



cutting through complexity

TAX

Investment in Brazil

11th Edition

kpmg.com/BR





cutting through complexity

Investment in Brazil

11th Edition

© 2011 KPMG International Tax Services Ltd., a Brazilian limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

© 2011KPMG Transnational Tax Services Ltda., a Brazilian limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in the Brazil.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

11th edition. 20,000 copies printed in Brazil, in September 2011.

Electronic version available at www.kpmg.com/BR

Design by Índice Arte Gráfica e Editoração Ltda. (indice@indicecomunic.com.br)

Dados Internacionais de Catalogação na Publicação (CIP) (Câmara Brasileira do Livro, SP, Brasil)

Investment in Brazil / KPMG . – 11. ed. –
São Paulo : Escrituras Editora, 2011.

ISBN 978-85-7531-382-4

1. Análise de investimentos - Brasil
2. Investimentos - Brasil I. KPMG.

11-10154

CDD-332.630981

Índices para catálogo sistemático:
1. Brasil : Decisões de investimentos :
Economia financeira 332.630981

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Preface

During the recent and most severe global economic crisis in more than six decades, Brazil proved to be a solid strong economy and has been pointed as one of the largest consumer markets in the world as well as a major center of opportunities for foreign investors.

As the *Financial Times* has recently stated, Brazil "is one of the fabled fast-growing BRIC economies – Brazil, Russia, India and China – that are reshaping the international order. And as the host of the next football World Cup and, in 2016, the Olympic Games, Brazil has confidently arrived on the global stage." (September 28, 2010).

This economic and political scenario undoubtedly requires a better understanding of the main factors that can affect investments in the country.

The performance of multinationals looking to get their share of this ever-growing market depends greatly on identifying the right opportunities while dealing with the challenges of operating in a foreign environment.

In this sense, this publication has the purpose to contribute for the improvement of the knowledge about Brazil, especially from an economic perspective.

Following, you will find useful information about the country and the main factors that may affect the investments taken herein.

Moreover, we hope this booklet will provide investors and entrepreneurs with an introduction to basic Brazilian tax law, as well as an overview of the principles of taxation that every savvy business person should be cognizant of.

Although covering many relevant areas, it cannot of course be exhaustive, and it is not designed to provide the complex and detailed information required for decision-making on investments.

All information contained in this booklet is valid as of June 2011. Every effort has been made to ensure that the information in this booklet is current.

However, since laws change frequently, comprehensive advice should always be sought before implementing any plan to invest in Brazil.

We are looking forward to assisting you with the handling of your investment planning.

Chapter 1

Investing in Brazil	11
Market Entry	13
Key Considerations when Investing in Brazil.....	14
Geography	15
Climate	16
Population	16
Language.....	18
Currency	18
History	18
Inflation	20
Government	20
Economy and Fiscal Policy.....	20
Privatization	21
Infrastructure.....	22
Oil and Gas.....	22
Real Estate	23
Brazil Transnational Companies	24
2014 World Cup & Rio 2016 Summer Olympics	25

Chapter 2

How to Invest.....	27
Acquisition	28
Succession Issues	30
Due Diligence	30
Tax Structuring	32
Corporate reorganizations	35
Anti-avoidance Rules	38

Chapter 3

Establishing a Business in Brazil.....	39
Structuring the Business.....	40
Types of Entities	43
Other forms of legal entities and partnerships.....	47
Bidding	48

Chapter 4

Foreign Exchange Controls	49
Restriction on Foreign Investments	50
Acquisition of Real Estate	50
Foreign Exchange Policy	51

Chapter 5

Corporate Taxation	55
Federal Corporate Income Taxes	56
Gross Revenues Taxes	60
Indirect Taxes	61
Import taxes	63
Other Federal Taxes	64
Other State Taxes	66
Other Municipal Taxes	66

Chapter 6

Incentives	67
Federal, State and Local Incentives	68
Regional and Industry Incentive Programs	69
Manaus Free Trade Zone (MFTZ)	70
Incentives Related to Goods	76
World Cup Tax Incentives	76

Chapter 7

International Tax Matters	77
Permanent Establishment	78
Tax Treaties	79
Low Tax Jurisdictions and Privileged Tax Regimes	80
Thin Capitalization Rules	82
Capital and Profit Repatriation	82
Capital Gains	85
Investments in Financial and Capital Markets by Non-residents	85
Taxation of the Foreign Profits (CFC Rules)	86
Brazilian Transfer Pricing Rules	87

Chapter 8

Trade & Customs	91
Exports	92
Imports	94
Trading Companies	96
Trade Treaties	96
Special Customs Regimes/Programs	98
SISCOMEX Carga System	100

Chapter 9

Accounting	101
Introduction	102
Non-financial Institutions	103
Listed entities	104
Financial Institutions	104
Insurance companies	105
Filing Obligations	105

Chapter 10

Labor	107
General Requirements	109
Employee Remuneration	110
Labor Rights	111
Payroll Taxes	112

Chapter 11

Taxation of Individuals	115
Foreign Workers	116
Concept of Residence	117
Repatriation Process	117
Basis of Assessment	117
Allowances and Deductions	118
Foreign Income <i>Carnê-leão</i>	119
Annual Income Tax Return	119
Taxation of Capital Gains Related to Individuals	119

Chapter 12

Other Legal Considerations	120
Regulatory Agencies	121
Consumer Rights	122
Intellectual Property	123
Franchising	126
Antitrust Rules	126
Arbitration	127
Bankruptcy	127
Corporate Governance	128

Chapter 13

Sustainability	130
Government	131
Market and Financial Initiatives	133
Business and Multi-stakeholder Initiatives	134

Chapter 14	
KPMG in Brazil	136
Audit	137
Tax	137
Advisory	138
Corporate Citizenship in KPMG.....	140
KPMG Global Business Group.....	144
Growing with strength and solidity	145
Glossary.....	146
Acknowledgments.....	153
Contacts	154



Chapter 1

Investing in Brazil

There used to be a saying about Brazil, it is the country of the future... and will always be... But it appears that now **the future of the Country has arrived.**

Recently profiled as the “World’s Next Economic Superpower,” there does not to be anything, not even a world economic crisis, that can put a stop to the country’s growth. The rising middle class, the strong demographic of growth, a stable financial environment and both a public and private commitment to infrastructure and financial investment have **laid the foundations to a future that some thought would not arrive.**

Over the past 3 years, 45 million Brazilians moved into the middle class. And, with their ascent into the new social stratum came a world of consumer opportunity. These new classes “C-ers” are buying everything from cell phones to refrigerators, they are using the internet more frequently than previous “C-ers” and they are buying homes for the first time in their lives. This rising consumer class is expected to be **a driving force to the strength of the consumer markets.**

In addition to a rising middle class, Brazil is expected to benefit from what is being called the “demographic bonus” which is to say that the current youthful population is expected to mature over the next 20 years. The average age of 29 is expected to increase to 34 in 2020 and to 38 by 2030- a similar transformation to what previously took place in the United States.

According to leading economists Cássio Turra and Bernardo Queiroz of the Federal University of Minas Gerais, Brazil has the potential to grow 2.5% per year exclusively as a result of this demographic bonus.

The strong consumer economy is expected to be supported with **stable economic policies.** For the second time in 2 years, Brazil has been upgraded by the rating agencies. Early in April 2011, Fitch gave the nation a BBB rating, up from BBB -, their lowest investment grade. Brazilian Finance Minister Guido Mantega has said that this rating reflects the solidity of the Brazilian economy.

To support this growth, Brazilians in both the public and private sector are aware that massive investments in infrastructure are needed. Both the government and private institutions are investing heavily in the future of Brazil.

In São João da Barra, for example, Brazil's richest investor is constructing a superport, LLX, a project which is estimated to have a budget of 3 billion reais, and is just the tip of the undertaking. Other investments include hydroelectric plants, railways, highways and ports.

As Brazil settles into its role as a key player in the global economic scene, no longer is the question, "should we enter Brazil?" Rather, it is clear, "What does it take to win?"

Market Entry

Given Brazil's prominence on the international stage and strong underlying fundamentals, it is no surprise that many companies are considering expanding into the Brazilian market. Although the country presents many reasons that justify its position as a strong market, this entry does **require research and planning**.

Whether considering acquisitions, making a Greenfield investment or restructuring, the investor needs to understand the strategic and financial impact of these decisions and the implementation risks.

Understanding where the opportunities and risks lie, the size of each opportunity and what competitors are doing will arm you with the confidence **to make a sound investment decision**.

The Brazil commercial arena is changing rapidly due the country's increasingly competitive markets, as well as government initiatives.

A number of potential target companies may lack reliable financial, tax, commercial and operational information as well as historical and forecast management reports, competitive intelligence, operational and market data may be untimely, inconsistent, inaccurate or simply nonexistent.

Key Considerations when Investing in Brazil

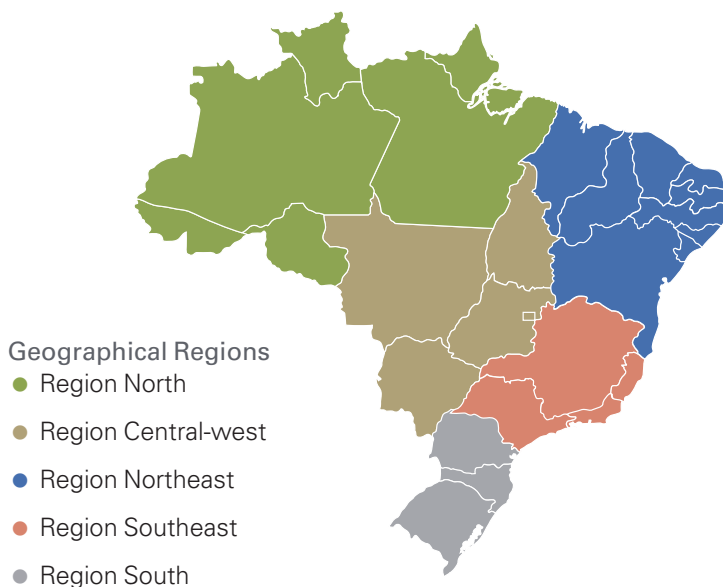
Strengths	Challenges
<ul style="list-style-type: none"> • Brazil is the fifth most populous country after China, India, the United States and Indonesia. • Consistent economic growth and governmental policies have boosted a solid enlargement of a middle class avid for durables goods and consumer products. 	<ul style="list-style-type: none"> • There is a large disparity in distribution of wealth.
<ul style="list-style-type: none"> • The 8th largest economy (seventh in terms of purchasing power 2010). 	<ul style="list-style-type: none"> • Productivity growth in the country is sluggish.
<ul style="list-style-type: none"> • Brazil's diverse economy is characterized by well developed agricultural, mining, manufacturing and service sectors. • There is increased globalization where the Brazilian government policies favor exports. • A diverse economy offers many investment opportunities in several segments in manufacturing and services industries. 	<ul style="list-style-type: none"> • Many of Brazil's sectors are still highly guarded with protectionist import taxes. • Natural targets, such as the family-owned businesses, often make use of aggressive tax schemes at the same time they lack on adequate corporate governance and financial reporting.
<ul style="list-style-type: none"> • All 3 ratings agencies classify Brazil's government paper as investment grade. • Inflation has been under control for over 10 years. 	<ul style="list-style-type: none"> • Central Bank's headline interest rate is one of the highest real rates anywhere.
<ul style="list-style-type: none"> • Brazil is a self-sufficient nation in terms of oil and with new off-shore discoveries is likely to be an oil exporter by the end of the next decade. 	<ul style="list-style-type: none"> • Deep water drilling (pre-salt) requires high level of expertise, particularly with regards to environmental risks and technology to make it cost efficient and competitive.
<ul style="list-style-type: none"> • Consolidated democracy, established institutions and enforced financial discipline – all state governments are required to run a primary surplus (before interest payments on public debt). 	<ul style="list-style-type: none"> • Transparency is sometimes lacking and corruption seems to be more apparent in government than in other developed nations.
<ul style="list-style-type: none"> • More business friendly environment than other emerging countries. • Established transportation networks and distribution channels in most industrialized areas. 	<ul style="list-style-type: none"> • Complex tax and labor regulatory environment with high taxes and social charges on payroll. • Considerable bureaucratic rules for certain businesses and industries.
<ul style="list-style-type: none"> • Major sports events (2014 FIFA World Cup and Summer Olympics) are likely to drive massive investments in infrastructure. 	<ul style="list-style-type: none"> • Infrastructure investment is still lacking.

Geography

Brazil is the 5th largest country in the world with a total area of 8.5 million square kilometers, covering approximately half of South America. It neighbors every country in South America except Chile and Ecuador.

For administrative and political purposes, the country is divided into 26 states and a federal district, grouped into 5 regions, as follows:

- North – comprised mostly of the Amazon Basin; also consists of the states of Acre, Amazonas, Roraima, Rondônia, Pará, Amapá and Tocantins.
- Northeast – comprised of the states of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe and Bahia.
- Central West – comprised of the states of Mato Grosso, Mato Grosso do Sul, Goiás and the Federal District.
- Southeast – comprised of the states of Minas Gerais, Espírito Santo, Rio de Janeiro and São Paulo.
- South – comprised of the states of Paraná, Santa Catarina and Rio Grande do Sul.



More than half of Brazil is 200 meters or more above sea level but only a small part rises above 1,000 meters, with the highest peaks reaching an altitude of around 3,000 meters.

Brazil's river system is extensive. The Amazon and its tributaries, which are great rivers in themselves, drain over half of Brazil. Other large rivers include the São Francisco in the northeast and the Paraná and the Paraguay Rivers, which flow south to empty into the Rio de La Plata.

The considerable hydroelectric potential of Brazil's rivers has been increasingly exploited over the last 35 years. Forests still cover vast expanses, farmland is found mainly in the South, Southeast and Central West with large areas suitable or adaptable for pasture.

Brazil has some of the largest iron ore deposits in the world and mines significant quantities of many other metals, minerals and precious stones.

Climate

The equator runs just north of the Amazon while the Tropic of Capricorn passes slightly to the north of the city of São Paulo. This means that most of Brazil lies within the tropical zone. Only the southern region is in the temperate zone. The Amazon area is hot and humid with heavy rainfall.

Population

According to data published by Brazilian Geography and Statistics Institute (*IBGE*), the Brazilian official statistics institute, Brazil has population of approximately 197 million people in 2010 (184 million in 2007 and 170 million in 2000).

The relative areas and populations of the 5 regions described earlier according to the 2010 census were as follows.

Region	Area	Population	GDP
North	45%	8.16%	5.02%
Northeast	18%	27.50%	13.07%
Southeast	11%	42.58%	56.41%
South	7%	14.58%	16.64%
Central West	19%	7.17%	8.87%

Source: *IBGE*, 2009-2010.

The North and Northeast are the underdeveloped regions of the country. Most industrial and commercial activities are concentrated in the South and Southeast regions.

To reduce social tensions resulting from these regional inequalities in economic development, the government has allocated substantial resources, either directly or through tax incentives, to northern and northeastern economic development during the past 40 years. Nevertheless, the practical result of this policy has been far less fruitful than expected.

Despite Brazil's vast territory, more than 80% of its population lives in urban areas (the metropolitan regions of São Paulo and Rio de Janeiro have populations of around 19 and 11,9 million respectively).

The major capital cities of Brazil and respective States by population, in accordance with the 2009 *IBGE* population report, are:

Capital	Population (millions)	State	Population (millions)
São Paulo	11.0	São Paulo	42.3
Rio de Janeiro	6.1	Rio de Janeiro	15.9
Salvador	2.9	Bahia	14.2
Brasília	2.6	Federal District	2.4
Fortaleza	2.5	Ceará	8.4
Belo Horizonte	2.4	Minas Gerais	19.9
Curitiba	1.8	Paraná	10.6
Recife	1.5	Pernambuco	8.6
Porto Alegre	1.4	Rio Grande do Sul	11.2

Source: *IBGE*, 2009.

Brazilian middle class has grown significantly in the past 5 years, rising to 50% from 40% of the total population. In nominal terms this represents an increase of 34%, adding more than 25 million people to the middle class. GDP *per capita* reached more than US\$ 10,000 during 2010, the highest ever.

Language

Since the discovery and colonization of Brazil by Portugal, Portuguese has been Brazil's language and Roman Catholicism is the predominant religion. Brazil is the only Portuguese-speaking country in South America.

Currency

The Brazilian currency is the Real. The Real replaced the Cruzeiro Real in July 1994 as part of governmental measures to end chronic inflation.

History

Brazil was discovered in 1500 by the Portuguese explorer Pedro Álvares Cabral. From then until its independence in 1822, Brazil's status was that of a group of separate colonies of the Portuguese crown.

As a colony, Brazil contributed to both the personal and the state revenues of the Portuguese crown via numerous taxes, of which the most onerous were a tithe of the produce of the lands granted to colonists and a fifth of the mining production.

The wealth of the colony was based on commodities, principally sugar in the 17th century, gold in the 18th century and coffee in the early 19th century.

As in the neighboring Spanish American colonies, by the late 18th century the influx of ideas from the European Enlightenment was generating a nascent independence movement.

Developments accelerated in 1808 when the Portuguese court fled to Brazil to escape Napoleon's troops. King João VI returned to Portugal in 1821 but his son, Pedro, remained as Regent. The following year, supported by Brazilian magnates, he refused the request of the Portuguese Parliament to return to Lisbon and, on September 7, 1822, declared Brazil's independence.

The subsequent imperial period was heavily influenced by Pedro II (Pedro I's son), a strong liberal who promoted education, improved communications, developed agriculture and encouraged immigration from Europe.

The coffee boom also began during this period, while Brazil emerged victorious from the armed conflict with the dictator Lopez of Paraguay.

On May 13, 1888, the crown decreed the abolition of slavery. This most certainly was instrumental in the downfall of the empire. Plantation owners, who received no compensation, turned against the Emperor together with disgruntled factions of the armed forces.

On November 15, 1889, the republic was declared by the hero of the Paraguayan War, Deodoro da Fonseca, and Pedro II fled to exile in Europe.

This old republican period, marked by expansion and increasing prosperity (a further commodity boom in rubber occurred in the period up to 1912), succumbed in 1930 to the revolutionary movement led by Getúlio Vargas, characterized by its social welfare program.

In 1945, the dictator Vargas was forced to resign and a liberal republic was restored. The subsequent 19 years saw considerable economic development. In particular, President Juscelino Kubitschek initiated the development of the Central West region and the construction of the new federal capital of Brasília.

The period also saw, however, growing government instability and corruption. These tendencies culminated in the military revolution of March 1964.

The early and middle years of the military dictatorship coincided with a period of unprecedented growth in the economy, stimulated by the inflow of large amounts of foreign credit.

The oil crisis of the late 1970s severely affected the Brazilian economy, and this factor, together with shrinking international credit in the face of world recession, resulted in the end of the “economic miracle” by 1980.

Increasing economic difficulties and political change in neighboring states generated growing demands for an end to military rule during the early 1980s, and in March 1985 power passed to a civilian president.

A constitutional congressional convention drafted and approved a new Federal Constitution in 1988, and in November 1989 the first direct presidential elections of the post-military era were held. In 1990, Fernando Collor de Mello took power as the newly-elected President and instituted a gradual liberalization of the economy.

Despite his initial success with inflation control, chronic economic distortions continued to hinder growth and eventually led to a return of high inflation rates.

Collor de Mello was impeached in 1992 and removed from office amid charges of corruption. His vice-president, Itamar Franco, served out the remainder of the term of office.

Elections in October 1994 brought Fernando Henrique Cardoso to power. Cardoso had been at the helm of the Plano Real (a successful monetary reform initiative), as Minister of Finance in the Franco administration. The plan reduced inflation and won wide respect for his government.

Luiz Inácio Lula da Silva, a former lathe operator and union leader, was elected President in 2003 and reelected in 2007.

The country has consolidated its democracy over the past years and has recently elected a new president. On January 1st 2011, Luiz Inácio Lula da Silva passed the country leadership to his successor, Dilma Roussef, the governing party candidate and first female leader in Brazil's history.

Inflation

An important feature of post-war Brazilian economic policy has been the willingness to accept high levels of inflation as one of the costs of pursuing a policy of rapid economic growth.

The development of sophisticated mechanisms to cope with inflation enabled both individuals and business enterprises to live with a hyperinflationary economy for many years.

The failure of the government to reduce inflation was widely recognized to be the consequence of both an inability to reduce the government deficit and the refueling effect of mechanisms designed to cope with past inflation.

With the introduction of Plano Real and the new currency, inflation has plummeted and the government has successfully removed indexation mechanisms from daily life in Brazil.

Government

Brazil is a federal republic comprised of 26 states and the Federal District. Each state has its own constitution with a governor and state legislature.

The states are divided into municipalities, which have some degree of autonomy, and these, in turn, are divided into districts.

The Federal Constitution of 1988 provides that the executive branch of the federal government be headed by a president, elected by popular vote every 4 years, being allowed one reelection.

Legislative power is exercised by the National Congress, consisting of a Chamber of Deputies and the Federal Senate. Congress meets in the Federal District and capital, Brasília.

Judicial power is exercised by the Federal Supreme Court, the Superior Court of Justice, the Federal Court system as well as separate courts for military, electoral and labor matters. There is also a state court system with local jurisdiction.

Private ownership of property is guaranteed, except when public interest or necessity justifies expropriation. In this event, fair compensation must be paid in advance.

Economy and Fiscal Policy

Government policy is focused on stimulating the business activities of the private and government sectors toward rapid industrialization and economic growth.

However, this policy includes some protective measures for domestic industries considered to be of strategic economic importance, as well as monetary policies designed to keep inflation in check and maintain the availability of foreign exchange.

Brazil's status as a world economic power is a relatively recent phenomenon. Until World War II cut off the flow of manufactured products from Europe and the United States, setting the scenario for the country to take the road to industrialization, Brazil was a classic example of a primary-product exporter which relied on other countries to supply the vast majority of its manufactured goods.

Even in the early 1950s, 65% of the economically active population was still engaged in agriculture, fishing or forestry, and only 12% worked in manufacturing (the rest were employed in service industries). Coffee sales provided more than half of the nation's export revenues.

Between 1950 and 1980, exports reached US\$ 23 billion (of which approximately 55% were manufactured goods), and São Paulo developed into one of the world's largest manufacturing centers.

Today, Brazil is a world leader in the production of foods and minerals. Many other sectors - such as the steel, aluminum, automobile, wood pulp, chemical and textile industries - are highly developed.

Brazil's GDP increased during 2010 by 7.5%, reaching R\$ 3.57 trillion (approximately US\$ 2.14 trillion at the exchange rate in force on December 31, 2010).

According to *IBGE* statistics, unemployment was 7% in June, 2010, which is the lowest rate registered in Brazil. However, research performed by Department of Statistics and Economic Studies (*DIEESE*), a data institute supported by labor unions, found the unemployment rate in the metropolitan areas of 6 of Brazil's state capitals (São Paulo, Salvador, Porto Alegre, Recife, Belo Horizonte and Distrito Federal) to be 14.2%. In its calculation, *DIEESE* considered unregistered employees as unemployed.

Privatization

One of the key elements of Cardoso administrations' economic policy was the extensive transfer of state-owned companies to the private sector. Through Law 8,031/90, Congress entrusted the sale process to the Federal Development Bank (*BNDES*), under which the initial sale of more than 20 state-owned industries, mainly in the steel, petrochemical and fertilizer industries, was authorized. Since May 1997, financial institution privatization processes have been conducted by the Brazilian Central Bank (*BACEN*) and authorized by the National Monetary Council (*CMN*).

The *BNDES* and the Federal government faced intense pressure from trade unions and special interest groups in Congress, which sought to halt or hinder the privatization process. A series of challenges were also mounted in the courts.

