R\$ 17,989.81	R\$ 26,961.00	7.5%	R\$ 1,349.16
R\$ 26,961.01	R\$ 35,948.40	15%	R\$ 3,371.28
R\$ 35,948.41	R\$ 44,918.28	22.5%	R\$ 6,067.44
R\$ 44,918.28	---	27.5%	R\$ 8,313.36

Notes:

1. These rates apply to all types of tax returns, i.e. married individuals filing jointly or separately and single taxpayers.
2. An individual who receives income in any month from a source other than an employer must prepare a compulsory monthly tax computation ("carnê leão") and pay any tax due by the last working day of the following month.
3. At December 31, 2009 the official exchange rate was USD 1 = R\$ 1.74.

Appendix VII

# Personal allowances and deductions





## Allowances

A taxpayer may deduct a flat allowance of R\$ 1,808.28 per annum per dependent in 2010.

A further allowance of up to R\$ 17,989.80 may also be taken relating to annual income from retirement or military pensions as from the year in which the taxpayer reaches 65 years of age.

## Deductions

The following may be deducted from taxable income.

- Contributions to the Brazilian Social Security System.
- Medical, dental and hospital expenses that are not covered by an insurance policy or subject to refund by any entity (with no limits).
- Amounts paid to recognised Brazilian health insurance/medical cost coverage plans (with no limits).
- Contributions to recognised Brazilian private pension funds (limited to 12% of the individual's annual income).
- Alimony payments based on a court order or other legal agreement.
- Schooling expenses up to an annual limit of R\$ 2.830.84 per student.

Business expenses are not deductible.

All individuals can elect to file a simplified tax return and take the benefit of the standard deduction, equal to 20% of the gross income, but limited to R\$ 13,317.09, which substitutes all other deductions.

The taxpayers may also deduct from the tax due and not from the taxable income, the following:

- Donations made to official government, state and/or municipal childcare entities.
- Certain qualified contributions to cultural and sports projects.
- Investments in audiovisual activities.

Note, however, that those deductions are limited to 6% of the tax due.

- Contributions made by the taxpayers to the official social security system on behalf of registered employees within certain limits.

## Appendix VIII

# Individual tax calculation

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2010

Assumptions

Resident, married with two children, wife takes classes, pays alimony to first spouse.

Income, gains and deductible expenses in 2010 were as follows.

	<u>R\$</u>
<b>Earnings</b>	
Brazilian-source salary income	110,000
Foreign-source income	80,000
Short-term money-market income - Brazilian source	5,000
Capital gain - Profit on sale of property	5,000
<b>Deductions</b>	
Social security contributions	4,510
Medical expenses	1,500
Alimony payments	10,000
Schooling expenses	7,000
<b>Income tax withheld at source (Brazil)</b>	
Brazilian payroll withholding tax	30,250
<b>Income tax paid abroad</b>	
Income tax paid to a foreign tax jurisdiction on foreign-source income	16,415
Withholding tax on short-term money-market income	750
Income tax on capital gain	750

## Tax computation on return

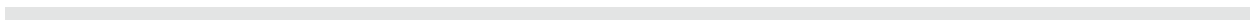
	<b>R\$</b>
<b>Earnings</b>	
Brazilian-source salary income	110,000
Foreign-source income	80,000
Short-term money-market income - Brazilian source	5,000
Capital gain - Profit on sale of property	5,000
Gross income	200,000
Less - Income taxed at source only:	
Short-term money-market income	5,000
Capital gain subject to special taxation (Note 1)	5,000
Net taxable income before allowances and deductions	<u>190,000</u>
<b>Deductions</b>	
Less - Allowances and deductions:	
Social security contributions	4,510
Dependents (three)	5,425
Medical expenses	1,500
Alimony payments	10,000
Schooling expenses (for three)	8,492
Net taxable income	<u>160,073</u>
<b>Income Tax Calculation</b>	
Income tax at 27.5%	44,020
Less - Amount deductible relating to lower tax brackets	8,313
	35,707
Less - Tax paid at source:	
On Brazilian-source salary income	30,250
On foreign-source income	16,415
Refund (Note 2)	<u>10,958</u>

Notes:

1. Capital gains are taxed at source only at the rate of 15%, payable by the taxpayer by the last working day of the following month.
2. Any tax due is payable in full at the time of filing or, at the taxpayer's discretion, in up to six instalments as from April 30. Each instalment may not be less than R\$ 50 and if the amount due is less than R\$ 100 it should be paid in a single instalment.
3. The official exchange rate in December 2009 was USD 1 = R\$ 1.74.