These factors delayed the privatization process, but the government showed determination and, in 1991, the privatization of a major steel manufacturer (*Usiminas*) was successfully completed.

This initial success was regarded as a significant step forward in the privatization process and it enabled the government to privatize several others State-owned companies.

Electrical and telecommunications companies have been privatized and foreign investors have won bids to assume railway concessions. The federal government's controlling interest in Vale do Rio Doce Company (*CVRD*), Brazil's largest mining company, was sold to both domestic and foreign private investors in 1997.

Infrastructure

Transportation, utilities and telecommunications are of fundamental importance due to the size of the country and the growing demands of industry.

The postal service is generally adequate. In major centers, messenger services are widely used.

There is an extensive air travel and domestic ground transportation network. Regular international services are provided by national and foreign airlines to all parts of the world.

Railroad facilities are underdeveloped, the principal lines being in the states of São Paulo and Rio de Janeiro. The privatization of railroads, which has already occurred, and ports is considered the solution for developing these sectors.

Due to the deficiencies in rail and sea transport, a very considerable amount of freight is transported by highway throughout the country. Although the main highways run near the coast, road construction in the interior is expanding and existing routes are being improved.

Subway systems are operating in the cities of São Paulo, Rio de Janeiro, Brasília, Belo Horizonte, Porto Alegre, Recife and Teresina, and alternative transit systems are being developed in other major cities. Commuter bus services remain the principal means of public transportation.

With the build-up of infrastructure that has begun in preparation for the 2014 World Cup and 2016 Summer Olympics, construction has already begun on a new, high-speed train route linking Sao Paulo and Rio de Janeiro. Subways are being overhauled, and highways are being repaved.

Oil and Gas

The Brazilian economy is being driven by strong worldwide economic growth, particularly in the emerging markets, which is directly impacting the investors' level of confidence in the Brazilian market.

The impact of this growth is bringing new horizons to the Brazilian oil and gas industry, which, in spite of constant changes caused by the volatility of prices, contention of costs, technological advances, regulations and access to capital and financing, is encouraging more and more investors to place their bets in this sector.

A direct consequence of the price highs for a barrel of petroleum has been the search for, and discovery of, new reserves. These new discoveries have increased the optimism of the energy sector that there is sufficient petroleum to meet world demand.

It is within this context that Brazil is becoming more and more prominent, consolidating its image as one of the preferred destinations for foreign investments, capable of participating in important alliances with international petroleum exporters.

Thus, Brazil may be capable of alleviating the pressure on oil price highs as a result of the length of its coastline and the potential for its reserves, which currently total around 12.8 billion barrels, according to the Brazilian Agency for Petroleum, Natural Gas and Biofuels (*ANP*).

The recent Brazilian discoveries in the pre-salt area located off the coast are considered the largest discoveries in the world since 2000 and the largest discoveries in the West since 1976.

Market analyses performed by KPMG based on the growth of the main companies in the oil and gas sector in the last 10 years have revealed that the present capacity of the Brazilian petroleum industry represents only 3% of what it will be in 25 years time.

By analyzing the historic financial position of Brazilian companies and making a simple projection for the future it is possible to forecast that this sector in Brazil should double in size every 5 to 6 years.

In monetary terms the petroleum and natural gas industry has grown by more than 300% since 1977.

In the first 4 months of 2010 Brazil exported more than US\$ 5.08 billion, an increase of US\$ 3.44 billion from the same period of the previous year. Only in April, 2010 Brazil exported 18 million barrels. (Source: *ANP*).

A supply of skilled labor at a competitive cost is another great advantage that makes Brazil one of the most attractive countries for investments in petroleum and natural gas.

The oil and gas sector attractiveness is enormous, considering that Brazil, according to ANP data, has 29 sedimentary basins, equivalent to 7.5 million km² (approximately 2.5 million km² under the sea). However, less than 4% of these basins are under concessions for exploration and production.

From 2000 to 2009 Brazil experienced a growth of more than 7.8 billion meters³ gas production and from 1977 to 2009 the proven reserves of petroleum have jumped from 7.1 billion to 12.8 billion barrels. These figures indicate just how promising the Brazilian reserves are.

Real Estate

On March, 2009, the Brazilian government launched the National Housing Plan, aiming to boost the construction sector as well as to mitigate the current housing deficit.

Its main goals are to improve the access of low income families to housing opportunities and to increase the employment rate and the citizens' income by means of investments in the construction sector.

In this scenario, Provision Measure 460/2009, converted into Law 12,024/2009, introduced a number of changes with a focus on the construction and real estate industries.

The first issue to be highlighted pertains to the reduction of the combined rate applicable on the monthly revenue received subject to the Special Tax Regime for real estate projects (*RET*).

Under these new rules, construction companies are granted a reduction to calculate the payment of federal taxes on their monthly revenue.

Additionally, the referred legislation has established a special rate applied on the construction of buildings below the ceiling price of R\$ 60,000.00, provided that they are included in the current National Housing Plan and finished until December 31, 2013.

In this case, the percentage corresponding to the sole payment of federal taxes for residential real estate projects of social interest constructed will be equivalent to 1% of the monthly revenue received, given the requirements are met.

Brazil Transnational Companies

In 2010, Brazil had 7 companies on the list of Fortune Global 500 companies. This total is up from 6 the year before, and up from 3 companies 5 years prior. However, companies of all sizes in Brazil have international operations and have looked beyond their country's borders for customers, suppliers, facilities, and investment.

It was not until the 1970s that Brazilian companies really began investing abroad. This trend was given a boost in the 1990s through privatization.

In recent years, the number of companies investing abroad and the amount of money being invested abroad have grown dramatically.

In fact, 2006 marked the first time in history that Brazilian Direct Investment (BDI) abroad exceeded Foreign Direct Investment (FDI) in Brazil, which continues to rise. In 2009, the total stock of Brazilian FDI, over \$158 billion, was nearly 3 times that of 2003.

In line with global trends, inflows of FDI have also slowed in Brazil during the global economic downturn, as foreign companies worldwide were investing less. Despite a 30% increase in 2008 over the prior year, FDI inflows fell 42% in 2009.

BDI outflows increased sharply in 2008 but turned negative for Brazil in 2009. However, this was driven in large part by intercompany loans, indicating that Brazilian parent companies were providing capital to their less-financially-sound affiliates abroad.

Both high domestic demand and a stimulus package helped drive economic expansion during the world economic crisis.

Despite a dip into the negative in 2009, the OECD estimated in its May 2010 Economic Outlook that Brazil's GDP will have grown at an average of 4.5% per year for the 5 years ending with 2011.¹

2014 World Cup & Rio 2016 Summer Olympics

The stage has been set to further fuel the economic growth that Brazil has been experiencing over the last several years.

The opportunities to host the World Cup in 2014, and the 2016 Summer Olympic Games in Rio de Janeiro, will give Brazil the chance to show the world its natural beauty, its unique culture, and its dynamic economic development.

In order to host these world's largest sport events, infrastructure improvements have already begun.

The expected lasting legacy and benefits of hosting such major events extends from significant improvements in infrastructure to boosts in the economy and in the tourism all over the country.

2014 World Cup

When FIFA announced that the 2014 World Cup would be hosted in South America, Brazil emerged as the clear choice, and Brazil was officially appointed to host the 2014 World Cup in October 30, 2007.

In May 2009, FIFA selected the 12 host cities for the 2014 host cities: Belo Horizonte, Brasília, Cuiabá, Curitiba, Fortaleza, Manaus, Natal, Porto Alegre, Recife, Rio de Janeiro, Salvador and São Paulo. Should Brazil's team win in 2014, it will be the country's 6th World Cup title, but the first one conquered in the own country.

The 12 stadiums will be delivered by reforming 2 private stadiums (Curitiba and Porto Alegre), by building 2 Greenfield stadiums (Recife and São Paulo) and by reforming or rebuilding 8 public stadiums (Rio de Janeiro, Minas Gerais, Brasília, Curitiba, Salvador, Fortaleza, Natal and Manaus).

According to research conducted by Brazilian Association of Infrastructure and Basic Industry (*ABDIB*) the total investments in these 12 stadiums are estimated at US \$3.1 billion.

Besides investments in stadiums, there is a plan to invest another US\$ 35 billion in public transportation, US\$ 3,9 billion in airports, US\$ 425 million in ports, US\$ 1,5 billion in energy, US\$ 7,1 billion in water supply, US\$ 7,3 billion in hotels, US\$ 674 million in hospitals and US\$ 720 million in security.

It is estimated that the 2014 World Cup, will drive more than US\$ 80 billion into the Brazilian economy. The benefits of hosting the 2014 World Cup include not only the investments in infrastructure and the money spent by tourists during the tournament, but also other sustainable legacies, such as, a long-term increase in the number of international tourists and foreign investments and other less tangible benefits, such as, the swell in national pride.

1 OECD Economic Outlook No. 87.

Olympics

Rio de Janeiro beat out Chicago, Madrid, and Tokyo to host the 2016 Summer Olympics, which will be the first Olympics held in South America. In addition to the spotlight on Rio de Janeiro, hosting the Olympic Games would also deliver an economic boon to the city, region, and country.

Rio de Janeiro's winning bid included a projected budget of US\$14.4 billion, including US\$ 2.8 billion for structuring the Brazilian Olympic Committee. The remaining US\$ 11.6 billion will be invested in infrastructure such as stadiums and other sports venues, as well as roads and subways.

The University of São Paulo Institute of Administration performed a study, commissioned by the Ministry of Sport, which estimated the economic boost of the Games at about R\$ 102 billion (roughly US\$51 billion).

That figure considers increases in production, expansion of the service sector, additional tax revenue, and growth in jobs.

The survey calculates that for every US\$ 1 invested by the Brazilian government, an additional US\$ 3.26 of private money will be invested in supply chains related to the games.

Although the preparations for the Olympics continue, more than half of the facilities to be used were already constructed or upgraded for the 2007 Pan and Parapan American Games.

In addition to event venue construction, Rio de Janeiro's metro lines and train routes are being expanded and improved, a bus rapid transit system will link the venues and provide a fast and cost-effective solution to transportation within the city.

The city will also be able to build upon the infrastructure and hospitality developments made in preparation for the 2014 World Cup.

Key Indicators	2011	2010
GDP (R\$ trillion)	3.9	3.5
Real GDP growth(%)	4.3	7.7
Unemployment rate (%)	5.9	7.1
Consumer price index (% change)	6.2	5
Exchange rate at year end (Real / US\$)	1.72	1.67
Total public sector budget balance (% GDP)	-2.5	-2.2
Total public sector debt (% GDP)	55.7	57.2
Goods exported (US\$ billion FOB)	240.2	201.9
Goods imported (US\$ billion FOB)	-226	-181.6
Trade balance (US\$ billion)/Current account balance (US\$ billion)	14.2	20.3
International reserves (US\$ billion)	NA	288.6
Inward direct investment (US\$ billion)	42.5	48.5
Total external debt (US\$ billion)	401.9	346.9



Chapter 2

How to Invest

The Brazilian merger and acquisition (M&A) environment is dynamic in the sense that tax laws are subject to frequent changes, creating not only pitfalls that can frustrate M&A tax advisers, but also tax planning opportunities.

Furthermore, while at times Brazilian tax law is considered firm, it can also provide significant flexibility for Brazilian tax planning.

Overall, there is a relatively high tax burden in Brazil, with complex and interrelated tax provisions. Therefore, good tax planning is essential for the parties involved in any M&A project in Brazil.

In light of the above, M&A transactions commence with preliminary negotiations between the parties on purchase terms and conditions, representations and warranties, and non compete and indemnification provisions, which may be reflected in a memorandum of understanding providing for further exclusive negotiations and due diligence investigations.

As a preliminary discussion point, the parties of the transaction should consider whether to pursue it through an asset or share acquisition, at which time it should be noted that the outcome of due diligence investigations might determine the most cost-effective alternative.

Acquisition

The acquisition of an existing business may be accomplished through the purchase of either a company's shares or its assets.

In principle, the sale or purchase of shares in a Brazilian entity is a relatively simple transaction from a Brazilian tax perspective. The taxation depends to some extent on the residency of the seller and purchaser.

The acquisition of a *Limitada* is effective upon the approval and registration of an amendment to the articles of incorporation of the target company, in order to reflect the assignment and transfer of quotas to the new partners.

Additionally, a detailed purchase and sale agreement is usually executed, including purchase terms and conditions, confidentiality and non-compete provisions and, based on due diligence investigation results, representations and warranties, indemnification clauses and guarantees, among other case specific provisions.

On the other hand, the acquisition of a privately held Corporation (*SA*) is effective upon the approval and execution of a share transfer in the Share Transfer Book.

A purchase and sale agreement is usually executed, including purchase terms and conditions, confidentiality and non-compete provisions and, based on due diligence investigation results, representations and warranties, indemnification clauses and guarantees, among other case specific provisions.

Additionally, the acquisition of a publicly held company may be performed privately between the interested parties, in which case the acquisition process will be similar to the acquisition of a privately held company, as described above.

On the other hand, when the purchaser is the controlling shareholder, and as a result of the operation, its participation in shares will increase by 10%, the purchase must occur through a public offering.

In case a public offering is implemented, it must be carried out through a financial institution, which will guarantee compliance with the obligations of the issuer.

If acquired, the shares subject to the offer must give the purchaser a controlling interest. The offer document must be published in the press and should include details on shareholders, such as price and payment conditions, minimum number of shares that the acquirer wishes to purchase and, if applicable, the maximum number, among other information.

Additionally, the acquisition of a publicly held company must be communicated to the Brazilian Securities Exchange Commission (*CVM*) and disclosed to the market as a material event.

In addition, the purchaser of the controlling stake is required to make a tender offer for the acquisition of the remaining common shares of the company for a price equal to at least 80% of the price paid for the controlling shares.

The buyer may offer minority shareholders the option to maintain their shares in the company in exchange for receiving an amount equivalent to the difference between the market value of the shares and the price paid for the controlling shares.

Moreover, operations, which may restrict competition, must be notified to the Federal Antitrust Agency (*CADE*) within 15 days.

Acquisitions of companies in certain sectors, including banking, insurance, energy and telecommunications, may be subject to specific regulatory approvals.

Succession Issues

The succession of tax attributes and liabilities is among the most significant issues involved in acquisitions.

The succession of liabilities will depend upon the type of transaction. When the transaction is structured as an asset purchase, tax succession becomes a major concern.

In summary, where the assets purchased fall within the definition of commercial, industrial or professional establishment, succession issues in the sense of inherited liabilities may arise.

In general, tax legislation and prevailing jurisprudence stress that corporate entities resulting from transformations, upstream or downstream mergers and spin-offs shall be liable for taxes payable by the original corporate entity up to the date of the transaction.

This liability is also applicable in the case of the winding up of companies whose business continues to be exploited by any remaining partner, under the same or another corporate name, or a proprietorship.

In addition, the legislation establishes that private corporate entities acquiring goodwill or commercial, industrial or professional establishments from other entities, and which continue to operate the company under the same, or another, corporate name or proprietorship, assume subsidiary liability for taxes related to the intangibles or establishments acquired, payable up to the date of the acquisition.

Furthermore, the acquirers are fully liable when the seller ceases its operations. Establishment for these purposes is broadly defined as an intangible encompassing the group of attributes that form a business, which a purchaser intends to continue under the same or another corporate purpose or name following an acquisition.

Bear in mind that there is no mathematical criterion to apportion liabilities and the definition and allocation of liabilities are generic and it will depend exclusively on future events, such as compliance with obligations by the seller, its partners or shareholders, and even the manner in which the acquisition is structured.

Because liabilities issues related to an acquisition will vary on a case-by-case basis, a previous analysis of the transaction is strongly recommended.

Additionally, to the extent the acquiring or surviving company maintains the activities and does not terminate employment agreements a change in ownership should not in general affect the succession of labor liabilities.

Due Diligence

The main purpose of due diligence investigations is to allow the prospective purchaser to better assess the value of proposed transactions and identify potential risks and opportunities, including debt-like items such as tax and labor contingencies.

In addition, due diligence results may be taken into account in drafting specific provisions in the transaction documents, especially when it is necessary to address any issues verified during the investigations.

The investigations are also useful in determining the steps to be taken by the acquirer when the transaction is completed, both in terms of remedying any identified problems and planning for future administrative adjustments.

The scope and length of the due diligence process will depend on the facts and circumstances of each transaction.

With the increasing complexity in the business environment, investors are now seeking to understand not only financial and tax related issues, but also commercial, operational and integration issues.

Various aspects of the target company may be analyzed, and many times a separate investigation by an accounting firm is conducted simultaneously with the legal investigation conducted by qualified attorneys.

Brazilian courts, including labor and tax courts, are prepared to issue certificates indicating any pending lawsuits involving the target company.

In addition to the examination of public records, various documents are requested from the target company and then analyzed by the attorneys representing the prospective purchaser.

While good acquisition due diligence is important worldwide, it is particularly important in Brazil. The complexity of the tax system, the large amount of tax litigation necessary to resolve tax issues, and the protective labor regulations, among other issues, may significantly complicate the evaluation of Brazilian targets, and sometimes even the negotiations.

It is common to observe a number of potential tax contingencies (issues not yet identified / assessed by the tax authorities or included in a tax lawsuit) that may amount to significant numbers.

The most common issues encompass:

- informal practices – income not recorded/false invoices entered in the accounting ledger;
- “outsourced” or unregistered employees;
- doubtful/aggressive tax planning;
- low quality of financial information/controls;
- inclusion of private/shareholders’ interests with the company’s interests;
- frequent changes/increases in the tax burden;
- high number of tax lawsuits; and
- succession risk.

Tax Structuring

Taxation of an Asset Deal

The seller of the assets would be subject to income tax and social contribution tax (approximately 34%) on the gain realized upon the sale in the assets, if any.

For Brazilian tax purposes, there are no preferential rates for capital gains, thus, both operational and non-operational gains are taxed at the same rate.

Depending on the type of asset sold Social Integration Program (*PIS*) and Social Security Contribution (*COFINS*) may apply.

In addition, State Value-Added Tax (*ICMS*) would apply to the transfer of inventory. However, the *ICMS* tax paid may be creditable by the purchaser to the extent that these same products are subsequently sold or are otherwise used as raw materials in the manufacturing of products that are sold by the purchaser.

The *ICMS* credits generated on the purchase of the assets may generally be used to offset the *ICMS* debts arising from subsequent taxable transactions.

There are restrictions on a taxpayer's ability to use credits on the purchase of fixed assets. The sale of fixed assets is normally not subject to *ICMS*. However, *ICMS* credits generated on the purchase of fixed assets may have to be written-off.

Excise Tax (*IPI*) also applies to transfers of inventory, provided the inventory was directly imported or manufactured by the seller. *IPI* tax paid may also be creditable by the purchaser if the product is to be used in the manufacturing of other products.

IPI may also apply on the sale of fixed assets, provided the asset was directly imported or manufactured by the seller and the subsequent sale occurred within 5 years of the date the asset was recorded as a permanent asset by the seller.

Property Transfer Tax (*ITBI*) may also apply to the transfer of real estate.

Taxation of a Share Deal

The sale or purchase of shares in a Brazilian entity is more common than asset deals mainly because of the lower levels of documentation requirements and indirect taxation. The taxation of a share sale depends to some extent on the residence of the seller and purchaser.

A Brazilian entity (*pessoa jurídica*) seller is subject to income tax and social contribution tax on the net gain from the sale of shares. In most cases, where a seller owns a significant interest (usually more than 10 %), the gain is calculated as the difference between the gross proceeds and the proportional book value of the Target entity's equity.

The sale of shares is not subject to *PIS* and *COFINS*, *ICMS*, or *IPI*. In addition, there are no transfer taxes or stamp duties on the sale of shares in Brazil.

If the seller is a Brazilian or a nonresident individual, the gain is subject to a final 15% withholding tax; however, the amount of the gain is calculated differently. For a Brazilian individual, the gain is calculated based on the difference between the gross proceeds and the capital contributed or paid in a previous acquisition.

If the seller is a nonresident entity, the capital gain will be subject to a withholding income tax of 15% or 25%. For a nonresident, because of the lack of clarity of the relevant tax provisions, there is some controversy about how the capital gain is determined.

In this regard, the different positions arise because of differences between the wording of the law and the regulations. It is important to state in the sales contract whether the sale price is gross or net of withholding tax.

If both the buyer and the seller are nonresidents, it is likely that the tax authorities will tax an eventual capital gain.

The capital gain on the sale of publicly traded shares is subject to tax at a rate of 20% for resident individuals and is exempt for nonresidents, provided that some formalities are met and the seller is not a resident of a tax haven jurisdiction.

Investments in Partnership Investment Fund (FIP)

FIP is a feasible and efficient investment vehicle in Brazil, especially for structuring investments by private equity funds.

According to Brazilian legislation, *FIPs* are not legal entities, but compilation with shares held by their investors. In general, *FIPs* are exempt from corporate taxes (income and social contribution taxes on profits) and gross revenue taxes (*PIS* and *COFINS*), provided some requirements are met.

Non-resident investors are not subject to Brazilian taxation upon the redemption of *FIP* quotas, even if the redemption is followed by liquidation.

The exemption only applies if certain requirements are met, when the non-resident (i) holds less than 40% of the *FIPs* quotas, (ii) is not entitled to more than 40% of the income paid by the *FIP*, (iii) is not resident in a low-tax jurisdiction, (iv) only invests in shares, debentures, subscription bonuses and other securities convertible into shares issued by Brazilian *SA* and (v) does not hold the investment in the *FIP* through an account set up in accordance with Brazilian Central Bank rules.

Purchase Premium

If structured properly, one significant advantage of a share sale over an asset sale would be that the amount paid in excess of the target's net equity may generate an amortizable premium or a step-up in the tax basis of otherwise depreciable or amortizable assets.

To take advantage of this opportunity, the acquisition of shares would need to be made through a Brazilian legal entity.

Note that this opportunity might not be available if a nonresident directly acquires shares in a Brazilian company, or might not be available to the same extent if assets rather than shares are purchased.

According to legislation currently in force, liquidating or merging the acquiring entity and the target may allow, in certain situations, to recover the premium paid on the shares.

To the extent that the premium relates to the value of depreciable fixed assets, the premium could be converted into acquisition costs of the fixed assets acquired and recovered through depreciation.

If such premium relates to the value associated with the future profitability of the company, it could be amortized. Any part of the premium that relates to the acquisition of intangibles is not deductible through the merger of the companies.

As previously mentioned, in 2008 Brazil enacted legislation making first steps towards the adoption of international accounting standards – International Financial Report Standards (IFRS).²

This has created a complex situation, due to the differences between existing and forthcoming rules (based on these international standards) and the “old” Brazilian GAAP.

To mitigate the effects of this gap and provide taxpayers with general guidelines, a series of pronouncements have been issued by Committee of Accounting Pronouncements (*CPC*), the entity responsible for issuing technical accounting pronouncements with the primary purpose of aligning the BR GAAP to IFRS, in order to effectively detail the process of convergence towards IFRS.

Despite the recent convergence of the Brazilian accounting standards to IFRS, the amount of goodwill attributable to expected future profits may, provided certain requirements are met, still be amortized for tax purposes over a minimum period of 5 years, beginning with the date the buyer and the target are merged.

Under IFRS, goodwill can only be expensed (written off) when it is determined that the goodwill is impaired.

² Law 11,638/07.

It is important to mention that, in recent years, Brazilian tax authorities have increased their scrutiny over the business reasons and economic fundamentals supporting the value of goodwill in merger and acquisition transactions.

Corporate reorganizations

Generally, corporate reorganizations, such as mergers, consolidations and spinoffs as described below, as well as liquidations and capital contributions (including capital contributions of shares) can be accomplished tax free in Brazil, provided the assets are transferred at tax book value and other formalities are met.

However, there may be reasons to structure a reorganization transaction as a taxable transaction (e.g., assets transferred at fair market value). For example, transferring assets as part of a reorganization may allow for international tax planning, a step-up in the tax basis of assets, or the use of current-year losses that would otherwise be subject to loss limitation rules.

Merger and Consolidation

A merger (*incorporação*) occurs when one or more companies are merged into, or absorbed by, another company, which survives.

A consolidation (*fusão*) occurs when two or more companies combine to form a new company. Brazilian law permits mergers and consolidations without special restrictions for Brazilian entities with foreign shareholding.

Mergers are used more frequently than consolidations, especially due to tax consequences.

The surviving company in a merger transaction and the new company resulting in a consolidation succeed its predecessors in all rights and obligations except for their tax losses, which cease to exist if not related to the surviving company. The *CVM* requires that certain procedures are followed in case of a merger or consolidation that includes one or more publicly held companies.

Pursuant to Brazilian corporate regulations, the company to be merged must prepare specific balance sheets up to 30 days before the date of the event. An appraisal is also required to support the value of all assets and liabilities to be transferred. Corporate documents must be prepared and filed to the Registry of Commerce, together with the balance sheet and the appraisal report.

Dropdown

A dropdown of assets is an alternative way to restructure a company. In a dropdown a company transfers certain assets and liabilities to a newly created entity, or to an existing subsidiary, as a capital contribution in exchange for shares in the transferee company.

A list of all assets and liabilities contributed to the new company, or the subsidiary, must be attached to the documents elaborated to support the transaction, properly kept. If assets subject to public registration are transferred pursuant to the dropdown (such as real estate, telephone lines, vehicles), it is recommended that a detailed list be prepared to facilitate the transfer of the proper registrations after the dropdown.

Spin-off

A corporate spin-off entails the transfer of part, or all, of a company's assets and liabilities to one or more existing companies, or entities formed for this purpose, and dividing the company's capital in the event of a partial spin-off. If all assets and liabilities of a company are transferred, the company can be liquidated.

The companies receiving the net value transferred absorb, proportionately, rights and obligations of the company that was split off.

Pursuant to Brazilian corporate regulations, the company to be spun-off must prepare specific balance sheets up to 30 days before the date of the event. An appraisal is also required to support the value of all assets and liabilities to be transferred.

Corporate documents must be prepared and filed with the Registry of Commerce, together with the balance sheet and the appraisal report. One disadvantage associated with a spin-off is that tax losses carry forwards of the company that was spun-off are lost in proportion to the net equity that was split off.

Conversion

A company may be converted from one type of legal entity to another, without undergoing a dissolution or liquidation. For example, an *SA* can be converted into a *Limitada*, or vice versa. Shareholder approval must be unanimous, unless otherwise provided for in the articles of incorporation. Dissident shareholders have the right to withdraw.

Dissolution

Normal dissolution may occur under the following circumstances:

- termination of corporate life under the circumstances provided for in the articles of incorporation;
- by resolution of the shareholders;
- existence of only one shareholder as verified at the shareholder meeting of the following year (except for wholly owned subsidiaries);
- termination of its authorization to operate.

Judicial dissolution may occur in the following cases:

- when the incorporation deed of the SA is annulled in any cause of action brought by any shareholder;
- when there is confirmation that the SA cannot achieve its business purpose, in a cause of action brought by shareholders representing and ownership of 5% or more of the corporate capital;
- by court or administrative decisions, in a liquidation process.

After satisfying the claims of preferred creditors, the liquidator must pay off any remaining liabilities of the company proportionally without distinguishing between debts that are overdue and debts that are becoming due.

Note that in relation to the latter, a liquidator may pay with a discount at prevailing bank rates.

Extinction

A company is extinguished by completion of a liquidation process or by merger, consolidation, or a spin-off resulting in all net assets to be transferred to other companies.

Extinction by dissolution is preceded by the liquidation process, whereas in the case of a merger, consolidation, or spin-off it is immediate.

After all creditors have been paid, the shareholders may approve a dividend distribution prior to the completion of the liquidation, to the extent that the company's assets have been realized. In the absence of any potential harm to creditors or minority shareholders, specific assets may be distributed to shareholders.

When all liabilities have been paid 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 complete and the company is automatically extinguished.

Anti-avoidance Rules

In the context of corporate restructuring, it is important to stress that tax planning is currently in the crosshairs of tax authorities in Brazil. These may disregard any transactions performed with the sole purpose to disguise a taxable event or the nature of the elements that give rise to a tax liability.

Thus, any operation performed shall have business and economic substance, i.e., the operation must have intention other than just tax saving.

Note that Brazilian anti-avoidance legislation is vague and still pending ordinary law and administrative regulation in order to be fully effective from a legal perspective.

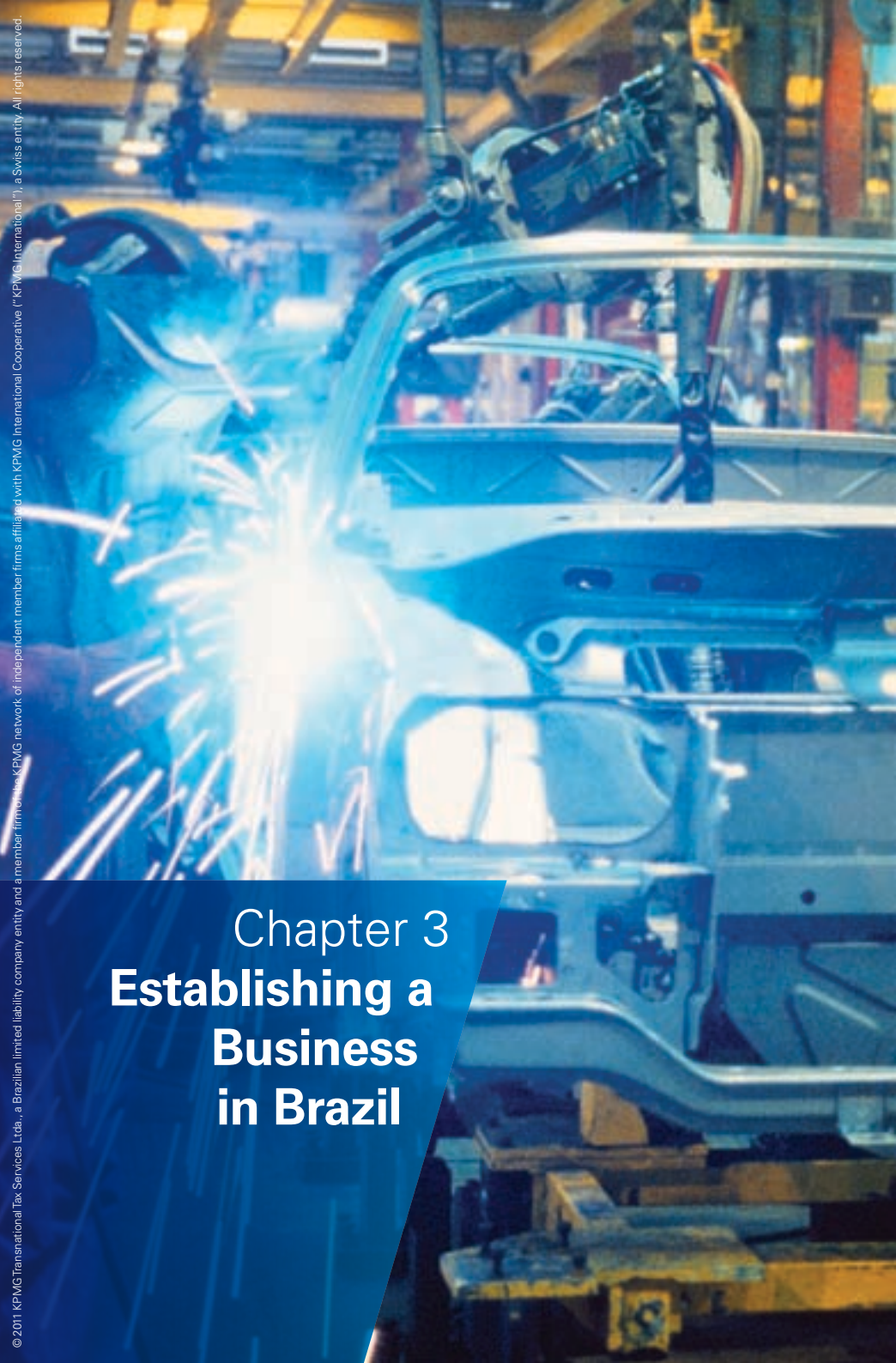
Currently, existing legislation provides that tax authorities have the power to disregard, for tax purposes, those acts or transactions that are intended to reduce the amount of a tax due, avoid or postpone the payment of a tax, or conceal aspects of a taxable event or the true nature of elements that give rise to such an event.³

Indeed, in practice the tax authorities have been assessing taxpayers on a wider concept (such as simulation) and, despite the lack of regulation, in various cases the assessments have been confirmed by the administrative tax courts.

Considering the above, the trends for the future seem to demand more analysis whenever tax planning strategies or even corporate reorganizations are contemplated.

One main reason is the lack of clear guidance in the law as to what constitutes economic substance and how to determine tax evasion. Currently, there has been coverage in the press regarding a proposal of law to address such matters. This draft legislation was part of discussion initiated by taxpayers' representatives with tax authorities.

3 Brazilian Tax Code, CTN, Article 116.



Chapter 3

Establishing a Business in Brazil

Brazil presents a prime opportunity for potential investors. From the smaller foreign company that has found a niche for its particular product or technological expertise to the multinational corporation whose Brazilian operation is among the largest of its international subsidiaries, the general message is clear: Brazil can provide opportunities for all investors.

Nevertheless, establishing and operating a business in Brazil often involves navigating specific legal aspects and regulations.

This Chapter focuses on the main legal and regulatory information that potential investors should be aware of.

Structuring the Business

Foreign investors may enter the Brazilian market directly, through a branch or a subsidiary, or through third parties by means of distribution and sales representation activities.

Each alternative presents its benefits and disadvantages, the ultimate decision depending on a variety of factors, such as contemplated size and length of investments, future prospects and expectations, ease of exit, among many others.

Oftentimes distribution and sales representation save costs when compared to the incorporation of a local branch or subsidiary.

However, these alternatives may be accompanied by a lack of control over certain aspects of the venture, such as the way third parties distribute or sell products in Brazil or protection of patents, know-how and trademarks.

Both distribution and sales representation activities must be entered into by written agreements signed by the foreign investors and the local third parties.

Before entering into such agreements, it is recommended that the foreign investors register their trademarks and patents, as the case may be, with the National Industrial Property Agency (*INPI*).

Distribution Activities

The Brazilian Civil Code (BCC Law 10,406/02) provides rules for distribution and agency activities. Although these activities seem similar, according to the BCC, the main difference is that under a distribution agreement, the distributor takes title to, and has possession of, the products subject to such activity.

Under a distribution agreement, an individual or an entity commits to transact business on behalf of another party (e.g., the manufacturer of the products to be distributed) in a designated area for specific remuneration, on a regular basis and without entering into an employment relationship with the third party.

It is recommended that at a minimum the distribution agreement defines in detail its object (i.e., description of the products involved), the exclusive sales territory, duration, purchase obligations, any advertising issues, and licensed use of the trademarks involved, as applicable.

If certain specific terms are omitted from the agreement the BCC may provide particular guidelines, however, the latter may differ from what may have been originally intended. For instance, pursuant to the BCC, if the term (duration) of the agreement is not formally established, it shall be considered as undetermined and its termination would require a 90 day prior notice.

Sales Representation

Unlike a distribution arrangement, sales representation arrangements are directly governed by specific legislation (Law 4,886/65 further amended by Law 8,420/92 and Law 12,246/10) and, in a supplementary way, by the general provisions of the BCC applicable to contractual issues.

Sales representation may be understood as an intermediating activity, in which the sales representative (entity or individual), on a regular basis and not pursuant to an employment relationship, promotes the products, attracts customers and facilitates sales on behalf of the seller.

A sales representative often also negotiates proposals and/or requirements in order to submit them to the seller for approval. In exchange for such services a sales representative receives a fee, usually determined as a percentage of the value of the products sold. A sales representation arrangement must also be formalized in written agreements.

Special care must be taken when drafting a sales representation agreement in order to ensure the arrangement is not characterized for tax purposes as an employment relationship between the contracting parties or as a permanent establishment of the foreign seller.

It is recommended that a sales representation agreement contains: (a) a description of the products being represented; (b) the term of the agreement; (c) the territory to be covered, such as a state or region; (d) the total or partial guarantee of exclusive representation in that territory, if applicable; (e) the conditions and details for payments of commissions/ fees; (f) restriction of the territory exclusivity, if applicable; and (g) any indemnification payable to the sales representative in case of termination of the agreement without just cause, which cannot be less than 1/12 of the total remuneration earned during the period when the representation agreement was effective.

Branches

As mentioned above, foreign investors may enter the Brazilian market directly, through a branch or subsidiary.

A branch is defined as a division, office or other business unit located at an address different from the one of the headquarter office. As such, a foreign parent company with a branch in Brazil may have unlimited liability for the debts of the latter.

Branches located in Brazil are governed by Brazilian law and courts with regards to business and transactions carried out in Brazil.

The creation of a branch of a foreign entity in Brazil can be time consuming since it requires prior authorization from the Federal Government. Specifically, the Ministry of Development, Industry and Commerce (*MDIC*) issues its approval in a Ministerial Decree.

Note that the *MDIC* must also approve any future amendments to the articles of incorporation of the Brazilian branch.

The most common markets with branches in Brazil are airline companies and financial institutions.

Subsidiaries

In general, foreign investors tend to incorporate a subsidiary rather than set up a branch in Brazil due to the following: (i) with some exceptions, the shareholders are not responsible for the Brazilian subsidiary's debts, and (ii) the process of establishing a subsidiary in Brazil is fairly simple and much less time-consuming when compared to establishing a branch.

Laws regulating the formation of legal entities in Brazil are applicable to foreign and Brazilian entities or individuals in substantially the same manner.

Nonresident individuals or legal entities may adopt any type of legal entity recognized by the Brazilian legislation, such as, *Limitadas* (Limited Liability Companies) or Corporations (*SA*).

According to the BCC, legal entities may be classified as *sociedades simples* or *sociedades empresárias*, depending on the nature of their activities.

In general, entities that perform business activities are considered *sociedades empresárias*, while those involved with intellectual, artistic, scientific, and literary professions are considered *sociedades simples*.

In practice, *sociedades empresárias*, regardless of the type of legal entity adopted and their type of activities (services, sales, or manufacturing), must be registered with the Board of Trade (*Junta Comercial*).

In addition, such entities must be registered with the federal tax authorities, state tax authorities (depending on the activities to be performed by the entity), municipal tax authorities and the social security system. If applicable, separate registrations are required for each branch of the subsidiary located in Brazilian territory.

Both *sociedades simples* and *sociedades empresárias* can adopt different types of legal vehicles. Both can choose, for instance, the legal form of a *Limitada*, which is normally preferred over an *SA* due to its more flexible provisions with respect to limitations on liability and, to some extent, the simplified level of administrative formalities.

However, the appropriate type of entity for a specific structure or activity depends on various factors, including the nature of the business, the desired capital structure and shareholding relationships.

For instance, only an *SA* is able to issue public shares and debt. Please note that *Limitadas* and *SAs* are required to have at least 2 shareholders, but the second shareholder can hold a minimal interest.

Under normal circumstances, it takes around 20 days to have a subsidiary duly incorporated in Brazil, either as a *Limitada* or as an *SA*. However, some specific operating licenses that may be required to begin operations may take up to 6 months or more.

Note that from a tax perspective there is no difference between a branch of a nonresident company and a local subsidiary, whether in the form of a *Limitada* or an *SA*.

Types of Entities

Limitadas (Limited Liability Companies)

Structure

The Articles of Incorporation of a *Limitada* follow the form of a partnership contract. Nevertheless, a *Limitada* is considered an entity that is separate from its owners.

A *Limitada* must have at least 2 quota holders regardless of citizenship or residency. Companies as well as individuals may be quota holders of a *Limitada*.

Nonresident quota holders must grant a power of attorney to a representative in Brazil, who must be a lawyer or another quota holder, to receive service of notice and act on their behalf at quota holders' meetings. Local representation is also required by the federal tax authorities.

Corporate capital

No minimum capital requirements are imposed, except for specific situations, such as obtaining a permanent visa for a nonresident to manage the company and applying for import/ export licenses or registrations.⁴

The corporate capital of a *Limitada*, which must be denominated in Brazilian currency, is divided into quotas with fixed or different unit values as specified in the articles of incorporation.

⁴ For instance, in order to request a permanent visa a minimum capital of US\$ 600,000 or US\$ 150,000, if the company commits to hire at least 10 employees in the 2 years ensuing its incorporation, is required.

The *Limitada* may have its corporate capital increased at any time after the subscribed capital is fully paid by the quota holders.

The reduction of the corporate capital of a *Limitada*, on the other hand, is only accepted when certain specific conditions are met (such as the offset of accumulated losses).

Management

The management of the *Limitada* must be performed by a resident individual (quota holder or not), who can be a foreigner with a permanent visa and a work permit.

Quota holders' Rights

The voting rights of the quota holders are proportional to their capital holdings.

Other rights legally guaranteed to the quota holders of a *Limitada* are (i) participation in the corporate profits; (ii) participation in the net assets in the event of liquidation; (iii) supervising the conduct of the business; (iv) preference in subscribing new quotas; (v) withdrawal from the company under certain circumstances, with reimbursement of the value of their quotas as ascertained by a balance sheet drawn up for this purpose.

Profit Participation

Specific details regarding the distribution of profits are usually stated in the articles of incorporation or subsequent amendments. Although the non-proportional distribution of profits is accepted under the BCC, foreign investors may find problems implementing it with the Central Bank of Brazil.

Other Issues Related to *Limitadas*

The articles of incorporation of the *Limitada* must be filed with the Registry of Commerce.

The transformation of a *Limitada* into an *SA* or vice versa may be carried out through a simple legal procedure. The applicable laws state that all shareholders/quota holders must agree with the transformation, unless the articles of incorporation provide otherwise.

In general terms, the Corporations' Law (Law 6,404/76) is also applicable to a *Limitada*.

Limitadas and *SA* are required to have at least 2 shareholders. Sole ownership is generally not allowed (but the second shareholder can hold a minimal interest – e.g. 99.99% and 0.01%).

SAs (Sociedades Anônimas or Corporations)

The organization and operation of an *SA* in Brazil is governed by Law 6,404/76, the Corporations Law as further amended.

The Corporations Law was designed to stimulate the development of the Brazilian capital market and to provide additional protection for minority shareholders.

The *SAs* may be publicly held or privately held, depending on whether their securities are accepted for trading in the securities market.

If an *SA* is publicly held it is supervised by the Brazilian Securities Exchange Commission (*CVM*).

The incorporation process is dependent on fulfilling the following preliminary requirements:

- subscription by at least 2 persons of all the shares;
- initial payment of at least 10% of the issue price of shares subscribed in cash unless specific legislation requires a higher percentage.

If an SA is to be formed by public subscription the share issuance must be registered with the CVM prior to the public offering and the mediation of a financial institution is required.

Corporate Capital

The SAs corporate capital is divided into negotiable shares, which are indivisible in relation to the company.

No minimum capital requirements are imposed on SAs, except for the specific cases, such as obtaining a permanent visa for a nonresident to manage the company and applying for import/ export licenses or registrations, as indicated above for the *Limitadas*.⁵

The SA form is mandatory for establishing a financial institution.

SAs may issue shares with or without par value. If the corporation establishes a par value for any of its shares, it must be the same for all other shares. The issuance of shares at a price lower than their par value is prohibited.

Shares issued by an SA can be ordinary or preferred; however, the issuance of preferred shares is limited to 50% of the total shares of the corporation. Bearer shares cannot be issued by an SA.

Preferred shares grant their holders preferential rights with respect to dividends and/or reimbursement of capital, with or without a premium.

Regardless of having priority rights in the reimbursement of capital, with or without premium, preferred shares will only be accepted for trading in the securities market if they have at least one of the following preferences or benefits:

- i. the right to the dividend to be distributed, corresponding to at least 25% of the net income for the year, to be calculated according to specific criteria;
- ii. the right to receive a dividend for each preferred share, which must be at least 10% higher than the dividend assigned to each ordinary share; or
- iii. the right to be included in the public offering for the sale of control, in addition to the right to receive dividends that are at least equal to the ordinary shares' dividend.

Additionally, the bylaws must precisely indicate the preferences and benefits assigned to preferred shareholders without voting rights, or with restricted voting rights.

⁵ For instance, in order to request a permanent visa a minimum capital of US\$ 200,000 or US\$ 50,000, if the company commits to hire at least 10 employees in the 2 years ensuing its incorporation, is required.

Management

The bylaws of the SA must attribute responsibility for management duties solely to the directors.

The administrative council can only define policy guidelines for SA's business activities, including the election, dismissal, assignment of responsibilities, and supervision of the directors.

The administrative council is also responsible for appointing independent auditors. The council does not have any executive functions; representation of the company is restricted to the directors.

In the absence of any specific provision in the bylaws and of any restriction imposed by the administrative council, each director is responsible for achieving the business objectives of the SA.

The fiscal council is responsible for overseeing the performance of the administrative council and the directors.

The Corporations Law allows indicating in the bylaws whether the fiscal council shall have permanent status or whether it will be appointed only when requested by shareholders.

Shareholder Rights

The following are the fundamental rights of the shareholders of an SA:

- i. participation in corporate profits;
- ii. participation in net assets in the event of liquidation;
- iii. supervising the conduct of the business;

- iv. preference in subscribing to new share issuances, subscription rights and debentures as well as profit participation certificates; and

- v. withdrawal from the company under certain circumstances, with reimbursement of the value of the shares if the shareholder disagrees with a shareholders' resolution that fundamentally affects the company.

The bylaws or articles of incorporation may confer additional rights that can be different for each type, form, and class of share, but all shares of the same class must confer equal rights to their owners.

Shareholder agreements with regard to the purchase and sale of shares, preemption rights, or voting rights must be filed by the company to the competent authorities to become valid in relation to third parties.

Profit Participation

Dividends may be paid out of accumulated earnings, profits, and unrestricted reserves. Preferred dividends may also be paid out of certain capital reserves subject to authorization included in the bylaws.

The shareholders have the right to receive a compulsory minimum dividend as established in the bylaws.

In case the bylaws are silent in this regard, the compulsory dividend must be equal to 50% of net profits increased or decreased by the legal reserve and contingency reserve or reversal of this reserve created in prior years.

The dividend may be limited to realized net profits, provided the difference is posted as profits to be realized and included in the first dividend declared after the realization.

Despite the legal requirements, the compulsory dividend may not be paid if it is incompatible with a company's financial situation.

Profits that are not distributed because of financial difficulties must be transferred to a special reserve and, if not absorbed by subsequent losses, are to be paid out as dividends as soon as the company's financial situation allows such a payment.

Normally, dividends are paid out once a year. However, companies authorized or required by law or their bylaws may prepare financial statements each semester as a basis for distribution of an interim dividend out of current year profits.

Other Issues Related to SAs

A shareholder may be represented at a general meeting by a proxy holder appointed less than one year before, who must be a shareholder, a corporate officer or a lawyer. In a publicly held corporation, the proxy holder may also be a financial institution. A fund shall be represented by its investment fund officer.

It is important to stress that in addition to notices of shareholder general meetings, a corporation must publish its financial statements as well as any shareholder, administrative council, director and fiscal council resolutions.

Other forms of legal entities and partnerships

Although it is unlikely that any of these would be used by a foreign investor, some other types of legal entities and partnerships accepted in Brazil are:

Joint Venture Partnership (*Sociedades em Conta de Participação*)

Joint Venture Partnerships are entities without legal personality, although they are subject to the same taxation rules.