Appendix IX

# Tax on foreigners working in Brazil



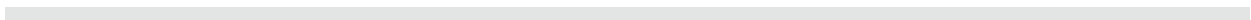
Individuals entering the country on temporary work visas under an employment contract with a company incorporated in Brazil are considered “tax resident” from their arrival. Foreign and Brazilian earnings are therefore taxed, as of that date, in accordance with the progressive tax rates.

Individuals entering the country on other temporary visas are considered “tax resident” of Brazil after completing a stay of 183 days in the country within any given period of 12 months. From the 184<sup>th</sup> day, the individuals are considered resident and taxed on their worldwide income. Foreign and Brazilian earnings are therefore taxed in accordance with the progressive tax rates. During the non-residency period, only Brazilian source income is subject to taxation at a flat tax rate of 25%.

It should be noted that the 183 days do not necessarily have to be consecutive. The 12-month period can commence from the date of any entry into the country. The residency taxation rules are applied as of the 184<sup>th</sup> day of a foreigner’s stay. There is no income tax filing obligation for the period of non-residency.

# Appendix X

# Wealth tax





Wealth tax is not yet applicable in Brazil. The 1988 Federal Constitution refers to a wealth tax to be imposed, but regulations have not yet been issued.

Appendix XI  
**Estate,  
inheritance and  
gift tax rates**

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The income arising from the estate of a deceased person and up to the final distribution of the estate is subject to income tax at the same rates for individuals (see Appendix VI).

For inheritance and gift taxes please see Chapter 21.

Appendix XII  
**FGTS, social  
security  
contributions and  
benefits**

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## FGTS deposits

The employer is obliged to make monthly deposits in the employees' name in government blocked accounts, equivalent to 8% of the remuneration paid. This contribution is a labour right, denominated the Employee Severance Indemnity Fund – FGTS.

## Social Security contributions

### Employer's contributions

- 20% of the employee's monthly remuneration
- Employers are also subject to the following contributions:

	<b>Percentage of employee's remuneration</b>
Education fund	2.5
Work-related accident insurance - maximum (1)	5.25
SESI/SESC Social programs	1.5
SENAI/SENAC Training programmes (2)	1.0
SEBRAE Program for small companies	0.6
INCRA Supplementary rural pension	0.2
Total	<u>11.05</u>

The contributions listed above vary according to the activity performed by each company, except for FGTS, which is a mandatory payment made on behalf of all employees, irrespective of activity.

#### Notes

1. The contribution related to Occupational Environmental Risks (RAT) varies from 0.5% to 5.25% of gross payroll depending on the intensity of risk existent in the workplace. As from Jan/10, companies were given a factor according to the number of work-related accidents registered (prior to 2010, companies with the same activity paid the same rate as work-related accident insurance). The factor calculated by the Social Security Authorities for each company individually varies from 0.5 to 1.75 (as from 2011 it will vary up to 2.0) and must be multiplied by the work accident rate (determined according to the economic activity of the company, which varies from 1% to 3%). The maximum amount to be paid as work accident insurance in 2010 may therefore be as high as 5.25%.
2. Applicable to industrial and commercial companies only.
3. All contributions are deductible for corporate income tax purposes.

#### Employees' contribution

From - R\$	To - R\$	Contribution %
0	1,024.97	8
1,024.98	1,708.27	9
1,708.28	3,416.54	11

Ceiling: R\$ 375.82

#### Notes:

1. Contributions are deducted from employees' monthly remuneration.
2. Contributions are deductible for individual income tax purposes.
3. The salary base for contributions is adjusted annually according to minimum wage restatements.

## Social security benefits

### Pensions

Type	Requirements
Old age:	
Male	180 months of contribution and 65 years of age
Female	180 months of contribution and 60 years of age
Period of service	
Male	35 years of contribution
Female	30 years of contribution
Disabled	12 months of contribution

The monthly pension varies according to the size of the contributions made. The maximum amount is R\$ 3,416.54. There is a minimum contribution period for pensions for individuals disabled due to accidents.