They exist only between the parties, but not in relation to third parties who deal exclusively with the managing partner (who has unlimited responsibility over the partnership's debts).

The management of the company falls exclusively upon the managing partner, who must, at the end of the contractual term, present the accounts to the other participating partners.

Limited Partnerships (*Sociedade em Comandita*)

These are considered legal entities incorporated through a corporate contract between the limited partner (*sócio comanditário*), whose liability is limited to the value of its quotas, and the general partner (*sócio comanditado*), who has unlimited liability with respect to the entity's debts.

General Partnerships (*Sociedade em Nome Coletivo*)

This is a type of legal entity in Brazil where all partners have unlimited liability, i.e., they are jointly and severally liable for the obligations of the partnership.

At least 2 partners are required, one of whom must manage the entity and reside in Brazil.

Private-Public Partnerships (PPP)

The Public-Private Partnership (PPP) has become an important administrative instrument for providing high quality public services for the population in a number of countries.

Countries that have adopted PPPs have taken advantage of private companies' expertise and efficiency in design, construction, operation, and management, while providing public services on a timely manner and at a lower cost to the government.

The first PPPs were contracted in Great Britain in 1992. A number of countries have followed this example and are adopting PPPs. Following this trend, Law 11,079/04 (Federal PPP Law) governing PPPs at the federal level was enacted in Brazil.

In addition, various Brazilian states (such as Minas Gerais, Santa Catarina, São Paulo, Goiás, Rio Grande do Sul, Bahia, Ceará, Sergipe, Pernambuco, Distrito Federal and Rio de Janeiro) have also issued legislation, governing PPS at the state level, which are very similar to the Federal PPP Law.

In general terms, a PPP is a sponsored or administrative type of concession agreement. In a sponsored concession, in addition to a tariff charged to the end users, a subsidy is provided by the public partner to the private partner.

An administrative concession consists of a contract for providing services where the public partner is the direct or indirect user of the public service.

The Federal PPP Law has introduced several innovations to Brazilian administrative contracts, which may substantially improve the quality of the public administration projects in the eyes of the investors and the private financiers.

This allows the application of internationally accepted PPP principles, which assures better quality in the public services for the users in a continuous, long-term manner.

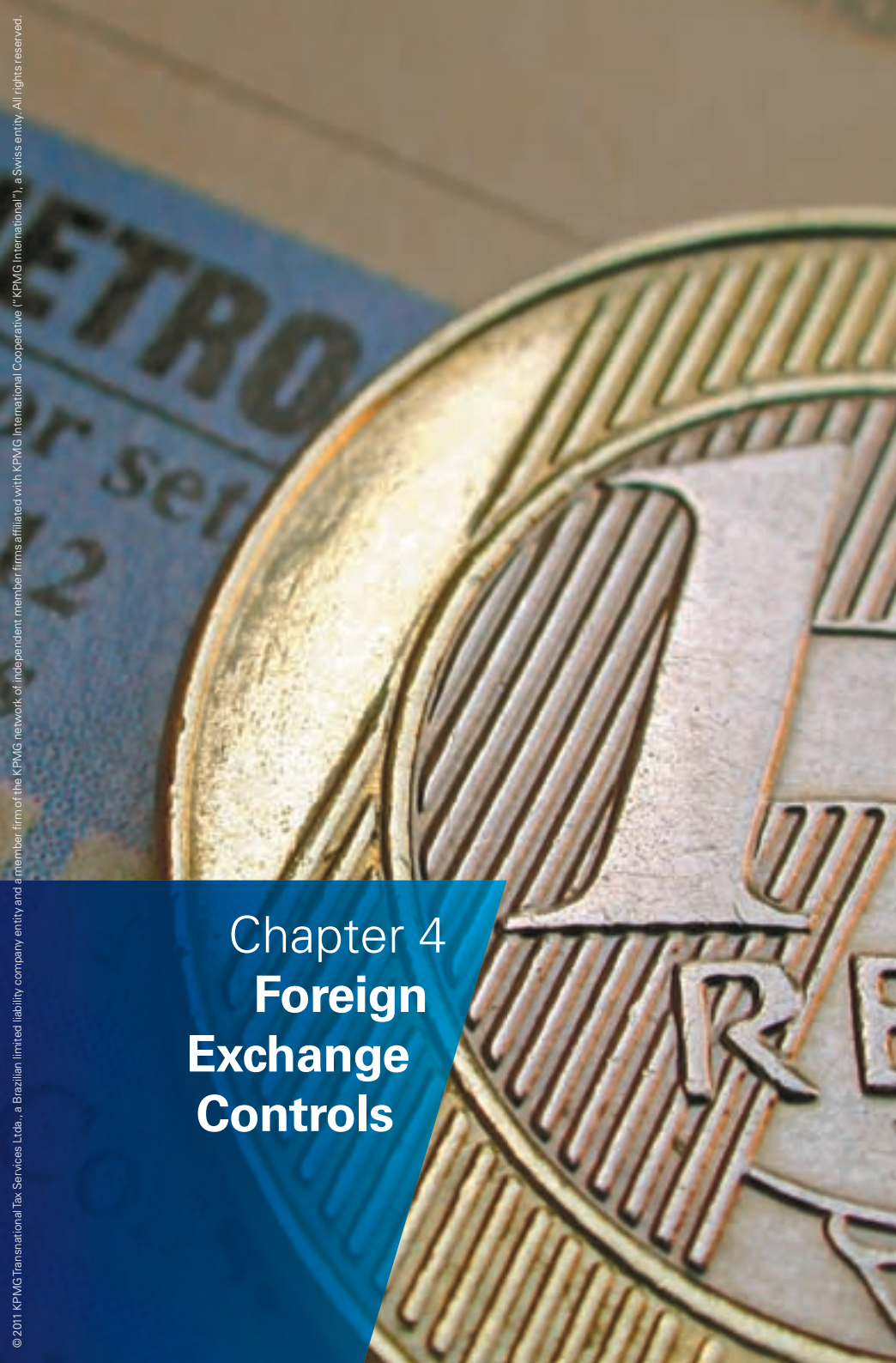
Several other PPPs are being structured in the road, water, rail, airport, prison, sport and leisure, public buildings and education sectors of Brazil and should be tendered and finalized in the near future.

Bidding

Transactions contracted with the public sector in Brazil involve the compliance with certain procedures and requirements. Acting in the public interest demands the control taken through biddings.

The public must have free access to information concerning bidding procedures and any interested party can administratively or judicially challenge government actions.

On bidding process, the nationality of the bidders will be considered only as a tie breaking criteria.



Chapter 4

Foreign Exchange Controls

Other practical issues to be observed when setting up and operating a business in Brazil revolve around compliance with the foreign exchange controls imposed by the Brazilian government, restricting access to the commercial exchange market to individuals and companies engaged in international trade transactions.

Restriction on Foreign Investments

Only a few economic activities such as public health, mail and telegraph, nuclear energy, airlines with domestic flight concessions, sanitation, and the aerospace industry continue to be restricted to foreign investors.

Foreign investors can currently hold only a minority participation in media, financial institutions and insurance companies, but may acquire the control of a bank, with prior authorization from the government or under a reciprocal agreement.

Additionally, there are restrictions on foreign participation in activities subject to national security concerns and on foreign ownership of rural areas and businesses in border zones.

A potential investor should consult the government agencies that would most likely hold an interest in a proposed project. This process can sometimes yield significant benefits to the foreign investor, since the government generally prefers to grant incentives (tax and funding costs, for example), rather than restrictions, to encourage investors.

Acquisition of Real Estate

The Brazilian legal environment brings detailed rules for local real estate property, granting protection to the owners.

Foreign individuals and entities have the right to acquire real estate property in Brazil, provided some additional obligations are met, such as getting a corporate taxpayer registration number – Individual Taxpayer’s Registry (*CPF*) or National Registry of Legal Entities (*CNPJ*) – and a local legal representative.

Furthermore, as anticipated, Brazilian regulation provides for special restrictions on foreigners who are interested in purchasing properties located near the coast, at the border or at specific locations considered to be concerns for national security.

The controversial Law 5,709/71 provides that foreign individuals who have permanent residence in Brazil, foreign companies authorized to operate here, and Brazilian companies controlled by foreigners are authorized to acquire rural properties, under certain conditions and limits.

Before purchasing real estate in Brazil, it is very important for buyers to check if the seller has valid title of the property and there are any pending or contingent collection lawsuits.

In addition, it is recommended to check whether the taxes on properties have been paid and there are no liens on the real estate. In all cases, buyers should seek legal advice.

Upon the purchase of freehold property, buyers should follow the steps to register the change of title with the real estate registry.

Long and short term leasehold agreements should also be registered within the real estate registry in order to minimize potential disputes with the landlord.

Foreign Exchange Policy

The status of the balance of payments is one of the most critical elements of the government's economic policy. Accordingly, maintaining the exchange rate at an appropriate level has been, and still is, an important objective of the economic policy.

Keeping domestic interest rates higher than interest rates overseas produced obvious long-term disadvantages for a country that has historically been a net foreign debtor.

However, this policy has been successful in attracting foreign capital. Interest rates have decreased over the past years, although they continue to be very high by international standards.

In 2005, new legislation – Regulation of Foreign Exchange Market and International Capital (*RMCCI*) – was enacted, which basically united the 2 foreign exchange markets existing in Brazil at the time by integrating the regulations governing the free exchange rate market (*Mercado de Câmbio de Taxas Livres*), floating exchange rate market (*Mercado de Câmbio de Taxas Flutuantes*) and the transactions known as International Transfer of *Reais*.

The *RMCCI* introduced flexibility in terms of foreign exchange transactions, reducing the burdensome requirements associated with implementing certain operations, allowing legal entities and individuals to purchase foreign currency without direct or prior Brazilian Central Bank (*BACEN*) approval.

Another result of the *RMCCI* is that Brazilian entities or individuals are allowed to make foreign direct investments abroad without prior approval from *BACEN* or observing quantitative limitations.

All foreign exchange transactions must be contracted with an authorized agent, normally a private financial institution authorized by *BACEN* to operate in the exchange market. Most foreign exchange transactions do not depend on *BACEN* pre-approval or approval, so private financial institutions may make their clients' remittances directly.

The entry of capital into Brazil must be registered with *BACEN* through the declaratory electronic system Electronic Declaratory Registration of Foreign Direct Investments (*RDE-IED*). The proper registration of foreign direct investments is very important in enabling the future repatriation of capital and remittance of dividends, interest on equity, and capital gains.

New foreign exchange regulations, in force since 2006, introduced rules which permit the registration of tainted foreign capital under certain circumstances. The tainted may be described as the foreign investment that, for any reason, is not registered at the *BACEN*.

The main tax issue related to the lack of registration is that the unregistered foreign direct investment is treated as national, preventing any valid remittance that implies currency exchange for the payment of dividends or capital repatriation. From a tax point of view, it could be said that the registration of the foreign capital in *BACEN* is a requirement for repatriating profits.

The Brazilian *BACEN* tracks foreign currency transactions involving the export of goods and services and provides this data to the Brazilian Federal Tax Authority.

Brazilian entities or individuals are allowed to keep export revenues in foreign currency in bank accounts abroad, provided they observe the limitation set forth by the National Monetary Council (*CMN*).⁶

It is important to keep in mind that a nonresident individual or legal entity holding export revenues abroad must declare them to the Brazilian Federal Revenue (*RFB*) and needs to keep proper accounting records and documentation for operations with such funds.

RDE-IED Registration

All foreign direct investments must be registered with *BACEN* online electronic system named *RDE-IED*. The registration is essential, in order to enable the future remittance of dividends and to assure the eventual repatriation of the original capital.

The registration of foreign capital must be made within 30 days from the date it enters Brazil except in the case of capital contributions with goods, which must be registered within 90 days as of customs clearance.

Periodically, certain information such as financial statements of the Brazilian entity and any changes in shareholdings must be recorded online and registered with the *RDE-IED*.

The Brazilian investee and the representative of the foreign investor, if applicable, are responsible, ves, for the registration of foreign investments.⁷

Foreign Direct Investments

Foreign capital in Brazil is governed by Law 4,131/62 as amended by Law 4,390/64. According to the referred law, “foreign capital” is considered to be any goods, machinery, and equipment that enter Brazil with no initial disbursement of foreign exchange, and are intended for the production of goods and services, as well as any funds brought into the country to be used in economic activities, provided that they belong to individuals or legal entities resident or headquartered abroad.

In 1988, political leaders representing labor in Congress sided with conservative politicians to approve an openly nationalistic constitution. Since then, however, the treatment of foreign investment has improved.

The constitutional distinction between foreign-owned and Brazilian-owned companies registered in Brazil was repealed by a constitutional amendment approved in 1995. Other constitutional barriers against foreign investment in protected sectors have also been removed.

These reform efforts have led to an increase in foreign investments, especially in capital-intensive industries.

Capital Contributions

The Brazilian concept of capital covers economic benefits in any form, and, accordingly, foreign capital contributions include cash, goods, services, and intangibles.

In practice, investments in cash are the simplest and most common form of initial investment, but investments in the form of assets and the capitalization of accounts payable for goods supplied by the foreign parent are often used when making subsequent investments.

Capital contributions of productive assets, such as plant and equipment, are subject to rigorous controls. The process includes certification that there is no local producer to supply the equipment.

In order to receive an import license, the applicant must evidence that the equipment contributes to the Brazilian economy in technological and economic terms and justify the foreign currency value attributed to the equipment, among other things.

Although Capital contributions of intangibles are allowed *BACEN* is very reluctant in accepting them. Proper valuations are required and discussions with *BACEN* are recommended.

⁷ Note that to be registered as a foreign capital investment, the amount contributed must originate from persons resident, domiciled, or with a head office outside Brazil. The capital contribution must be effectively brought into the country and invested in the acquisition of shares or quotas.

Financial Transactions (*RDE-ROF*)

Most cross-border financial transactions such as loans, rentals, leases, as well as agreements involving transfer of technology (royalties, know-how, technical assistance, etc.) must be posted in *BACEN* online electronic registration system Electronic Declaratory Registration of Financial Operations (*RDE-ROF*) in order to enable remittances abroad.

The private financial institution responsible for the corresponding foreign exchange contract normally assists the companies with the *RDE-ROF* registrations. In the case of cross-border loans, *BACEN* has the right to convert the portion of an interest remittance it considers to be above market into early return of principal.

Payments of Dividends and Interest on Net Equity

Provided the foreign capital is properly registered, the foreign investor should have no difficulties in receiving dividends or interest on equity from its Brazilian subsidiary. However, companies with negative net equity are not allowed to remit dividends or interest on equity until all the losses are absorbed by profits.

Conversion of Foreign Debt into Share Capital

The conversion of foreign loans duly registered in the *RDE-ROF* into equity investments does not require prior approval from *BACEN*.

The conversion of debt into foreign direct investment is defined as “the transaction whereby rights and credits eligible for transfer abroad, as well as assets belonging to non-residents are used for the purchase, contribution of capital to a Brazilian entity or to absorb losses in a Brazilian entity.”

Nevertheless, the registration of a foreign direct investment resulting from debt conversion does require certain documents and *BACEN* filing procedures.

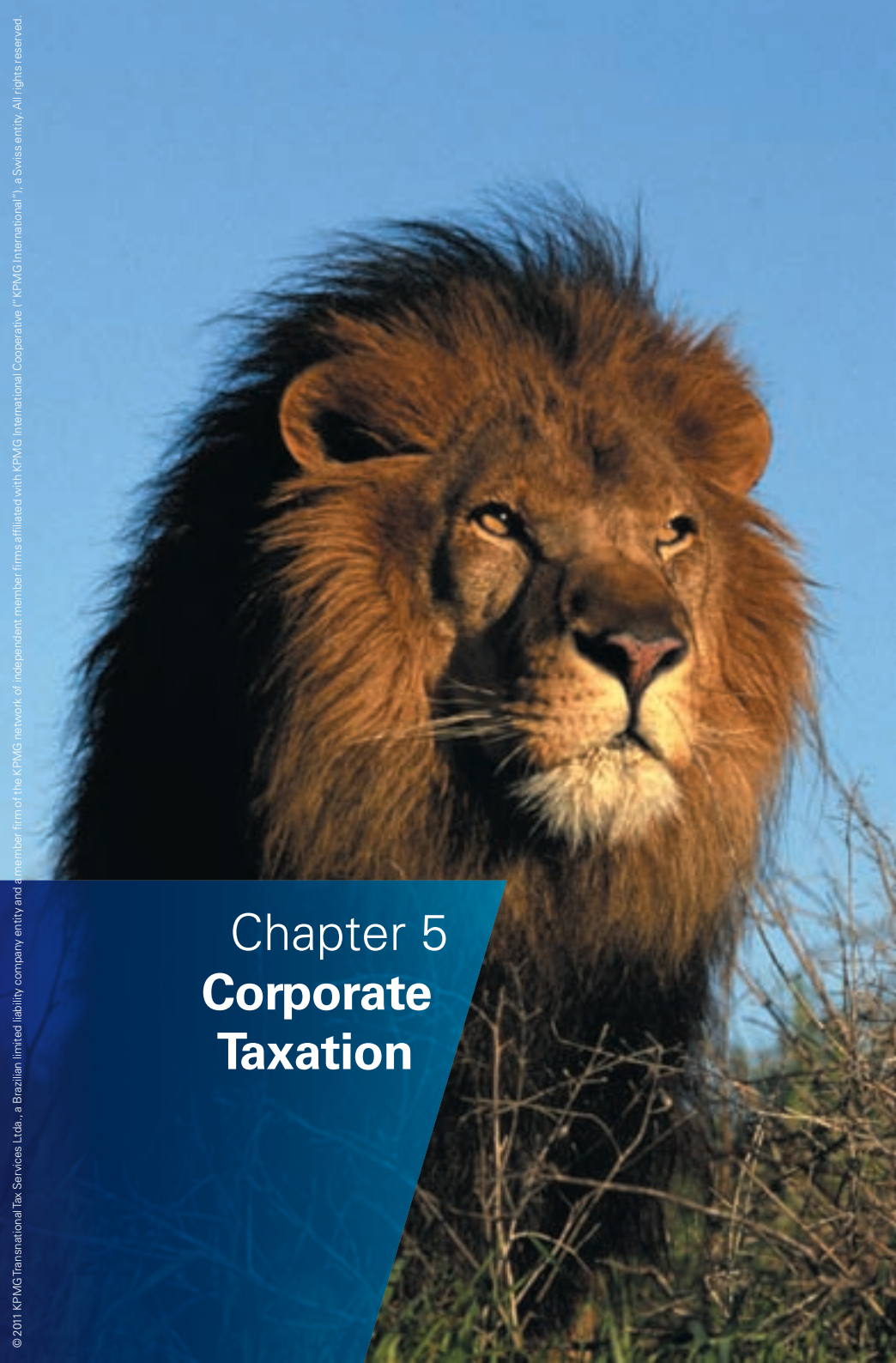
Portfolio Investments (*RDE-Portfolio*)

Nonresident individuals or legal entities (including foreign funds or financial institutions) that make certain financial investments in the Brazilian market are required to register such investments in an electronic *BACEN* registration system called *RDE-Portfolio*.

Please note that the foreign investor must observe *BACEN* and Brazilian Securities Exchange Commission (*CVM*) rules. For instance, it is necessary to appoint a legal representative in the country and to open an individual or collective bank account.

Reporting

Annually, individuals or domestic legal entities with assets abroad in an amount greater than the equivalent of US\$100,000.00 (one hundred thousand United States dollars), must file a specific form, Brazilian Capital Abroad Return (*DCBE*), with *BACEN* reporting all foreign investments, detailing these assets.



Chapter 5 **Corporate Taxation**

Given Brazil's strong growth fundamentals supported by financial stability and infrastructure investment, it is no surprise that companies are considering expanding their business in the Brazilian market. But decisions made now can have enduring consequences. Lack of market understanding or insufficient forward planning can blight a venture in years to come.

Commercial and operational issues, taxation, intellectual property, employee remuneration and regulation all bring challenges in new markets and jurisdictions. Meanwhile pricing, innovation, supply chains and routes to market in one industry or sector may turn out to be quite different in another.

The Brazilian tax system is based on the principle of strict legality and its main principles are defined by the Federal Tax Code of 1966 and by the Federal Constitution of 1988. The tax legislation defines 3 jurisdictions and tax collection levels. Thus, taxes may be levied by the federal, state and municipal governments.

On the other hand, there is a separation of jurisdictions and powers between the judiciary and the administrative boards for the judgment of controversies. In this sense, a tax matter is usually analyzed at the administrative level before the judiciary.

The federal tax system is managed by the Brazilian Federal Revenue (*RFB*), which is part of the Ministry of the Economy (*Ministério da Fazenda*). All states and most municipalities have similar agencies.

Federal Corporate Income Taxes

There are 2 income taxes in Brazil: (a) the corporate income tax and (b) the social contribution tax on profits. They are imposed on similar taxable bases.

The Brazilian tax year is the calendar year, irrespective of the corporate year. The annual income tax return must be filed by the date determined by the *RFB* – normally the last business day of June. The income tax return must also be filed when certain special events occur during the year (e.g., mergers, liquidations, spin-offs).

Corporate Income Tax

The income tax regulations in force are consolidated under Decree 3,000 of March 26, 1999, which is applied to all tax payers. Only the federal government may charge income tax; however, part of the income tax collected is transferred to states and municipalities.

Brazilian corporate income tax is a federal tax charged on net taxable income. It applies at a basic rate of 15%, plus a surtax of 10% on annual income that exceeds R\$ 240,000.00 per year or R\$ 20,000.00 per month.

Social Contribution Tax on Profits

This tax was introduced to fund social and welfare programs and is paid in addition to the corporate income tax.

The social contribution tax on profits is also a federal tax levied on net taxable income and is applied at a rate of 9%. It is not deductible for corporate income tax purposes. The tax base of this contribution is similar to the tax base of the corporate income tax, although some specific adjustments may be applicable to one tax and not to the other.

The current tax rate (effective after May 1, 2008) for financial institutions, private insurance and capitalization companies is 15%.

Calculation Methods

There are 3 methods provided by legislation to calculate corporate income tax and social contribution tax due on profits: actual profit, presumed profit and arbitrated profit.

Actual Profit System

Under the actual profit system, net taxable income corresponds to the company's net book profit, arrived at by applying Brazilian GAAP, adjusted by some inclusions and deductions per Brazilian corporate tax legislation.

In this sense, under the actual profit system, companies are required to keep appropriate accounting records, the Taxable Income Control Register (*LALUR*) and supporting documentation and calculations in order to demonstrate the amount of tax due.

Taxpayers under the actual profit system may choose to calculate taxes on a quarterly or annual basis. The choice must be made at the beginning of each calendar year and is valid for the entire fiscal year.

Under the annual actual profit system, taxable income is computed on an annual basis, but monthly advances during the year are required to be made on an (a) estimated basis or (b) actual basis. The estimated base corresponds to the presumed profit tax base, discussed further below.

The main exclusions from taxable income include dividends received from other Brazilian entities related to profits generated after 1996 and equity pick-up revenue from investments in other companies. Main inclusions relate to nondeductible accounting provisions and non-deductible expenses.

Expenses relating to the ordinary conduct of a trade or business of a company, properly documented and necessary to maintain a company's source of income are generally deductible.

Presumed Profit System

Brazilian companies may elect to compute corporate taxes based on presumed net profit, provided they (a) do not have total revenues in the preceding year higher than R\$ 48 million, (b) are not financial institutions, similar entities or factoring companies, (c) do not earn foreign profits, income or gains (i.e. directly or through foreign subsidiaries), and (d) do not qualify for an exemption or reduction of the corporate income tax.