### Sickness benefit and accident insurance benefit

The maximum amounts payable for each of these benefits is also R\$ 3,416.54 per month.

### Unemployment benefit

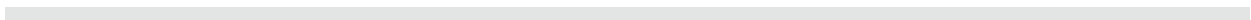
The unemployment benefit is paid by the government and can reach the maximum of R\$ 954.21 per month. To receive this benefit, the unemployed individual must fulfil certain conditions determined by the legislation and they will only receive it for a period of three to five months.

#### Notes:

1. All benefits are adjusted annually.
2. On February 1, 2010 the official exchange rate was USD 1 = R\$ 1.85.
3. The employment benefit is strictly connected to the minimum wage variation. Therefore, any change in its value is reflected in the benefit value.

# Appendix XIII

# Indirect taxes





## Federal

### Excise tax (IPI)

This federal value-added tax is levied at varying rates on nearly all sales and transfers of products industrialised in or imported into Brazil, depending on the degree of necessity. Industrialisation may be incomplete, partial or intermediate. Examples of average rates for various products and groups of products are as follows.

	%
Food in general	0
Soft drinks	40
Alcoholic drinks	8/60
Plastic and rubber	0/20
Textile materials	0/10
Machinery and equipment	2/30
Precision instruments	0/15
Cigarettes	30/330

Exports are exempt. Imports are normally taxed at the same rate as Brazilian-made products. Rates are changed frequently and vary depending on the product.

### Customs duties (II)

Customs duties are levied on foreign goods upon entry into Brazilian territory. Rates vary in accordance with product specifications listed in the Common External Tariff (TEC). Exemptions or reductions may be granted temporarily. For further details see Chapter 8.

### Payroll taxes

These taxes are summarised in Appendix XII above.

## Tax on financial transactions (IOF)

This tax is levied at various rates, which may be summarised as follows.

	%
Loans and credit operations	0.0041/day
Insurance policies	0 to 7.38
Incoming loans repayable in foreign currency in less than 90 days	5.38
Incoming resources for application in fixed-income funds	0 to 1
Incoming loans for periods longer than 90 days	0

Rates may be changed at any time, via Federal Decree.

## Rural property tax (ITR)

Taxation at the minimum rate of 0.03% per annum on appraised property values but can be increased to up to 20%, depending on the degree of utilisation and exploration and the total area of the property.

## Social contribution on billing (COFINS)

This monthly contribution, in its noncumulative basis, is levied at the rate of 7.6% on corporate gross revenue after certain deductions and exclusions. However, it is possible to offset credits calculated on certain consumables against tax due. As from August 2004, financial income is not subject to this contribution. Companies not subject to the noncumulative basis are levied at the rate of 3% and may not deduct credits.

Special schemes are provided for certain business, such as the pharmaceutical, automobile and tyres industry, petroleum and its derivatives and beverages, which are subject to different rates.

See an example COFINS calculation under PIS below.

## Social Integration Program (PIS)

This monthly contribution, in its noncumulative basis, is levied at the rate of 1.65% on corporate gross revenue, including financial income, and after certain deductions and exclusions. However, it is possible to offset credits calculated on certain consumables to reduce tax due. As from August 2004, financial income is not subject to this contribution. Companies not subject to the noncumulative basis are levied at the rate of 0.65% and may not deduct credits.

Special schemes are provided for certain business, such as the pharmaceutical, automobile and tyres industry, petroleum and its derivatives and beverages, which are subject to different rates.

PIS and COFINS calculation example:

**Revenue and Expenses**

Internal sales revenue	200,000
Export revenue	150,000
Financial income	30,000
Raw material acquisition	50,000
Equipment leasing expenses	10,000
Electricity	2,000
Depreciation (1)	8,000

**Tax computation**

**Tax calculation basis**

Internal sales revenue	200,000
Export revenue	150,000
Financial income	30,000
Total	<u>380,000</u>
Less	
Export revenue	150,000
Financial income	30,000
<b>Tax calculation basis</b>	<b>200,000</b>

	<u>COFINS</u>	<u>PIS</u>
<b>Tax due before discount</b>	<b>15,200</b>	<b>3,300</b>

Credits calculation	
Raw material acquisition	50,000
Equipment leasing expenses	10,000
Electricity	2,000
Depreciation (1)	8,000
Deduction calculation basis	<u>70,000</u>

	<u>COFINS</u>	<u>PIS</u>
<b>Credit to be deducted</b>	<b>5,320</b>	<b>1,155</b>

Tax to be paid	9,880	2,145
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**State****Sales and Services Tax (ICMS)**

This state valued-added tax is levied on sales or physical movement of goods; on freight, transport and communication services; and on electricity, as follows.