The election to use the presumed method is made annually, at the beginning of the year and the choice may be renewed every year.

The election is valid for both corporate income tax and social contribution tax on profits. Under the presumed tax regime, the taxes must be calculated and paid on a quarterly basis.

The presumed profit is arrived at by applying a certain predetermined percentage, which varies according to the activity, over the gross sales.

The total amount of capital gains, financial revenue and other revenue must be added to this presumed profit base to compute the corporate taxes. The corresponding tax rates are then applied over the presumed profit.

For instance, for the income tax, the percentage for the revenues derived from the sale of products is 8%, while the percentage for service revenue is 32%. For the social contribution tax on profits, the percentages are 12% and 32%, respectively.

Illustrative calculation:

Income Tax	Amount (\$)
Gross Sales	1,000
Presumed Profit for income tax (8%)	80
Financial Revenue	500
Total Presumed for income tax	580
Income tax due (app. 25%)	145

Social Contribution	Amount (\$)
Gross Sales	1,000
Presumed Profit for social contribution (12%)	120
Financial Revenue	500
Total Presumed for social contribution	620
Social contribution due (app. 9%)	55.80

It should be noted that under the presumed tax system losses carry forwards may not be utilized to reduce the presumed profit.

The choice to pay the income taxes under the presumed system does not prevent the Brazilian entity from paying dividends corresponding to the amount of actual book profit, in case it exceeds the presumed profit.

However, the company is required to keep proper accounting records and balance sheets to demonstrate the book profits.

Arbitrated System

Under certain circumstances, such as inadequate or unreliable record keeping, the tax authorities may arbitrate profits. In this sense, the method is a type of punishment applicable in situations provided for by law.

The income tax paid on the arbitrated profit is definitive and cannot be offset against future payments. The arbitrated profit system is similar to the presumed profit, but with higher percentages to be applied over the gross sales. In addition, penalties may be charged by tax authorities.

Tax Losses

Tax losses may be carried forward indefinitely (there is no statute of limitations). The offset is limited to a maximum 30% of annual taxable income and no carry back of losses is allowed.

Non-operational losses may be carried forward, but they may only be utilized to offset non-operational profits (e.g., capital gains).

Tax losses are lost if between their generation and their utilization, cumulatively, there is a change in control and change in the type of activity performed by the taxpayer.

Tax Audits

Tax audits are performed by federal tax inspectors on a random basis. The scope and frequency of auditing does not follow a set pattern.

In general, the right of the tax authorities to make corporate income tax assessments (statute of limitation for tax purposes) expires 5 years after the end of the tax year in which the tax return should have been filed.

Administrative appeals against assessments must be filed within 30 days of assessment. If the assessment is upheld, the taxpayer may appeal to an administrative court. If still unsuccessful, the taxpayer can appeal to the judicial court.

Penalties and Fines

The penalty for past due federal taxes is currently set at 0.33% per day, up to 20% depending upon the period in arrears. Interest on past due federal taxes is charged at a floating rate of Special System of Settlement and Custody (*SELIC*) plus 1%.

Assessed tax deficiencies are generally subject to a 75% fine, which may be reduced to 37.5% if settled within 30 days. In the case of absence or underpayment of monthly advances of income tax or social contribution tax on income, the applicable fine is 50%, even if tax loss has been verified in the annual calculation. If fraudulent intent is proven, the fine is increased up to 150%.

When business entities are in arrears with any federal taxes or social security contributions, they are prohibited from distributing bonus shares to their stockholders or from paying any profit participation to quota holders, partners, directors, or members of the administrative council. In case of failure to comply with the restrictions, penalties may apply.

Gross Revenues Taxes

Social Integration Program (*PIS*) and Social Security Contribution (*COFINS*)

PIS and *COFINS* are federal taxes charged on gross revenues, on a monthly basis, under 2 regimes: cumulative and non-cumulative.

Historically, *PIS* and *COFINS* were charged at 0.65% and 3%, respectively, for most companies and generated a harmful cascading effect because of the lack of a credit mechanism, thereby increasing the tax burden and the cost of products and services in Brazil.

New *PIS* and *COFINS* tax provisions were implemented in December 2002 (Law 10,637/02) and December 2003 (Law 10,833/03). As a result of such rules, the *PIS* and *COFINS* rates were increased from 0.65% to 1.65% and from 3% to 7.6%, respectively, and a credit mechanism was introduced.

According to this new non-cumulative mechanism, taxpayers may generally recognize *PIS* and *COFINS* credits corresponding to 1.65% and 7.6% over certain costs and expenses. Such credits may be used to offset *PIS* and *COFINS* due on their taxable revenue.

Thus, taxpayers under the non-cumulative system are subject to *PIS* at 1.65% and *COFINS* at 7.6% and are allowed to recognize tax credits for *PIS* and *COFINS* levied on certain inputs. These inputs include: (a) products purchased for resale; (b) goods and services used as inputs in the rendering of services or manufacturing (excluding labor);

(c) consumed electrical power; (d) the rental of real estate and fixed assets applied in the activities; (e) the acquisition of fixed assets and (f) returned goods, if the corresponding revenue was included in the previous month's *PIS* and *COFINS* taxable bases.

Tax credits may be used to offset future *PIS* and *COFINS* due or other federal taxes provided certain requirements are observed.

The *PIS* and *COFINS* non-cumulative regime is mandatory for companies subject to the actual profit method of computing corporate income taxes.

The former *PIS* and *COFINS* cumulative system remains applicable for certain entities, such as financial institutions and companies under the presumed profit system, among others entities, and for some revenues deriving from telecommunications, transport and software development services, which are generally subject to a 0.65% tax rate for *PIS* and 3% tax rate for *COFINS* with no credits available. Financial institutions are subject to a 4% *COFINS* rate.

Companies with revenues subject to the cumulative system and other revenues subject to the non-cumulative system will be required to calculate *PIS* and *COFINS* separately in both systems.

Revenues related to export transactions and the sale of fixed assets are, in general, exempt from these taxes.

There are special *PIS* and *COFINS* regimes for companies engaged in some types of industries, such as automotive, auto parts, cosmetics, pharmaceutical, oil, beverage, packaging materials, energy, and real estate, among others.

Additionally, as of May 1, 2004, the import of goods and services are also subject to *PIS* and *COFINS* at a combined rate of 9.25%. The 9.25% combined rate applies to taxpayers under both cumulative and non-cumulative regimes. In some cases, taxpayers may recognize *PIS* and *COFINS* credits on the import.

Indirect Taxes

Federal Excise Tax (*IPi*)

IPi is a federal tax levied on the import and manufacture of goods. In many aspects, it operates like a value added tax, which is charged on the value aggregated to the final merchandise. As a general rule, *IPi* paid on a prior transaction can be used to offset the *IPi* liability arising out of subsequent taxed operations.

The applicable rate depends on the product and its classification under the *IPi* Tax Rates Table (*TIPi*). The classification within *TIPi* generally follows the Brussels Harmonized Tax Codes.

IPi also has a regulatory nature, i.e., the Executive Power may increase its rates at any time by decree as a way to implement financial and economic policies. Additionally, *IPi* rates can be higher for nonessential products such as cigarettes, perfumes and others.

Each facility (branch) is considered a separate taxpayer for *IPi* tax purposes.

For domestic transactions, in most cases, the taxable event is the exit of the manufactured product from the facility where it was manufactured. *IPi* is usually applied on the value of the transaction plus State Value-Added Tax (*ICMS*).

Brazilian tax legislation defines “manufacture” as any process that modifies the nature, operation, finishing, presentation or purpose of a product, or improves a product for consumption.

IPi taxpayers are entitled to an *IPi* tax credit equivalent to the tax paid upon the acquisition of the inputs to be used in the manufacturing process. This credit may be offset against *IPi* triggered by subsequent transactions. Under certain circumstances, excess *IPi* tax credits that cannot be offset against *IPi* due on subsequent transactions may be offset against other federal taxes. *IPi* does not apply on the sale of fixed assets, but some requirements must be observed.

State Value-Added Tax (*ICMS*)

ICMS is a state type of value added tax levied on the import of products and certain transactions involving goods (including electricity), inter-municipal and interstate transportation services and communication services.

In general, when transactions involve 2 different states, the rates are 7% (when the purchaser is located in the states of the North, Northeast and Center West regions or in the state of Espírito Santo) or 12% (for purchases located in the South and Southeast regions).

For transactions within the same state and in the case of imports, the rates may be 17%, 18% or 19%. The 19% rate is applicable for the state of Rio de Janeiro; the 18% is applicable for the states of São Paulo, Paraná and Minas Gerais; and the 17% is applicable for the remaining states. Sales of automobiles, communications services and electricity are subject to 25% *ICMS*.

ICMS is also due either when a product is resold in the domestic market or when it is physically removed from a manufacturing facility. The taxable base is equal to the value of the transaction, including the *ICMS* itself (gross-up), insurance, freight and conditional discounts.

IPI must also be added to the *ICMS* tax base when the transaction is carried out between non-*ICMS* taxpayers or when it involves a product that will not be further manufactured or resold (e.g., fixed assets).

Similarly to *IPI*, each branch of a company is considered a separate taxpayer for *ICMS* tax purposes.

In general, *ICMS* taxpayers are entitled to a tax credit in the amount of the tax paid in the previous transaction with the same asset (inputs), provided the purchaser is an *ICMS* taxpayer with respect to that product, i.e., the subsequent transactions with the purchased product are also subject to *ICMS*. The tax credit may be offset against future *ICMS* payables.

If the purchaser is not an *ICMS* taxpayer, and depending on whether its sales are subject to this tax, *ICMS* may become a cost and will not be recoverable as a credit.

In regards to *ICMS*, it is important to highlight that due to the fact that each state has its own legislation there is a “tax war” between the various states in Brazil, each aiming to attract investments.

In order to generate more profits for the state government, a state will often grant *ICMS* tax benefits for investments on its territory without the approval of other states.

As a result, some states are currently challenging tax benefits granted in another state, which have not been properly approved by all states.

To mediate this complex situation, tax reform legislation has been proposed, however, it is still pending a decision by the Congress.

Municipal Service Tax (*ISS*)

ISS is a municipal tax levied on revenues derived from the provision of services. Although it is a municipal tax, the specific services subject to *ISS* are listed in federal law (Complementary Law 116/03).

The tax base for *ISS* is the price or value of the service. The rates vary from 2% to 5%, in accordance with the municipality where the service provider is located, where the service is provided and the type of the service.

For most services, there is significant debate as to whether the *ISS* should be paid to the municipality where the service provider is located or the municipality where the service is performed.

In principle, the taxpayer is the service provider. However, the municipal tax legislation may impose a withholding responsibility to the company hiring the services.

When providing a service also involves a sale of goods, *ISS* applies to the total price of the transaction, except when there is a specific provision determining the applicability of *ICMS* on the value of the products sold.

Import taxes

Import Tax (II) and other Miscellaneous Fees

It applies to the cost, insurance and freight (*CIF*) value of imported products at variable rates. This is a final tax, meaning that no credits are granted.

Specific rates depend on the classification of the imported product in *II* Tax Rates Table (*TEC*), and the taxable event is the customs clearance.

Other customs fees include processing fees for import licenses, freight duties, when necessary, which fund the merchant marine fleet (levied at 25% on the freight cost), as well as miscellaneous port charges.

Federal Excise Tax (*IPI*)

IPI applicable rates also vary in accordance with the tax classification of the product in the *TIP* (*IPI* tax products list, based on the *TEC*).

The rates average between 10% and 20%. *IPI* is levied on direct imports and subsequent domestic transactions with imported products or manufactured goods.

As a general rule, an *IPI* tax credit in the amount of the tax paid on the import is granted in cases where the subsequent transaction involving the same product, or another product in whose manufacture the imported product was used, is subject to *IPI*. The taxable base is the *CIF* amount plus the import tax.

State Value-Added Tax (*ICMS*)

ICMS is also charged on imports. Importers are generally entitled to recognize a tax credit in the amount of the tax paid to be used to offset future *ICMS* liabilities. Applicable rates are normally 17% to 19%. The tax base is the *CIF* amount plus the import tax, *IPI*, the *ICMS* itself and *PIS* and *COFINS*.

Social Integration Program (*PIS*) and Social Security Contribution (*COFINS*) Import

PIS and *COFINS* are enforced on the import of products and applied at a combined rate of 9.25% (1.65% and 7.6%, individually). *PIS* and *COFINS* paid on imports may generate a tax credit to be offset with *PIS* and *COFINS* due on domestic transactions provided the importer is subject to the non-cumulative *PIS* and *COFINS* basis.

The tax base is the *CIF* amount plus *ICMS* and *PIS* and *COFINS*. Please note that certain products may be subject to different tax rates.

Contribution for Intervention in the Economy (*CIDE*)

CIDE is a 10% contribution levied on payments to nonresidents in the form of royalties, technical and administrative services and technical assistance, among others.

Note that, differently from the withholding tax, *CIDE* is a tax imposed on the Brazilian payer of the fees and, therefore, may not be reduced by tax treaties and may not generate a tax credit abroad.

There is a limited tax credit granted to the Brazilian entity for *CIDE* paid on royalties for the use of trademarks or trade names which reduces the effective tax rate.

Law 11,452, enacted on February 27, 2007, established that royalties for software licenses are no longer subject to this levy.

This provision is retroactive to January 1, 2006, which allows recognizing tax credits for *CIDE* payments made for software license fees.

CIDE Combustíveis is another contribution levied on the import and sale of oil and gas related products including ethanol.

According to current legislation, the manufacturer, the formulator and the importer are the taxpayers for *CIDE* Combustível purposes.⁸

Municipal Service Tax (*ISS*)

As of January 2004, *ISS* also applies on the import of services. The Brazilian company retaining the services is obliged to withhold the tax on the service fees paid to the nonresident.

Furthermore, Complementary Law 116/03 introduced an *ISS* exemption to certain exports of services.

Other Federal Taxes

Withholding Income Tax (*IRRF*)

Withholding income tax applies to certain domestic transactions, such as fee payments to certain service providers, salary payments and financial income resulting from investments. In most cases, this withholding tax is a prepayment of income tax liability reflected on the final tax return of an individual or an entity. However, in some cases it is considered a final taxation.

Also, withholding income tax is due on payments of Brazilian source income to most nonresidents (e.g., payments of Brazilian source royalties, service fees, capital gains, interest, and others). According to Brazilian tax law, withholding tax is due upon the payment, credit, delivery, utilization or remittance of the funds, whichever occurs first.

⁸ See law 10,336/01

The rates depend upon the nature of the payment, the residence of the beneficiary and the existence of tax treaties between Brazil and the country where the beneficiary is located. Most common rates range from 15% to 25%. As a general rule, income paid to beneficiaries located in low tax jurisdictions is subject to 25% withholding tax.

Tax on Financial Operations (IOF)

IOF is a federal tax levied on credit, exchange, insurance and securities transactions executed through financial institutions and includes intercompany loans. The tax also applies to gold transactions.

The tax rates can be raised by the Federal Government by decree and become effective immediately. The tax base varies according to the taxable event and the financial nature of the transaction.

The *IOF* is levied at varying rates, depending on the type of transaction and maturity terms, if applicable.

Transaction Type	Tax Range
Credit transactions	0 – 1.5% per day
Securities transactions	0 – 1.5% per day
Insurance transactions	0 – 25%
Exchange transactions	0 – 25%
Gold transactions	1% payable on the first sale transaction

For loan transactions in Brazilian currency, the *IOF* is levied on the average daily balance or on a transaction basis. The applicable rate is 0.0041% plus an additional 0.38% per day if the borrower is a legal entity and 0.0082% plus an additional 0.38% per day if the borrower is an individual.

Note that for loans with a maturity date longer than one year the effective rate is limited to 365 times the applicable daily rate.

For insurance transactions, *IOF* tax rates range from 0% to 7.38%, however, the applicable rate is 7.38% for most transactions.

Regarding securities transactions, the *IOF* tax rate varies from 0% to 1.5% according to the type of investment. It is important to note that if the securities are traded by means of foreign investments in the Brazilian financial and capital markets, the liquidation of the corresponding foreign exchange contract is subject to *IOF* at a rate of 6%, except for variable-rate income investments (e.g., stocks negotiated in the stock exchange).

The *IOF* rate is zero on foreign exchange operations related to the inflow of revenue derived from the export of goods and services and outflow of funds derived from the import of goods. The import of services, however, is subject to *IOF* at a rate of 0.38%.

Recently, the Brazilian government increased the *IOF* rates levied on currency exchange transactions for foreign investments in the financial and capital market. The main reason for this, according to the Government, was to reduce the appreciation of the Brazilian currency by discouraging the inflow of short-term investments.

The increased rates were applied, for instance, on foreign investments in fixed income and investment funds, such as foreign investments made through Investment in Partnership Investment Fund (*FIPs*), which are widely used by private equity funds.

On December 31st, 2010, the Brazilian government published Decree 7,412, changing the *IOF* legislation once again. In general terms, the *IOF* rate levied on currency exchange transactions for foreign investments in the financial and capital market remained at the increased rate of 6%.

However, the decree reduced the *IOF* rate levied on foreign investments made through *FIPs* or Investment Funds in Emerging Entities (*FMIEE*) to 2%.

Rural Land Tax (*ITR*)

ITR is an annual federal property tax levied on the ownership or possession of real estate located outside urban perimeters. Taxable bases vary according to the value, size and location of the real estate, and tax rates vary in accordance with land use.

Other State Taxes

Tax on Transfer of Property by Donation/ Succession (*ITCMD*)

ITCMD is a state tax imposed on the transfer of ownership of goods and rights upon *causa mortis* (succession) and donations. Tax rates vary according to state legislation.

Vehicle Tax (*IPVA*)

IPVA is a state tax levied on ownership of motorized vehicles (cars, trucks, boats and other taxes). The tax base is the value of the vehicle with rates varying according to state legislation.

Other Municipal Taxes

Municipal Real Estate Tax (*IPTU*)

IPTU is an urban real estate property tax charged annually by municipalities based on the assessed value of the property, which may not correspond to fair market value. Tax rates vary according to the municipality and location of the property. The *IPTU* taxpayer is the owner of the real estate, or the tenant if the property is leased and the agreement provides for it.

Property Transfer Tax (*ITBI*)

ITBI is a real estate transfer tax charged at variable rates ranging from 2% to 6%. This tax is usually not levied if real estate is transferred under a corporate reorganization (e.g., mergers, spinoffs, capital contribution in kind and others).



Chapter 6 Incentives

A wide range of government incentives is available for startup projects in Brazil. In general, the international investor has equal access to these incentives when compared to local investors.

The use of government incentives is a significant feature of the Brazilian business environment. Usually, incentives take the form of subsidized loan financing and tax exemptions or reductions, rather than cash grants.

Federal, State and Local Incentives

Federal government incentive programs are designed to promote domestic policy objectives, including the growth of exports and the capitalization of domestic private industry, whereas state and local incentive programs are directed toward specific objectives such as increasing local employment opportunities.

State and local governments commonly use an exemption or deferral of indirect and property taxes that they are entitled to levy, and provide assistance to potential investors in obtaining access to available federal programs.

Thus, a company that has decided to establish a new plant for export production and which is eligible for federal programs will seek the best available package of local incentives when deciding where to locate a plant.

Brazilian government incentive programs are subject to frequent revisions, both in relation to their basic approach as well as the specific categories and rates of tax incentives granted.

Accordingly, companies planning to avail themselves of incentive programs should, as a first step, obtain the latest available information.

Usually, federal and state governments do not give cash grants to reduce initial outlays on industrial buildings and equipment.

As an exception, capital grants in the form of land can be obtained from local governments and are often provided through state development agencies.

Additionally, there are various government incentive programs providing low cost financing. In former years, Brazil has experienced chronic inflation and even presently continues to have high bank interest rates.

Under these circumstances, subsidized rate financing has long been very important for certain sectors of the Brazilian economy, and has formed the basis for the expansion and modernization of Brazilian agriculture.

Regional and Industry Incentive Programs

Various concessions are offered to encourage economic development in Brazil, either on a regional or industry basis, by offering taxpayers the opportunity to invest part of their tax liability and by granting certain fiscal incentives, summarized below, for approved investments.

Superintendence of Amazonas Development (*SUDAM*) and Superintendence of Northeast Development (*SUDENE*)

Companies located in the Northeast region and the Amazon region may benefit from certain tax incentives.

SUDAM and *SUDENE* are both administratively and financially independent special agencies. *SUDAM* oversees development in the Amazon region. The region encompasses the states of Acre, Pará, Roraima, Rondônia, Amapá, Amazonas, Tocantins, Mato Grosso, Mato Grosso do Sul, Goiás and part of Maranhão.

The purpose of *SUDENE* is to promote inclusion and sustainable development in the Northeast region.

The geographical definition of the Northeast region encompasses the states of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia and part of the states of Minas Gerais and Espírito Santo.

Both programs are administered by the Brazilian federal government, and are affiliated to the Ministry of National Integration.

Under these programs, companies can receive either partial or complete tax exemption on income taxes for Brazilian companies.

The tax exemption applies only to income from facilities operating in the designated regions and the benefits are available for companies that have setup, modernization, extension and diversification projects in the region.

Eligibility for these concessions depends on *SUDAM/SUDENE*'s approval of an industrial project or a project for the expansion of an existing industry.

SUDAM/SUDENE not only evaluate the project in terms of its technical and economic feasibility, but also verify whether the project is appropriate within the overall economic development of the region.

Manaus Free Trade Zone (MFTZ)

The Manaus Free Trade Zone (MFTZ) was created in 1957 as a “free port”. In 1967, by means of Decree 288/67, the Federal Government granted the Amazon region with several tax benefits with the basic intention of promoting its development.

The MFTZ comprises three poles:

- i. commercial pole;
- ii. industrial pole: called Pólo Industrial de Manaus or “PIM”; and
- iii. agricultural pole.

The city is home to over 500 industries, which may be eligible for the following tax incentives.

Corporate income tax (IRPJ) – 75% reduction of corporate income tax for the period of 10 years (currently limited to year 2023), which cannot be distributed as dividends. The reduction is exclusively for corporate income tax purposes, not being applicable to Social contribution on net income (*CSLL*).

Import duties – As a general rule, companies are granted with a reduction of up to 88% of the import tax, payable at the moment of delivering the final good. In some cases, the import tax reduction will depend on the level of local components and labor force used to produce the final good. The tax legislation also foresees an exemption of import tax, as long as the products are consumed and/or manufactured within MFTZ and certain conditions are met.

Excise taxes (IPI) – Exemption of IPI for products consumed and/or manufactured within MFTZ. In some cases, companies must invest a percentage of their gross revenues in R&D projects.

Sales tax (ICMS) – Deferred *ICMS* tax on import of raw materials used in a manufacturing process of intermediate products. Reduced *ICMS* tax rate on some imported products destined to commercial transactions (i.e. resale) and, in some cases, *ICMS* is not due on import of fixed assets.

Also, companies may be granted with a presumed *ICMS* tax credit on purchase of raw materials (applicable for some companies). On sales transactions, *ICMS* tax incentive may vary from 55% to 100%. Local state contributions may be charged upon sales transactions or *ICMS* tax incentive.

Taxes on Gross Revenues (*PIS/COFINS*)—With respect to *PIS/COFINS*, there are three important benefits:

- i. as a general rule, *PIS/COFINS*-Import are triggered on the import of goods and/or services, but these taxes are suspended when the importer is located in the MFTZ;
- ii. the revenues derived from the local sale of raw-materials, intermediate and packing materials are subject to *PIS/COFINS* at zero tax rate when the supplier and the buyer are located in the MFTZ and the acquired materials are used in the manufacturing process in the MFTZ; and
- iii. the revenues obtained with the sales of products manufactured within MFTZ are subject to *PIS/COFINS* at reduced tax rates (for most cases 3.65%), which will vary according to the tax regime the customers are subject to.