	%
Intrastate transactions	up to 25
Interstate transactions	7 to 12
Most imports	up to 25

In some states certain products are tax exempt, including foodstuffs. Exports are also exempt. The lower interstate rates are normally charged on transfers to smaller, less-developed states.

**Transfer tax – Inheritance and Gift Tax (ITCMD)**

A property transfer tax is normally payable at a rate of up to 4% on inheritances and donations of properties and rights.

**Municipal****Service tax (ISS)**

Rates vary from 2% to 5%. The rates listed are more common for services rendered in larger cities.

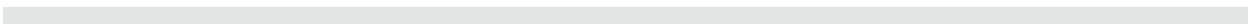
	%
Hospitals, schools, colleges	2
Civil construction,	5
Leasing	2
Tourism sector	5
Specified entertainment activities	5
Other services	5

**Property tax (IPTU)**

This annual tax amounts to between 0.2% and 5% of appraised fair property values.

**Tax on sale or transfer of properties (ITBI)**

A property transfer tax of up to 6% is payable by the acquirer on sales or transfers of real estate.



# Appendix XIV

# Setting up in Brazil - A Checklist

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This checklist illustrates points that investors and their advisers should consider when contemplating setting up a business enterprise in Brazil.

## I. Investor considerations

### Market - Existing and potential

- Existing and potential market for goods or services.
- Competition.
- Market surveys.
- Patent, trademark and design protection.
- License to trade (some sectors only).
- Franchising.
- Industrial standards.

### Preparation of a business plan

- Determination of overall strategy.
- Financial projections, including cash flow.
- Assistance from professional advisers.

### Form of entity to incorporate a subsidiary

- Corporation (“sociedade por ações”).
- Private limited-liability company (“limitada”).
- Partnership.
- Branch.
- Joint venture (incorporating a company with one of the corporate forms mentioned above).

(See Appendix XV for details)

### Capital structure

- Nature of business and minimum capitalisation requirements.
- Import of capital.
- Foreign-equity limitation.
- Possibility of raising capital from local sources.
- Availability of financing - Local/foreign source.
- Repatriation of interest and principal of foreign-source loans.
- Bank financing.
- Equity issues.
- Injection of cash from parent or holding company.
- Government assistance.
- Other forms of financing (debentures/ share issuances).
- Lease or purchase of assets.
- Debt/equity ratio.
- Tax implications.
- Obtain advice from bankers, attorneys and accountants.

**Location**

- Logistics.
- Market and labour factors.
- Transport facilities.
- Availability of tax/nontax incentive development areas/enterprise zones.
- Tax implications - Federal, state and municipal.

**Premises**

- Type needed.
- Own or leased.
- Current requirements.
- Expansion possible.
- Storage/warehousing.
- Insurance.
- Health and safety regulations (licenses).
- Planning restrictions.
- Restrictions on ownership of buildings, land.
- Approvals required.
- Tax implications.

**Management - Availability and compensation**

- Legal requirements.
- Skills required.
- Compensation levels.
- Availability locally; recruitment.
- Possibility of bringing own overseas staff.
- Limitations on expatriate staff - Number and compensation.
- Executive recruitment services.
- Pension and other retirement arrangements.
- Visa requirements.
- International schools for children of expatriate staff.
- Tax aspects.

**Labour - Availability and compensation**

- Types of employee engagement.
- Numbers and types needed.
- Compensation levels.
- Terms of employment.
- Work permits.
- Recruitment.
- Employee benefits/pensions.
- Payroll taxes and social security costs.
- Training programs.
- Unions.
- Government assistance, grants.