Minimum Manufacturing Process (*PPB*)

The *PPB* benefit is usually applicable to Brazilian companies engaged in the manufacturing and sales of products and services related to specific types of technology, such as goods and services related to information technology and automation.

The incentive was initially addressed to the computer industry, but later expanded to include a wider range of electronic products and telecommunication equipment.

The *PPB* benefit is granted to Brazilian companies that have a project approved by the Ministry of Technology and Science (*MTC*) and that annually invest a percentage (limited to 5%) of their gross revenues derived from the sale of technology related goods and services with Research and Development (R&D) in the country.

The percentage varies per year. The benefits are basically related to Excise Tax (*IPI*) and State Value-Added Tax (*ICMS*).

A reduction of the *IPI* tax due is granted as follows:

- 80% through December 2014;
- 75% from January through December 2015;
- 70% from January 2016 through December 2019; and
- after 2016 the benefit is scheduled to be extinguished.

For *ICMS*, the benefits vary according to the state involved. Basically, the benefit may relate to a reduction of the *ICMS* rate for intrastate transactions; a deferral or exemption of *ICMS* due or a “special credit” (*crédito outorgado*).

Technology Innovation Incentives

Law 11,196/05 and Decree 5,798/06 provide for various tax benefits with the purpose of fostering research and development and technological advances.

Tax benefits apply for most companies investing in technology innovation and include, among others:

- accelerated depreciation for income tax purposes of newly acquired equipment (R&D destined);
- *IPI* tax reduction
- accelerated amortization for certain intangibles and R&D expenses;
- technology innovation is defined as the creation of a new product or manufacturing process as well as the inclusion of new functionalities or characteristics to a product or process, which results in incremental improvements and in an effective quality or productivity increase, resulting in more competitiveness in the market.

Companies enjoying these benefits may not be entitled to other benefits such as the *PPB* (minimum manufacturing process).

Benefits for Information Technology and Information and Communication Technology Companies

Law 11.774/08 grants benefits for companies in the Information Technology (IT) sector.

These benefits apply to companies from the aforementioned sector seeking to improve their professional capability to develop new software.

Through this law, the Brazilian government allows some companies in the IT sector to have their professional development costs and expenses excluded from net profit in calculating actual profit, with no detriment to their normal expenses deductibility. This provisional measure has also created other benefits, including ones related to social security contributions.

Industrial Warehouse Regime under the Customs Computerized Control (*RECOF*) and Special Customs Regime for Imports of Inputs (*RECOM*)

RECOF and *RECOM* are special systems under which certain products may be imported, and sometimes acquired in the local market, without taxes – i.e., Import Tax (*II*), *IPI*, Social Integration Program (*PIS*) and Social Security Contribution (*COFINS*), if they will be used in the manufacturing of products to be exported. The benefit may also apply to *ICMS*.

There is a list of products that may be imported under such systems (mainly parts for vehicles, aircrafts and electronics). There are several requirements that must be met, including rigid control over the imported inventory.

The main advantage of these systems is that the products may be imported without foreign exchange coverage, i.e., the foreign party may keep title over the products and contract the Brazilian importer for the manufacturing function.

Special Custom Regime for Exports and Imports of Goods Destined to Exploration and Production of Oil and Natural Gas (*REPETRO*)

REPETRO is a special benefit on the import and export of goods to be used in activities of research, exploration, development and economic exploration of oil and gas in Brazil.

Companies that have authorization or concessions to carry out such activities in Brazil may benefit from the *REPETRO* system provided some requirements are met, including obtaining previous authorization from federal tax authorities.

There are 3 types of benefits: (a) exempting from import tax, *IPI* and *PIS* and *COFINS* temporary import of foreign equipment; (b) exempting from import tax, *IPI* and *PIS* and *COFINS* the import of raw materials, parts and pieces to be used in the manufacturing of goods to be exported (drawback); and (c) presumed export, which allows Brazilian suppliers of goods to sell them to foreign parties with the benefits applicable to exports but with the possibility of keeping the goods in the country.

This last type of *REPETRO* needs to be combined with the subsequent temporary import of the goods. *ICMS* benefits may also be available, depending on the provisions of *ICMS* legislation in force in the state where the activities are to be carried out.

Special Regime for Brazilian Aeronautics Industry (*RETAERO*)

RETAERO is a benefit that grants suspension on *PIS/COFINS*, *PIS/COFINS*-Import and *IPI* in domestic sales or import of input to be used in the production of pieces, utensils, component parties, equipments, tools, systems and subsystems, inputs and raw materials for maintenance, conservation, modernization, repairing, revision, conversion and industrialization of some types of airplanes.

The company may also be granted exemption of the already suspended taxes in case it proves the utilization of the inputs in the production or after the exportation of the goods.

The benefit can be extended to the sale or import of basic industry technology, development and technology innovation, assistance and transfer of technology destined to enterprises that are beneficiary from RETAERO. In this case, the regime grants suspension only on *PIS/COFINS* and *PIS/COFINS-Import*.

Special Incentive Regime for Oil Companies Infrastructure Development in North, Northeast and Midwest Regions (*REPENEC*)

REPENEC is a benefit that grants suspension on *II*, *PIS/COFINS*, *PIS/COFINS-Import* and *IPI* to be used for domestic sales or import of machinery, equipments and construction materials for implementation of infrastructure work in the North, Northeast and Midwest, in the petrochemical, oil refining and production of ammonia and urea from natural gas.

The company may also be granted exemption of the already suspended taxes in case it proves the utilization of the inputs in the infrastructure work.

Development Fund of Port Activities (*FUNDAP*)

FUNDAP is a special state incentive that allows a deferral of the *ICMS* due on imports performed by qualified trading companies located in the State of Espírito Santo, which, in practice, results in a significant financial benefit.

Special Incentive Regime for Infrastructure Development (*REIDI*)

REIDI is a special tax regime created with the purpose of fostering development and implementation of projects in the infrastructure sector.

The main tax benefit granted is exemption from *PIS* and *COFINS* upon local and foreign acquisitions. Legal entities must have a previously approved infrastructure project in order to qualify for the *REIDI* benefits.

Special Taxation for Export of Information Technology Services (*REPES*)

Law 11,196/05 provides for a special tax regime for the export of information technology services called *REPES* and another directed towards hardware sales (digital inclusion program).

Companies that are involved exclusively in the development of software applications and other technology services, that calculate *PIS* and *COFINS* under the non-cumulative regime, and that have export revenues greater than 60% of their annual sales may benefit from a *PIS* and *COFINS* exemption, for a five year period, with respect to the acquisition of goods and IT services, if certain conditions are met.

Please note that IT service companies are usually subject to the cumulative *PIS* and *COFINS* regime with respect to software development, software licenses and assignment of software rights. Therefore, they may not benefit from the *REPES*.

Special Acquisition Regime of Capital Goods (*RECAP*)

RECAP is a tax regime that allows special tax conditions for the acquisition of fixed assets by exporters. Export companies under *RECAP* regime will be exempted from *PIS* and *COFINS* on acquisition of capital goods.

Regime of Package Delivery in the Internal Market (*REMICEX*)

Decree 6,127/07 and Normative Instruction 773/07 regulate *REMICEX*, a tax incentive established by article 49 of Law 11,196/05. *REMICEX* provides that revenues from sales of packaging materials by Brazilian manufacturers to foreign resident buyers, even when delivered domestically, are exempt from *PIS* and *COFINS* taxes provided the related product is subsequently exported within 180 days.

Corporate Income Tax Reductions

Certain expenditures incurred by corporate taxpayers in specific cultural, audiovisual, children funds donation and meal programs may also generate reductions in the amount of corporate income tax liability under the actual profit method. These reductions, however, are subject to individual and global limits varying from 1% to 4% of the amount of tax due.

ICMS Special Regime

As *ICMS* plays an important role for most businesses, despite the benefits provided in the legislation, it is also possible to negotiate a special regime with state governments.

The referred special regime may grant specific *ICMS* tax benefits that are not established in the legislation for the requiring party.

Incentives Related to Goods

Tablets

Recently published Provisional Measure 534/ 2011 reduced to zero the *PIS* and *COFINS* rates levied on the manufacturer's revenue derived from the sale of tablet PCs produced in Brazil under the *PPB* regime.

This provisional measure assures that the aforementioned tax rate reduction of *PIS* and *COFINS* is granted to tablet PCs, provided that, besides complying with a specific *PPB*, duly approved by the Ministry of Technology and Science, some characteristics are observed, such as the size of the tablet and the Table of Excise Tax Incidence (*TIP*) classification.

The invoices issued by the producer, wholesaler and retailer upon the sale of these products must contain the words "Product manufactured under minimum manufacturing process," and must also indicate the normative act that approved the respective *PPB* project.

The *PPB* benefit is part of the Digital Inclusion Program intended to enhance accessibility to new technologies.

World Cup Tax Incentives

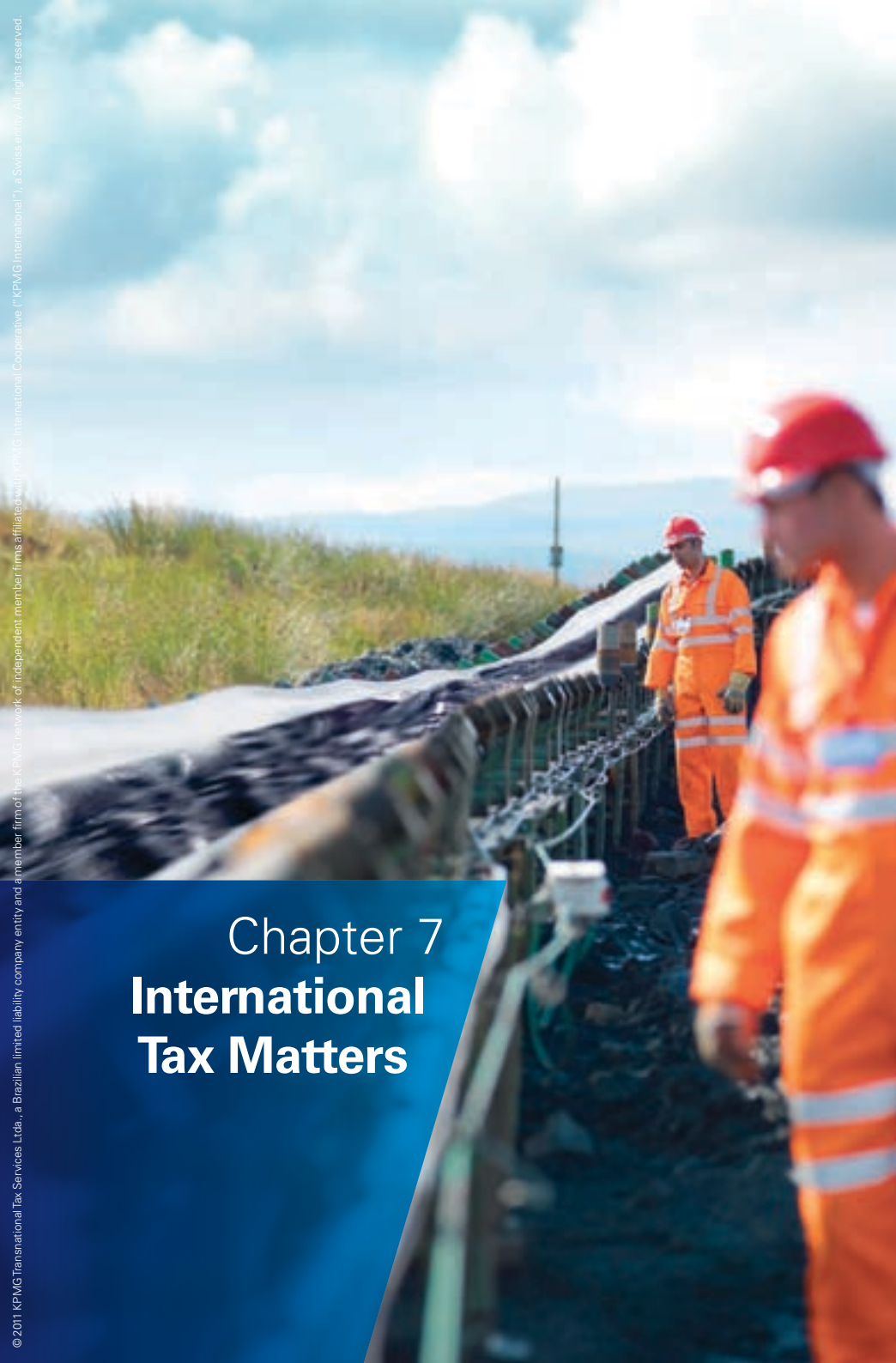
A tax incentive package relating to the construction and refurbishment of the host stadiums was included in the proposed legislation required to exempt FIFA, its operations, and its partners from tax.

According to the bill of law 7.422/2010, the federal tax incentives would suspend or provide exemptions from Excise Tax (*IP*), Import Tax (*II*), Social Integration Program (*PIS*) and Social Security Contribution (*COFINS*) for the construction and refurbishment of stadiums that will hold World Cup matches.

However, such tax incentives do not seem to benefit important infrastructure projects such as transportation upgrades, road construction, and telecommunications improvements.

At the state level, materials used for the construction of stadiums may be exempt from State Value-Added Tax (*ICMS*), under the *ICMS* Conventions enacted in 2008 and 2009. Imported products, for which there is not a similar product produced nationally, might also be exempted from *ICMS*.

Despite these exemptions, the Minister for Sport calculates that Brazil will raise approximately R\$ 10 billion (roughly US\$ 5 billion) in taxes on activities and products relating to the World Cup.



Chapter 7 International Tax Matters

Permanent Establishment

As a general rule, only companies incorporated in Brazil are generally subject to taxation as residents, since, in principle, Brazilian companies must register for tax purposes. However, companies that carry out taxable activities in the country, but have not properly registered for tax purposes, are usually also subject to taxation.

Contrary to the international mainstream, Brazilian tax law does not contain the permanent establishment concept and does not provide clear guidance regarding the potential tax impacts of having foreign entities carrying out business activities in Brazil.

There is also a lack of guidance from tax authorities, and only a few administrative precedents in the form of tax assessments on the matter.

This may be because in certain cases, the tax burden on the income of a nonresident is even higher than the eventual taxation as a resident that a permanent establishment characterization would generate.

For instance, while the corporate profits of a resident are taxed at a combined 34% rate, gross nonresident service fees are taxed, in general, at a rate of 25% – withholding income tax (WHT) and Contribution for Intervention in the Economy (*CIDE*), if applicable.

Also, the Brazilian Civil Code (BCC) prohibits foreign entities to operate in Brazil without authorization. In principle, authorization is granted by means of establishing a branch, which is taxable in Brazil in the same manner as a Brazilian legal entity.

Nevertheless, the following situations may potentially generate a taxable presence in Brazil and, therefore, it is recommended to analyze the specific activities that would be carried out in Brazil to assess eventual risks.

- De facto branch: the foreign company has an unregistered branch or office.
- Consignment: sales are made under consignment and proper accounting records are not kept by the consignee in Brazil.
- Binding agent: sales are made in Brazil through a resident agent or representative of a foreign company who has the power to bind the company to a contract and habitually exercises it.

Tax Treaties

Brazil has signed Double Taxation Treaties (DTT's) with various countries. The main method of tax relief under an applicable tax treaty is the foreign tax credit.

The existing treaties offer very limited opportunities to reduce or eliminate withholding taxes on payments abroad. Additionally, tax sparing clauses are found in most treaties in force.

Brazil has double taxation treaties with the following countries: Argentina, Austria, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Ecuador, Finland, France, Hungary, India, Israel, Italy, Japan, Luxembourg, Mexico, the Netherlands, Norway, Peru, the Philippines, Portugal, Slovakia, South Africa, South Korea, Spain, Sweden and Ukraine.

Treaties with Venezuela, Paraguay and Russia have been executed but are pending final approval from the National Congress.

Brazil had a treaty with Germany, but it was denounced by Germany in 2006. The official German reason given for the cancellation is the existence of numerous provisions, which appear to be one-sided and which are no longer in line with German treaty policy and treaty practice even with regard to developing countries.

The treaty would also no longer offer the necessary legal protection for the German economy.

The application of the various provisions of DTT, based on the Organisation for Economic Co-operation and Development (OECD) Model, is a controversial issue in Brazil, especially in view of the lack of internal understanding combined with the historical position of the tax authorities. In fact, significant debate exists on 2 treaty related issues: (a) whether Brazilian transfer pricing rules, which are not based on the OECD model, would be against the "Associated Enterprises" provisions of the treaty; and (b) whether the interpretation of the Brazilian tax authorities that Brazilian withholding tax may be imposed on service fees is correct.

In the past years, Brazilian practitioners have been discussing whether or not service fees would fall under article 7 of the DTTs, which restricts taxation to the residency country, unless there is permanent establishment in the other contracting state.

Generally speaking, Brazilian tax authorities do not agree with the article 7 approach. Rather, the authorities have stated that service fees should fall under the "Other Income" article of the treaties, giving rise to withholding taxation.

Low Tax Jurisdictions and Privileged Tax Regimes

In most cases, remittances to beneficiaries located in certain listed low tax jurisdictions are subject to a 25% withholding tax rate. Black listed jurisdictions are: Andorra, Alderney (Channel Island), American Samoa and Western Samoa, American Virgin Islands, Anguilla, Antigua and Barbuda, Aruba, Ascension Islands, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Campione d'Italia, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Djibouti, Dominica, French Polynesia, Federation of Saint Kitts and Nevis Guernsey, Gibraltar, Granada, Grenadines, Hong Kong, Isle of Man, Jersey, Kingdom of Swaziland, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Madeira Island, Maldives, Malta, Marshall Islands, Mauritius Islands, Montserrat, Monaco, Nauru, Nevis, Netherlands Antilles, Niue, Oman, Panama, Pitcairn Islands, Queshm Islands, Republic of Kiribati, Saint Helena, Saint Kitts, Saint Vincent, Saint Lucia, Saint Peter and Miguelan Island, San Marino, Sark, Seychelles, Singapore, Solomon Islands, State of Brunei Darussalam, Sultanate of Oman, Swiss, Territory of Norfolk Islands, Tonga, Tristan da Cunha, Turks and Caicos Islands, United Arab Emirates and Vanuatu.

Note that new jurisdictions may be added to this list at any time.

Law 11,727/08 (amended by Law 11,941/09) has also created a new concept, the so-called privileged tax regime for transfer pricing purposes. According to the law, a privileged tax regime is a regime that:

- i. does not tax income, or taxes it at a maximum rate equal to, or lower than, 20%;
- ii. grants tax advantages to nonresident individuals or legal entities;
 - a. without requiring the performance of a substantial economic activity in the country or jurisdiction;
 - b. provided that no substantial economic activity is performed in the country or jurisdiction;
- iii. does not tax earnings originated abroad or taxes them at a maximum rate equal to, or lower than, 20%;
- iv. does not allow the access to information related to the corporate structure, ownership of goods or rights, or to the economic transactions performed.

Although there has been a lot of discussion around the applicability of this new definition, based on the wording of the law, the concept of privileged tax regime is relevant for: (a) transfer pricing purposes, (b) thin capitalization rules, and (c) the deductibility of expenses.

Under this new rule, the Brazilian Revenue Services has listed in Normative Instruction 1,037/2010 the following regimes as privileged tax regimes:

- holding companies in Denmark, which do not perform a substantial economic activity;
- Uruguay (only with respect to *Sociedad Anonima Financiera de Inversion* – Safis until December 31, 2010);
- Iceland (only with respect to International Trading Companies – ITCs);
- Hungary (only with respect to Offshore KFT companies);
- United States of America (only with respect to Limited Liability Companies, or LLCs, with participation of non-resident investors and that are not subject to federal income tax in the USA);
- Malta (only with respect to ITC and International Holding Company – IHC).

Recently, the Government of Luxembourg presented a request to the Brazilian tax authorities with the purpose to remove its entities from the Brazilian black list.

This request was approved in March 2011 and the Luxembourg holding companies, set up pursuant to the 1929 Luxemburg legislation, are no longer on the Brazilian black list as a privileged tax regime.⁹

In addition, holding companies in Netherlands which do not perform a substantial economic activity were listed in the Normative Instruction 1,037/2010 as privileged tax regime; however, the inclusion has been suspended by Declaratory Act 10/2010 due to a revision request presented by that country.

Besides, the Spanish government also presented a request to the Brazilian tax authorities with the same purpose.

As a result of the approval of the claim, the tax authorities suspended, on a temporary basis, the inclusion of the Spanish Entidad de Tenencia de Valores Extranjeros (ETVEs)¹⁰ as benefiting from a privileged tax regime. However, no final decision has been reached yet.

⁹ Declaratory Act 3, enacted and published in the Official Gazette on March 28, 2011.

¹⁰ Declaratory Act 22, enacted and published in the Official Gazette on November 30, 2010.

Thin Capitalization Rules

Brazil's new thin capitalization rules were recently introduced by Provisional Measure 472/2009 and converted into Law 12,249/2010. According to these rules, some requirements must be satisfied for certain interest expenses to be deductible for tax purposes.

The thin capitalization rules provide that in order to the interest expense arising from business operations financed by debt be deductible, the debt cannot be greater than:

- i. two times the amount of the participation of the lender in the net equity of the borrower;
- ii. two times the amount of the net equity of the borrower, if the lender is a foreign party without participation in the borrower;
- iii. 30% of the net equity of the borrower when the lender is located in a tax haven jurisdiction or operating under a privileged tax regime (whether a related party or not).

To sum up, on cases i and ii above, the total amount of the Brazilian entity's debt cannot exceed twice the amount of the foreign related parties' participation in the Brazilian entity's net equity.

Brazilian companies are not prohibited from being thinly capitalized; rather, the deductibility of interest expenses generated by a thinly capitalized company is limited.

Capital and Profit Repatriation

Dividends

Dividend payments are based on net accounting income (after taxes). Alternatively, companies can pay dividends out of retained earnings and profit reserves.

Dividends paid out of retained earnings and certain reserves are not subject to withholding income tax if related to profits generated after January, 1996.

Note that dividends are neither treated as expenses nor as deductible amounts, regardless of the type of shares they relate to (voting or preferred).

In principle, companies with negative net equity may face practical issues if they wish to remit dividends before all accumulated losses are absorbed or eliminated. Furthermore, entities could be subject to penalties if there are outstanding tax liabilities at the time dividends are paid.

Interest on Net Equity

According to Brazilian law, in addition to dividends, Brazilian subsidiaries may also pay interest on equity to their shareholders.

From a Brazilian tax perspective, interest on equity is a hybrid instrument as it is deductible for Brazilian tax purposes while it is considered as remuneration for the investor based on shareholder's net equity.

In general terms, interest on equity is calculated by applying the daily pro rata variation of the government's long-term interest rate (*TJLP*) on the adjusted net equity of the Brazilian entity, considering all equity variations occurred during the year.

The interest on equity deduction is limited to the highest of 50% of the payer's retained earnings and 50% of the payer's current profits, with some adjustments. Nevertheless, although not clearly stated in the law, the Brazilian Central Bank (*BACEN*) does not accept remittances of interest on equity based on current profits when the company had accumulated losses in the prior year balance sheet (as of December 31). It normally requires the offset of the accumulated losses before making interest on equity remittances.

Interest on equity is subject to 15% withholding tax on the date it is paid or credited to the recipient. This rate increases to 25% if the recipient is located in a low tax jurisdiction.

On the other hand, the local payer is allowed to deduct interest on equity paid or credited to resident or nonresident shareholders for corporate income tax and social contribution tax on profits purposes.

Furthermore, when the shareholder is a resident entity the withholding tax can generally be credited, although other tax consequences may arise.