### **Production capabilities**

- Capacity - Current and projected.
- Capital commitments - Initial and projected.
- Raw materials - Sources, availability, customs duties.
- Technology available.
- Import restrictions.
- Projected costs - Overall and unit.

### **Selling the product**

- Projected costs.
- Promotion methods.
- Selection of advertising and/or public relations firms.
- Market campaigns.
- Sales force.
- Sponsorship.
- Exhibitions and trade shows.
- Pricing policies.
- Exporting process.
- Sales tax, excise tax and indirect tax requirements.
- Existence of sales price controls.
- Tax implications.

### **Incorporation procedures**

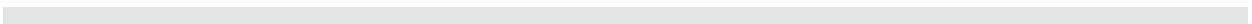
- Appointment of professional advisers - Attorneys, accountants, tax advisers and bankers.
- Registration.
- Ordering stationery/design of logo.
- Corporate secretarial and administrative services.

## **II. Legal considerations**

- Approval of foreign investment by government authorities.
- Documentation and registration requirements for type of entity selected.
- Permits and licenses required.
- Company name.
- Statutory operating and audit requirements.
- Conduct of the entity.
- Business contracts and agreements.
- Employment contracts.
- Property evaluation and documentation.
- Business, banking and industrial regulations.

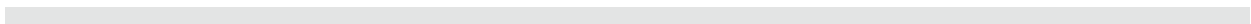
### III. Accountancy considerations

- Evaluation of industry/feasibility study.
  - Tax planning.
  - Requirements for tax purposes.
  - Profit planning for initial years.
  - Accelerated depreciation.
  - Management control systems (i.e. financial management systems, employee records, inventory control).
  - Financing requirements.
  - Bookkeeping requirements.
  - Use of computers.
  - Financial statement preparation.
  - Management consulting.
  - Help from auditors.
  - Projections.
-



Appendix XV

# Structuring an investment in Brazil - A Checklist



This checklist illustrates the points that investors and their advisers should consider when deciding the form of business entity by which to operate.

## I. Corporations (sociedade por ações)

### **Investor considerations**

- Rules and limitations for foreign ownership/shareholders.
- Number of founding shareholders required, including local shareholders, and voting limitations.
- Advantages/disadvantages of corporations.
- Availability of local funding, including equity issuances.
- Capital payment.
- Degree to which capital must be imported.
- Extent of powers to be given to the executive officers/board of directors.
- Requirements as to local and/or labour representation on board of directors.
- Repatriation of capital and profits.
- Publishing of corporate documents.

### **Legal considerations**

- Organisation and incorporation requirements.
- Registration requirements.
- Documentation.
- Management structure.
- Residency and representation of foreign shareholders/members of the board of directors.

### **Accountancy considerations**

- Tax advantages of corporations.
- Tax planning opportunities to minimise tax.

## II. Private limited-liability companies (limitada) and partnerships

### Investor considerations

- Rules and limitations on foreign quotaholders/partners.
- Requirement for residency (or legal representation) of quotaholders/partners.
- Advantages/disadvantages of “limitadas”/partnerships.
- Repatriation of capital and profits.

### Legal considerations

- Incorporation requirements.
- Registration requirements.
- Documentation.
- Management structure.
- Residency and representation of quotaholders/partners.

### Accountancy considerations

- Taxed as conduit or entity.
- Tax planning opportunities to minimise tax.

## III. Branches

### Investor considerations

- Limitations on foreign interests.
- Advantages/disadvantages of branches.
- Capital requirements.
- Costs and exposure of publishing financial statements.
- Repatriation of capital and profits.

### Legal considerations

- Incorporation requirements.
- Capital to be assigned to the branch for legal purposes.
- Registration requirements.
- Permanent legal representative residency.

### Accountancy considerations

- Taxation of a branch.
- Taxation of profits, whether or not repatriated.
- Taxation of reinvested profits.
- Tax planning opportunities to minimise tax.

## IV. Joint ventures

### **Investor considerations**

- Government and local authorities' view of joint ventures.
- Emphasis on foreign participation in joint ventures.
- Advantages/disadvantages of joint ventures.

### **Legal considerations**

- Incorporation requirements.
- Registration requirements.
- Documentation.

### **Accountancy considerations**

- Taxed as conduit or entity.
- Tax planning opportunities to minimise tax.

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