Therefore, as there may be significant tax opportunities in paying interest on equity consideration shall be given to the tax treatment in the foreign jurisdiction of the beneficiary (e.g., whether the income is taxable, whether Brazilian withholding tax is creditable).

Royalties

Royalty payments are subject to withholding tax at a standard rate of 15% or at the applicable treaty rate.

Royalty payments are also subject to *CIDE* at a rate of 10%. Note that *CIDE* is not a withholding tax and it is levied on the payer of royalties. In the case of royalty payments for trademarks and patents *CIDE* may generate a partial tax credit.

Currently, there is discussion whether royalties should also be subject to Social Integration Program (*PIS*) and Social Security Contribution (*COFINS*) and services tax (*ISS*) on the import.

In fact, Brazilian Federal Revenue has recently come up with decisions in favor of the non-triggering of *PIS* and *COFINS* on the remittance of royalties' payment abroad.

The referred decisions make clear that the agreement shall clearly discriminate the amount related to royalties from technical services/ assistance.

Royalties for trademarks, patents, know-how as well as other agreements involving transfer of technology (e.g., specialized technical services and technical assistance) are subject to specific requirements for both remittances abroad and deductibility.

The agreements must be registered with the *BACEN* and the National Institute of Industry Property (*INPI*).

Additionally, royalty deductions are restricted to certain overall and by type limits based on net revenue. For example, royalties for trademarks are limited to 1% of net revenue and royalties for patents are limited to a percentage of net revenue that varies according to the type of industry (from 1% to 5%).

Collectively, they may not exceed 5% of an entity's net revenue. However, as there are specific tax deduction limitations, royalties are not subject to Brazilian transfer pricing rules.

Service Fees

Service fees are subject to different taxation depending on whether the services are considered technical or non-technical. The Brazilian legislation does not provide a clear definition for technical and non-technical services.

However, withholding tax regulations issued by tax authorities described technical services as the work or enterprise whose performance requires specialized technical knowledge and that is rendered by independent professionals (*profissionais liberais*) or artists.

Non-technical services are subject to withholding tax at a rate of 25% while technical services are subject to withholding tax at a rate of 15% and to *CIDE* at a rate of 10%.

Both technical and non-technical services are subject to *PIS*, *COFINS* and *ISS*. If the fees are to be paid to related parties transfer pricing rules must be observed as well as general tax deductibility requirements, such as documentation, evidence of the work performed, formal agreements and others.

If service fees include remuneration for transfer of technology, specific requirements may apply for remittances abroad and tax deductibility.

Capital Gains

In case a nonresident individual or entity sells an asset located in Brazil, including shares in a Brazilian company, any capital gains will be subject to Brazilian withholding tax at a 15% rate (25% if the seller is located in a listed low tax jurisdiction).

After 2003, transactions between nonresidents are taxed in Brazil if the assets giving rise to capital gains are located in Brazil. The representative of the nonresident buyer is responsible for withholding and paying the Brazilian tax on capital gains.

Capital gains correspond to the difference between the value of the transaction (e.g., sales price) and the cost of the investment. However, if shares are involved there are 2 possible methods to compute the cost of such shares.

The 2 methods often lead to different acquisition costs and, thus, different amount of capital gains.

One method considers as the cost of acquisition the amount of the historical investment made in local currency (*Reais*), with an adjustment for inflation until December 31, 1995. Under the second method, the cost should be equal to the amount of the foreign capital registered with the *BACEN* in the *RDE-IED* system.

There are ongoing discussions as to which method is correct. Therefore, proper discussion and analysis is recommended before disposing or acquiring shares in a Brazilian entity.

Investments in Financial and Capital Markets by Non-residents

Revenues earned by foreign investors and derived from investments in the financial market are subject to withholding income tax.

The applicable rates are:

- 10% for investments in stock funds, swap operations, and future market operations performed outside stock or mercantile exchange markets;
- 15% for other cases, including fixed income investments;

- 0% for capital gains, defined as positive earnings associated with stock, commodities and other similar exchange market transactions, and for gold traded outside commodity exchange markets, earned and distributed by foreign investment funds; for income from Brazilian Federal Government bonds acquired after February 16, 2006, except for income generated by bonds with a resale clause assumed by the acquirer; for mutual funds in cases where the fund's portfolio is composed of at least 98% Federal Government bonds; and for Investment in Partnership Investment Funds (*FIPs*), Emerging Companies Investment Funds (*FIEEs*) and funds that invest in quotas of these funds (provided conditions are met).

If the foreign investor does not invest through the provisions of Resolution 2,689/00, or if the investor is domiciled in a tax haven jurisdiction, income derived from the investments in the Brazilian financial market is subject to taxation in the same way as investments by residents.

The Resolution 2,689/00 establishes certain requirements and procedures provided by the *BACEN* for foreign investors to be eligible to a beneficial tax treatment.

Taxation of the Foreign Profits (CFC Rules)

Brazilian controlled foreign company (*CFC*) rules are relatively new, with some provisions that are distant from concepts and provisions present in *CFC* legislation of other countries.

Profits generated by a foreign subsidiary, or branch, must be included in the December 31 financial statements of the Brazilian company, in proportion to its participation in the capital of the foreign subsidiary, in the year when the profits are earned, regardless of whether the profits are distributed.

Profits of foreign subsidiaries may also be subject to taxation in Brazil before December 31 in certain circumstances, e.g., liquidation of the Brazilian company.

Brazilian tax law provides that the financial statements of the foreign subsidiary must be prepared according to local legislation and translated into Brazilian currency.

In general, consolidation of profits and losses of foreign companies is not authorized for Brazilian tax purposes, except for branches of the same entity located within the same jurisdiction, provided certain conditions are met.

Foreign profits earned by the Brazilian entity through its subsidiaries must be considered on a per subsidiary basis. However, the foreign subsidiary must consolidate in its financial statements, the results of its subsidiaries, including any foreign subsidiaries.

On the other hand, the proportionate share of losses of foreign subsidiaries may not be used to offset Brazilian profits. However, regulations allow offsetting such losses against future profits of the same subsidiary, without any quantitative or qualitative limitations.

Lastly, it is important to mention that if the foreign profits includible in the taxable income of the Brazilian parent are subject to income tax in the foreign jurisdiction, the Brazilian parent company would be entitled to a tax credit in Brazil. However, this credit and the corresponding offsetting are subject to certain limitations.

The actual profit method to compute corporate taxes is mandatory for Brazilian companies that hold investments abroad.

Additionally, note that domestic branches of foreign companies are generally taxed in the same manner as standalone subsidiaries.

Declaration of Brazilian Capital Abroad (DCBE)

All foreign investments must comply with the rules set forth by the *BACEN*. In this sense, individuals and legal entities resident, domiciled or headquartered in Brazil, with values of any kind, currency assets, investments, property and rights outside the national territory with a value equal or greater than US\$ 100,000 should file annually form *DCBE*, with the *BACEN* reporting all foreign investments.

Penalties will apply if such information is not provided or if the information provided is false, inaccurate, incomplete or overdue.¹¹

Brazilian Transfer Pricing Rules

Transfer pricing rules have been in place in Brazil since 1997. The comparable uncontrolled price method Comparable Independent Prices (*PIC*) and Export Sales Price (*PVEx*) are the only methods available to test both import and export transactions. The other methods do not consider comparability factors or reflect the objective of reaching an arm's length result.

Although the names of the methods coincide with those specified in the OECD guidelines, such as the resale price method (*PRL*) or cost plus method (*CPL*), their application is unique to Brazil and driven by predetermined profit margins that range from 15% to 60%, regardless of the nature of the taxpayer's business or industry.

¹¹ Resolution 3.854/2010, Article 8.

The main characteristics of Brazilian transfer pricing rules are as follows.

- The rules are applicable to transactions between a Brazilian entity and its exclusive distributor regardless of the shareholding relationship between the parties. The rules are also applicable to transactions between an entity or individual taxpayer resident or domiciled in Brazil and any corporate or individual taxpayer, whether or not related, resident or domiciled in a country that does not have income taxes or levies income taxes at 20% (listed low tax jurisdictions) or less or imposes restrictions on the exchange of information regarding shareholding structure.
- Brazilian provisions do not establish the “best method rule.” Taxpayers are allowed to choose the method that provides the best results from their perspective.
- The local rules do not provide for advanced pricing agreements (APAs). Although there is a provision which permits changing the margins fixed by law, this administrative procedure is not commonly adopted.
- Safe harbors are available only for export transactions and aim at facilitating compliance for exporters.
- Neither benchmark research nor a basket approach is available in the rules, as the price analysis should be made per transaction with no function analysis.

Service Agreements

Service transactions are also subject to transfer pricing rules, although the rules do not provide specific methods. The rules are not applicable to the payment of royalties or fees for technical, scientific, administrative or similar assistance, provided that the agreement is registered with the *INPI*.

Interest

Interest paid or credited to a related party, arising from a loan contract that is not registered with the *BACEN*, shall be deductible from taxable income limited to an amount that does not exceed the 6 month LIBOR rate on US dollar deposits plus an annual spread of 3%. This is also the minimum interest that should be charged when a Brazilian party is the lender.

The Ministry of Finance can change the percentages mentioned in the transfer pricing calculation methods under certain circumstances.

When Compliance is Required

The transfer pricing analysis must be prepared by local companies on an annual basis and general information must be disclosed on the annual income tax return. The detailed calculations should be kept by the taxpayer to have available for the tax auditor when required during an audit.

Failure to present the documentation permits the tax authorities to arbitrate the price by using one of the methods provided by law. There is no penalty for not presenting the documentation. The penalty and interest are only applied when the transfer pricing adjustment results in additional corporate taxes.

Import Transactions

In order to verify the adequacy of the prices practiced in import transactions from related parties, Brazilian taxpayers may choose one of the following methods:

- **Comparable Uncontrolled Price Method (PIC)** – A reference price is arrived at by calculating the average of similar or identical purchase and sale operations between unrelated parties, on the Brazilian market or the market of other countries, under similar payment conditions.
- **Resale Price Method (PRL)** – A reference price is arrived at by calculating the average resale price for transactions with unrelated buyers less unconditional discounts granted, taxes and contributions on sales, commissions, brokerage fees paid and a profit margin of 20% (on the resale price).
- **Resale Price Method II (PRL II)** – A reference price is arrived at by calculating the average resale price for transactions with unrelated buyers less unconditional discounts, taxes and social contributions on the sales, commissions and fees paid, plus a profit margin of 60% on the resale value after deducting the value added in Brazil.

- **Cost Plus Method (CPL)** – A reference price is arrived at by calculating the average cost of production in the country where the products were originally produced, plus taxes and charges imposed by that country on exports and a profit margin of 20%.

Export Transactions

The Brazilian regulations foresee 3 safe harbors, which aim to facilitate compliance with transfer pricing rules by exporters. If any one of the following conditions is met, the taxpayer may benefit from the safe harbors provided by law.

- When the average sales price for the goods, services or rights is greater than 90% of the average sales price for the same goods, services or rights on the Brazilian market during the same period under similar payment conditions.
- When the net income from exports during the calendar year does not exceed 5% of total net income during the same period.
- When a corporate entity demonstrates that it has calculated net pretax profits from export income to related companies equivalent to a minimum of 5% of its total income. From 2002, the corporate entity must have attained the average profitability for the current year and the 2 preceding years.

Note that the first 2 options above are not applicable when the individual or corporate entity is resident or domiciled in a listed favorable tax jurisdiction.

Also, safe harbors do not imply the definitive acceptance of the revenue value recognized based on the price practiced, which may be contested, if listed as inappropriate in a written notification by the tax authorities.

When none of the safe harbors are applicable, the taxpayer should test the transactions by adopting one of the methods provided by law, as follows.

- **Comparable Uncontrolled Price Method (PVE_x)** – Comparison of the sales price with the average sales price on exports to non-related parties for equivalent or similar goods, services or rights during the same tax year and under similar payment conditions.
- **Wholesale Price Method (PVA)** – Comparison of the sales price with the wholesale market price of similar or equivalent goods sold on the wholesale market of the country to which the product is exported under similar payment conditions, less sale taxes in that country and a profit margin of 15% on the wholesale price.
- **Retail Price Method (PVV)** – Comparison of the sales price with the average price of similar or equivalent goods sold between unrelated parties on the retail market of the country to which the goods are exported under similar payment conditions, less sales taxes in the that country and a profit margin of 30% on the retail price.
- **Cost Plus Method (CAP)** – Comparison of the sales price with the average cost of production or acquisition of exported goods, services or rights, increased by taxes paid in Brazil and a 15% profit margin.

With respect to the export transactions undertaken during fiscal years 2005, 2006, 2007, 2008 and 2010, the Tax Administration issued a rule aimed at reducing the impact associated with the appreciation of the Real in relation to foreign currencies over the last 2 years.

The rule permits the adjustment of export revenues by the multiplication factor of 1.35, 1.29 and 1.28, 1.20 and 1.09 respectively.

This adjustment has no impact other than for transfer pricing purposes.



Chapter 8 Trade & Customs

Brazil remains one of the world's largest exporters of agricultural products, although exports of manufactured goods have largely increased and products such as airplanes, steel, electronics and many more have reached similar statistics.

The expansion of Brazilian sales to nontraditional countries or those countries with a small share in total exports has been an important feature in the success story of Brazilian exports. Exports to Eastern Europe, Africa, Latin America, Asia and Oceania have shown an impressive growth.

With respect to operational import and export chains, Brazilian importers and exporters are required to obtain specific registrations. However, in reality, most imports are not subject to pre-licenses, while exports are, in general, tax-free.

Brazilian foreign exchange regulations still play a significant role in the operational side due to registration requirements – currency exchange contracts associated with imports and exports are linked with federal tax and customs systems. Penalties may be enforced in cases where a Brazilian importer or exporter fails to settle such contracts in due time.

Exports

General Comments

Trade policy is conducted by the Chamber of Foreign Trade (*CAMEX*) which works under the Ministry of Development, Industry and Commerce (*MDIC*). Exporters must register, usually through the assistance of a forwarder, with Secretariat of Foreign Commerce (*SECEX*) - a governmental agency responsible for controlling imports and exports.

Since an export transaction carries the requirement of executing a corresponding currency exchange contract (for the exchange of foreign currency into Reais or vice versa), exporters must also register transactions with Brazilian Central Bank (*BACEN*), which is responsible for controlling the country's inflow and outflow of foreign currency.

In practice, each foreign exchange contract is linked to a specific customs transaction through interconnected electronic systems, Integrated Foreign Trade System (*SISCOMEX*), under which import and export transactions are registered, and its foreign currency exchange counterpart, Brazilian Central Bank Information System (*SISBACEN*), which is controlled by *BACEN*.

Export transactions generally do not require preapprovals, except for transactions involving certain listed products. This list includes animals or products of animal origin, oil, gas, goods containing nuclear and radioactive materials, and weapons, among others.

Tax Implications

Export revenues are generally tax exempt in Brazil, except for Brazilian corporate taxes.

In theory, an export tax exists, but it is currently only applied to a very restricted list of products, such as cigarettes, certain types of furs, cowhide, weapons and ammunitions.

Generally speaking, exports are not subject to Excise Tax (*IPJ*), State Value-Added Tax (*ICMS*) or Social Integration Program (*PIS*) and Social Security Contribution (*COFINS*), while a credit mechanism is allowed for the same taxes paid on inputs used in the manufacturing of exported products.

The credits related to federal taxes (*IPJ*, *PIS* and *COFINS*) are normally easily consumed by exporters as they generally may be used to offset any federal taxes payable.

On the other hand, several restrictions and the associated bureaucracy make the utilization of the *ICMS* tax credits very difficult for companies with a high level of exports.

Certain payments abroad related to exports, such as agent commissions and interest related to export financing, also benefit from a zero rate withholding tax.

Under certain regimes, specific tax exemptions may also be granted on imported raw materials or parts to be used in the manufacturing of products to be exported.

Export Financing

Banks provide financing for exporters against forward sales contracts and by discounting drafts accepted by foreign importers.

This financing is also made available for “indirect exporters” or manufacturing companies, which export through trading companies.

Exporters may use these funds to buy raw materials to be used in the manufacturing of finished products to be exported.

In principle, *BNDES* provides the following types of financing on exports through authorized financial institutions.

- Pre-Shipping: financing for the production of goods to be exported in specific shipments.
- Fast Pre-Shipping: financing for the production of goods to be exported within 6 to 12 months.
- Special Pre-Shipping: financing for the domestic production of goods to be exported that are not tied to specific shipments but have a preset time period for such.
- Pre-Shipping anchor companies: financing for the sale of goods produced by small and medium companies through an export company.
- Post-Shipping: financing for the commercialization of goods and services abroad, through refinancing to the exporter or through the use of a buyer’s credit facility.

Imports

General Comments

Considering that foreign trade balance is one of the main objectives of federal economic policy, imports have been of critical importance and have played a significant role in recent years in Brazil.

Since the opening of the Brazilian economy at the beginning of the 1990’s, when a strong spike on imports ensued what would become the trademark of the last decade, this adverse condition has been largely reversed in recent years by the historical improvements on exports.

This is largely due to the development, modernization and increased competitiveness of the Brazilian industries exposed to the global economy.

While import restrictions have been a major element of Brazilian trade policies, import tariffs have been reduced across the board in recent years.

The negotiation of a Mercosur Common External Tariff (*TEC*) has not only made Brazil one of the major players in the region but also demanded the simplification of import regulations to the extent that imports, with some exceptions, do not require pre-licenses.

In addition, the introduction of the electronic system for the registration of imports and exports *SISCOMEX* has contributed to speeding up registrations and customs clearance as a whole.

Brazilian importers must be registered with *SECEX* prior to carrying out import transactions. Import transactions must also be registered in the *SISCOMEX* electronic system under which an import declaration (*DI*) must be obtained to clear customs.

In case a pre-license is necessary, this may vary according to the type of product imported and the import system adopted, it must be obtained prior to the shipment of products to Brazil and is generally valid for a 90 day period starting from the date of issuance.

This is also obtained through the *SISCOMEX* electronic system. Certain products, such as petrochemicals, human blood, weapons, herbicides and pesticides, and leather, among others, also require preapproval from certain government agencies before the import license is issued.

The import of used products requires pre-licenses, which is normally only granted if a similar product of Brazilian origin is not readily available.

From a *BACEN* perspective, Brazilian importers are required to close the corresponding foreign exchange contracts to settle the import transactions within a certain period; otherwise, high fines can be imposed.

Tax Implications

Brazil imposes federal, state and, sometimes, municipal taxes on the import of goods and services. The import of goods is subject to Import Tax (*II*), *IPI*, *ICMS*, *PIS* and *COFINS* and other miscellaneous customs duties, as explained on the topic related to import taxes.

The classification of products under *TEC* is crucial to determine the applicable rate for most taxes. *TEC* is based on the Brussels Harmonized Code.

RADAR

RADAR is a system that sets access to the registration and tracking of performance of companies on customs transactions. The purpose of the system is to provide objective, real-time information, including customs, tax and accounting information to enable the identification of the behavior and infer the risk profile of various agents relating to foreign trade.

In order to operate in the foreign trade a company must possess a *RADAR* registration. Among other requirements to obtain such license, the company must be able to prove its economic substance and business purpose and demonstrate the capability of performing exports.

Trading Companies

Trading companies generally play a very active role in the import and export of products due to their practical experience and knowledge of operational and documentation aspects. Trading companies may work as outsourced, independent customs brokers, preparing the import and export paperwork and customs clearance, and may also import products on behalf of Brazilian companies.

Trade Treaties

Mercosur

Mercosur is a customs free trade zone comprised of 5 member countries: Argentina, Brazil, Paraguay, Uruguay and Venezuela (the Venezuela inclusion is still in process).

The main objectives of the *Mercosur*, as a global trader, are the total elimination of import tariffs between the members, the increase of the current free trade agreements' framework, and the diversification of the current import and export table of products.

Therefore, products traded between Mercosur member countries are exempt from import tariffs, provided the products have a Mercosur origin. Mercosur origin rules are generally based on minimum local added value and changes in the classification of the product.

However, each member country may include certain products in an "exception list," under which listed products are not necessarily subject to the common rate applicable to non-Mercosur members, but to a higher or lower rate, depending on the case.

Other Agreements

Brazil has entered into other agreements with different countries in the Americas, such as the Free Trade Area of the Americas (FTTA/ALCA) – the Latin American Integration Association (*ALADI*), and World Trade Organization (WTO). In addition to these agreements, Brazil has bilateral agreements of economic supplementation with Uruguay, Argentina and Mexico, as well as partial reaching bilateral agreements of economic supplementation with Guiana and Suriname.

Origin Rules

In general, imports covered by trade treaties benefit from import tax rate reductions or exemptions provided certain conditions are met, which are essentially related to compliance with origin rules. It is important to mention that origin rules are intrinsically associated with the country where the products are manufactured, regardless of the country that is listed as the seller of the products.

Origin rules basically require a minimum local added value in the manufacturing country or a change in the tax classification with respect to the product exported when compared to its components. In some cases, both requirements must be met depending on the product traded and the countries involved.

Imports of products originating from Mercosur member countries (Argentina, Paraguay and Uruguay) generally benefit from a 100% reduction of import tax, provided that a minimum local added value of 60% occurred in the exporting country.

A different local added value percentage may apply depending on the traded product and also the specific trade agreement.

Customs Valuation

Brazilian customs rules provide for a customs valuation policy based on the 1994 General Agreement on Trade and Tariffs (GATT), effectively introduced in Brazil in 1996. The main purpose of the methods provided by Brazilian customs rules is to demonstrate the fair market value of the import transaction when compared to an actual transaction.

This is made by means of using the methods foreseen under Brazilian customs valuation rules, which are generally based on either: (a) the value of the transaction (b) comparables, (c) resale, or (d) cost methodologies.

The import price is verified for customs valuation purposes at the moment an import declaration is registered in the *SISCOMEX* system. It is based on internal lists of prices that are not publicly available and are used by Brazilian customs authorities as an initial basis for comparison. There should be no customs valuation issues to the extent that the customs value is within these parameters.

In case the import price does not comply with such rules, the import price base must be justified. To do this, the importer must then fill out a customs valuation form and present proper documentation showing that the customs value adopted reflects the actual value of the transaction at fair market conditions by using one of the 6 methods provided in the customs legislation.

The value of the transaction is the most accepted and used method. It consists of adding certain costs and expenses associated with the product to the total cost of the imported product in order to determine a real value that is as close as possible to the value of an import transaction at arms' length conditions. It is important to mention that the relationship between the exporter and the Brazilian importer is a key factor for Brazilian customs authorities when applying customs valuation rules.

Special Customs Regimes/ Programs

Brazilian custom regulations provide a number of special regimes and programs under which certain tax and customs benefits apply. Therefore, careful planning of the supply chain by international groups of companies with activities in Brazil is recommended before importing and exporting, in order to verify whether the Brazilian company can benefit from more efficient structures and systems.

Below is an overview of some available special regimes and programs:

- **Drawback** grants the beneficiary an exemption from import tax, *IPI*, *PIS* and *COFINS* and exempts imports of raw materials to be used in the manufacturing process of products to be exported. A minimum level of local manufacturing is required. *ICMS* benefits may be also available.
- **Temporary Admission** regime allows the import of goods staying in the country on a temporary basis with a total or partial exemption from taxes levied on imports. This may benefit, for instance, goods that enter the country under a lease or rental transaction and those related to sports and cultural events and commercial fairs and exhibitions.
- **Special Temporary Admission System for Manufacturing Purposes (temporary admission to upgrade another product)** is similar to the regular temporary admission system, but the exemption from taxes is granted on the import of goods to be applied to certain restricted manufacturing processes of products to be exported. In principle, it does not apply in cases where the manufactured goods are sold locally.
- **Temporary Export System** allows the export of goods that will be out of the country on a temporary basis with a total or partial exemption from taxes levied on the export, if any, and on the subsequent re-import. This may benefit, for instance, goods that leave the country to be used for sports and cultural events, commercial fairs and exhibitions.
- **Special Temporary Export System for Manufacturing Purposes (Temporary admission to be upgraded by another product)** is similar to the regular temporary export regime and allows the export and re-import of goods that will be subject to certain restricted manufacturing processes abroad. Import taxes are due, however, on the foreign products aggregated to the re-imported good. .

- **Bonded Warehouse** is a special import system whereby the Brazilian party may defer the payment of taxes due on the import by keeping the imported goods stored in a bonded warehouse. The taxes are due only upon the customs clearance, i.e., the removal of the goods from the bonded warehouse. It may also benefit goods sent to Brazil for commercial fairs and exhibitions. In the case of exports, the Brazilian exporter, under this system, may benefit from export tax incentives before the actual shipment of the products out of the country (available to the so-called *comerciais exportadoras*).
- **Bonded Customs Deposit (DAC – Depósito Alfandegado Certificado)** is a regime under which products are presumed exported but physically remain in a bonded warehouse in Brazil. The beneficiaries are the companies allowed by the tax authorities to operate under this regime.
- **Export Processing Zones (ZPEs)** are planned industrial areas in which established companies have their operations exempt from federal taxes and contributions (II, *IP*), surcharges on freight for merchant marine renovation, Social Integration Program and taxes on financial transactions (*IOF*). They also enjoy exchange freedom which means they are not obliged to convert the foreign currency obtained in their exports into *Reais*, provided they send most of their products to the foreign market.
- **Presumed Export** occurs when goods are sold to a nonresident, but do not physically leave the country. The transaction is still considered an export for customs, foreign exchange and tax purposes. This benefit only applies in specific cases such as: (a) sales to a foreign government (or an international agency or organization in which Brazil is a member country) to be delivered in Brazil on behalf of the foreign party, (b) the good will be completely incorporated in Brazil in a finished product that will be exported, (c) the good will be completely incorporated in a good owned by the nonresident buyer that is already physically located in Brazil under a temporary admission system.

- **Tariffex** is another import tax benefit available on imports of equipment in cases where there is no similar equipment in the country. The tax benefit consists of an exemption from or reduction of the import tax and is granted after the importer submits and obtains approval from the authorities.
- **Blue Line** allows the benefited company to speed up the customs clearance process. In order to benefit from this regime, the company must comply with a number of requirements including an audit of its external controls over the customs processes.

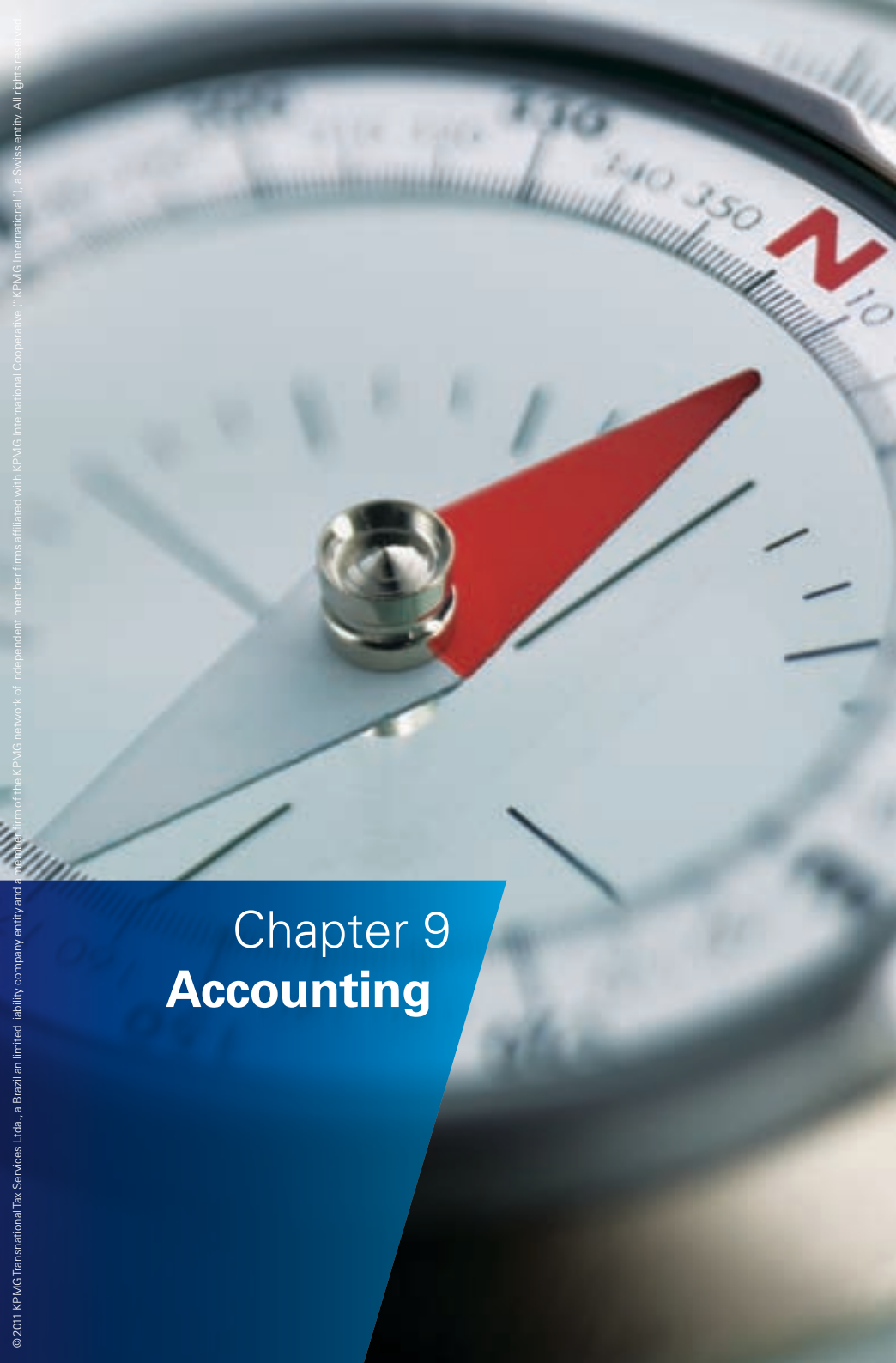
SISCOMEX Carga System

The so-called *Siscarga* system is being implemented to tighten control over imports, exports and in-transit (full and empty) units, as well as empty units being discharged, loaded, or in-transit on any vessel throughout the Brazilian territory.

The implementation of this new system will affect all participants in the supply chain of cargo entering and departing Brazil, i.e., importers, exporters, terminal operators, shipping agencies, shipping owners, Brazilian Customs, and the Brazilian merchant marine.

The new *Siscarga* system requires that all affected parties must timely adapt their systems to comply with new deadlines regarding the transmission of cargo information, as well as with respect to mandatory fields in certain documents such as the bill of lading. For example, a major change under the new system is the anticipation of when to present documentation for export cargo.

All information must now be input into the system at least 48 hours before the cargo arrives in Brazil. The information supplied via the *Siscarga* system must be 100% accurate, or the cargo will be denied entry and blocked for transport.



Chapter 9

Accounting

On 1st of January 2008 onwards changes were introduced in Corporate Law setting the way to a process of accelerated convergence of Brazilian Generally Accepted Accounting Principles (BR GAAP) to IFRSs.

Full convergence with IFRS was reached for financial reporting years ending at 31 December 2010 and onwards.

The move towards IFRS in Brazil started in 2006 when the Brazilian Central Bank (*BACEN*) published its intention to require certain financial institutions to present consolidated financial statements in accordance with IFRS by 2010.

The Brazilian Securities Commission (*CVM*) decided in 2007 to extend these requirements to all publicly listed entities to present consolidated financial statements in accordance with IFRS by 2010. Early adoption of IFRSs was permitted and a small number of companies did adopt early.

Non-Publicly Accountable Enterprises (NPAEs) are obliged to prepare their financial statements in accordance with BR GAAP, but are permitted to adopt IFRSs for the consolidated financial statements. Non-large sized NPAE's have the option to apply the Brazilian equivalent to SME.

A Large-sized entity is defined by Corporate Law as a company or group of companies under common control, whose total assets, in the previous year, amounted to over R\$ 240 million, or whose total gross annual revenues exceeds R\$ 300 million.

Specific exceptions apply to financial institutions and insurance companies.

Non-financial Institutions

Convergence of BR GAAP and IASB IFRSs

The Brazilian congress approved in December 2007 (effective 1 January 2010) a law that set the path for the convergence of the BR GAAP to IFRS.

The law established that accounting pronouncements issued by the Brazilian Accounting Pronouncements Committee (*CPC*) will have to be in line with the IFRSs issued by the IASB.

The *CPC* is made up by main bodies of the Brazilian capital markets, the accounting institutes, the *BACEN* and *CVM*. Its objective is to issue local enforceable accounting rules in line with the IFRSs as issued by IASB.

The *CPC* has its own due process, involving deliberations of the *CPC* members and public consultation, before it issues standards. Afterwards, the pronouncements issued by the *CPC* must be endorsed by the government bodies and by the CFC in order to have legal effects and be applied by companies subject to regulation by the *CVM*, *BACEN* or CFC.

CPC has issued, and regulatory bodies have endorsed, substantially all BR GAAP standards equivalent to IFRSs and IFRICs, which became effective for financial statements for periods starting on or after 1 January 2010. As a result, BR GAAP substantially converged with IASB IFRSs.

Therefore BR GAAP used by Brazilian enterprises in their statutory financial statements is largely in accordance with IASB IFRSs, except for:

- expenditures previously capitalized under the prior version of BR GAAP which will be amortized over their expected useful life, if any (optional temporary GAAP difference only relating to the individual financial statements)*;
- investments in associates, jointly controlled entities and subsidiaries are value under the equity method in the individual financial statements*;

* individual financial statements are not claimed to be in compliance with IFRS, as opposed to consolidated financial statements.

- real state entities are allowed to apply the POC method to recognize sale of units under construction (this is the only “carve out” from the IFRS as issued by the IASB, so in this case the financial statements claim compliance with IFRS as adopted in Brazil);
- *CPC* has imposed some restrictions on the alternative treatments given by the IFRSs (e.g. revaluation option for property, plant and equipment is not permitted in Brazil, less options at first time adoption); since the *CPC*'s actions mandate treatments that are permitted by IFRSs, these additional requirements do not prevent compliance with IFRSs.

Companies are required to follow the IFRSs as issued by the IASB. However, additionally Brazilian GAAP stand alone financial statements (stand alone financial statements are equivalent to separate financial statements as defined under IFRS with the exception that in the stand alone FS the interest in subsidiaries, associates and jointly controlled entities are accounted for using the equity method) are required by Brazilian Corporate Law.

“Side-by-side presentation” of consolidated FSs (under IFRS and BR GAAP) and individual FSs (under BR GAAP), in the same set of FSs, for Brazilian publicly listed entities are allowed, considering that the two frameworks are substantially equivalent.

Listed entities

All *CPCs* were endorsed by *CVM*, which means that all Listed Entities need to prepare their consolidated financial statements in accordance with IFRSs as described above.

Financial Institutions

In Brazil the financial institutions do not use the BR GAAP for regulatory financial statements, but accounting standards as issued by the *BACEN*, which are based on BR GAAP in certain respects and based on rules issued by *BACEN* in other aspects.

BACEN requires certain financial institutions to present consolidated financial statements in accordance with IFRS. As listed banks are required to prepare their consolidated financial statements in accordance with *CVM* regulations as described above, effectively *BACEN* requirements with respect to consolidated financial statements in IFRS apply to non-listed financial institutes that are required to have an audit committee in accordance with *BACEN* regulations.

For compliance with IFRS, *BACEN* requires these financial institutions to apply IFRSs as translated by *IBRACON*, which are in line with IFRSs as issued by IASB (without the limitations adopted in BR GAAP as described above), except for the fact that, for 2010 only, financial institutions were given the option not to present comparative financial statements and to use 1st of January 2010 as transition date. Effectively this measure has given these financial institutions to adopt IFRS either in 2010 (for those that don't apply the option) or 2011 (for the ones that apply the option).

Financial institutions presenting consolidated financial statements in IFRS as issued by the IASB do not have to comply with the more restringing options given by the *CPCs*, as the Brazilian Central Bank has not adopted all *CPCs* (and consequently financial institutions cannot elect to the “side-by-side presentation” mentioned above).

Insurance companies

As with financial institutions, listed insurance companies have to follow *CVM* regulations for their consolidated financial statements.

Non listed insurance companies were obliged to use the IFRS converged *CPC* standards for the preparation of their 2010 consolidated financial statements.

However, in line with the Brazilian Central Bank, the Brazilian Private Insurance Regulator (*SUSEP*) gave these companies the option not to present comparative financial statements and to use 1 January 2010 as transition date.

For the individual financial statements insurance companies will adopt BRGAAP from 2011 onwards with a transition date of 1 January 2011.

However, from 2011 onwards, *SUSEP* has carved out the deemed cost option at first time adoption and included an option for companies to provide for credit losses based on expected losses (as opposed to incurred losses) for both the consolidated and the individual financial statements. Discussions are still ongoing if and how this will impact consolidated financial statements 2010 retrospectively.

Filing Obligations

Below are some Federal filing obligations that must be observed by Brazilian companies. There are other State and Municipal filing obligations that are not included within this section.

Corporate Income Tax Return (*DIPJ*)

Regardless of any election made to pay corporate taxes, Brazilian companies must file the *DIPJ* based on its consolidated results for the calendar year (January 1st to December 31st).

Commonly, the *DIPJ* must be filled by June of the subsequent year. The annual income tax return must also be filled in case of certain events, such as mergers, liquidation, spin-offs.

DIPJ return can be submitted to the Brazilian Federal Revenue (*RFB*) via internet.

Federal Tax Settlement Return (*DCTF*)

Taxpayers should report the tax debts and credits of Federal taxes (Corporate Income Tax (*IRPJ*), Social Contribution Tax on Profits (*CSLL*), Social Integration Program (*PIS*), Social Security Contribution (*COFINS*), Excise Tax (*IIPI*), Tax on Financial Operations (*IOF*), Withholding Tax (*IRRF*), Contributions for Interventions in the Economy (*CIDE-Combustível*), and (*CIDE-Remessa*) on a monthly basis. *DCTF* return can be submitted to *RFB* via the internet.

PIS and *COFINS* Return (*DACON*)

DACON is a filing obligation related to the payment of *PIS* and *COFINS* subject to the non-cumulative system.

DACON return can be submitted to *RFB* via the internet on a monthly basis and in some cases semi-annually.

Transitory accounting adjustments (FCONT)

As a result of the Transition Tax Regime (*RTT*), a new specific tax control called *FCONT* was created to reflect the adjustments arising from the differences between the new accounting rules and the rules in force in 2007.

The adoption of the *FCONT* is mandatory and exclusive for entities calculating the Corporate Income Tax based on the actual profit method and that have elected to use the *RTT*.

The *FCONT* shall be submitted to the *RFB* via internet, in general terms, on an annual basis (there are exceptions regarding some corporate events).

Electronically Commercial and Fiscal Bookkeeping (SPED)

SPED is an instrument that electronically unifies the receipt, validation, storage and authentication of the books and documents that are part of a company's commercial and fiscal bookkeeping.

Due to the implementation of *SPED*, certain accounting/fiscal books in paper format are substituted by an electronic format. The digital bookkeeping will include certain accessory obligations that taxpayers will have to comply with, such as *DIPJ*, *DACON*, Guide for Information and Analysis (*GIA*), etc., as this data will have to be in electronic format.

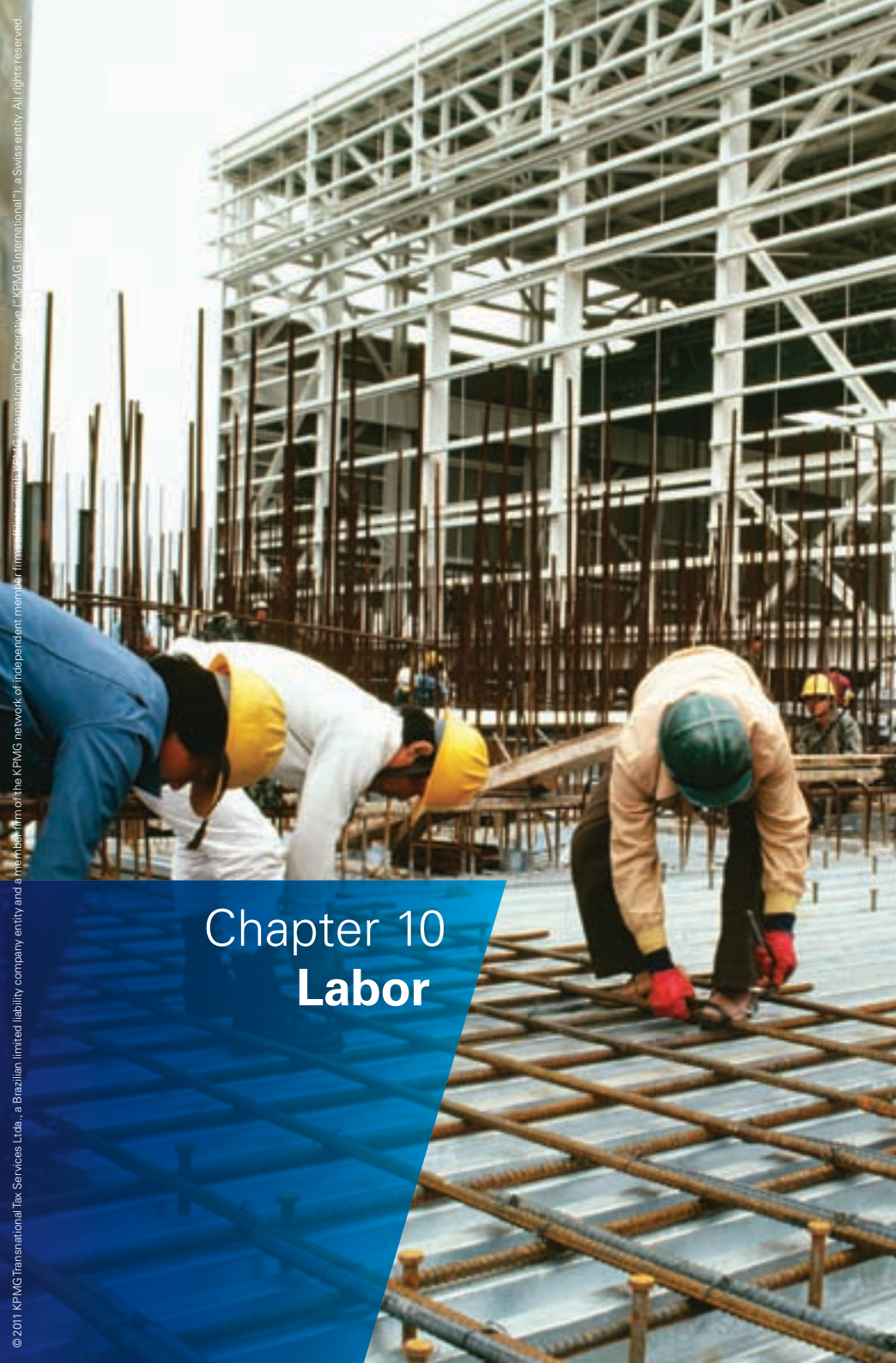
The principal objectives of *SPED* are: (i) to promote the integrated audit activities by tax authorities through sharing information; (ii) to allow the delivery of various accessory obligations to different government agencies at once; and (iii) to ease the identification of illegal activities from a tax perspective by sharing accounting and tax information.

Electronic Fiscal Invoice (NF-e)

The *NF-e* is a digital document, issued and stored electronically, with the purpose of documenting an operation of transfer of goods or rendering of services. Its legal validity is guaranteed by the electronic signature of the issuer and its receipt by the state and federal tax authorities.

The implementation of the *NF-e* substitutes the actual issue of a paper format invoice and its purpose is to simplify the taxpayer's communications with the tax authorities. It also allows tax authorities to follow commercial transactions in real time.

It is an initiative to modernize and integrate the national tax system, facilitating the analysis of federal, state and municipal taxes, and improving the tax audit process by allowing for the sharing of information.



Chapter 10 Labor

Until the 1940s, labor rules in Brazil were found in laws, decrees and various regulations, and no specific code or standard existed consolidating all rules in force. This made it extremely difficult to follow all changes and regulations. In 1943, through the enactment of Decree-law 5,452/43, known as Consolidation of Labor Laws (*CLT*), the entire labor legislation was consolidated into a single piece of legislation, which has been governing all labor relations to this day.¹²

At that time, the strength of the Brazilian economy was based on the manufacturing sector, and this sector was chosen as the main basis for the creation of standards and rules that would comprise the *CLT*.

However, the current labor market is considerably different from the one of 60 years ago, since the service sector has been accounting for an increasing portion of the Gross Domestic Product (GDP). Additional factors, such as new technologies, the use of more specialized workforce and more flexible labor agreements have contributed and shaped the current labor market.

Nevertheless, since the time of its enactment, the *CLT* has never been significantly updated or revised and in some cases, its provisions are obsolete for the current day and age.

This situation becomes more serious as the labor environment evolves in line with a more global economy.

Currently, market practices in terms of benefits and human resource relationships have become more flexible and provide more comfort for employees to carry out their work.

For this purposes various benefits are granted to employees, such as a car, cell phone, bonuses and others.

However, by virtue of the legislation, such benefits may be treated as compensation for services performed and be subject to all taxes and contributions applicable to salary payments. In addition, these benefits must be included in the calculation of severance payments.

Some may argue that the labor legislation has been favorable to employees. In addition, employees do not assume the possible costs of the process (burden of the defeated party) should their claims fail to be based on circumstances that have actually resulted in loss for employees during their work for an employer.

¹² Although some worker categories are still subject to a specific legislation/regulation that differs from the Consolidation of Labor Laws, this is not the specific case of the great majority of the Company's employees, and for this reason we will not elaborate further on this matter.

Thus, there are a high number of claims in the Labor Court, which result in increased expenses for companies involved in such litigation.

As a result, many companies may be in an unfavorable, even vulnerable, situation regarding the labor legislation. In many cases, human resource policies are adopted that are not provided in the current legislation with the intent to benefit employees and to follow market trends and practices.

Thus, the great majority of companies may be subject to the risk of questioning by their employees and/or the competent authorities.

The Labor Law Consolidation encompasses the Labor Law Code and amendments introduced by the Federal Constitution (FC) of 1988. The following is a summary of the principal *CLT* items of general interest.

Labor inspectors regularly enforce the numerous detailed requirements covering such matters as recordkeeping and payment of overtime and benefits. It is essential that the personnel department is knowledgeable about current labor laws in order to effectively deal with these matters.

General Requirements

Terms of Employment

Since the law establishes most provisions of an employment contract, it is uncommon to have an extensive written contract with lower level employees.

Employees have a work booklet Employment Record Card and Social Security Card (*CTPS*), signed by the employer stating the position and salary, thus, establishing the formal labor contract.

A foreign employee may not be hired unless he presents his foreigner identity card issued by the Brazilian authorities.

All employees must be registered in the employee's register of the firm and have their work booklet signed by the employer.

An annual return must be filed with the local office of the Ministry of Labor reporting the total number of employees and specifying the number of foreigners and minors employed, if any.

Working Conditions

Employers are required to make reasonable provisions for the comfort and convenience of their employees.

Appropriate dining facilities or meal vouchers must be provided on premises where more than 300 persons are employed.

Working Hours

The workweek, determined by the FC, is 44 hours per week, conventionally treated in Brazil as 8 hours a day from Monday to Friday and 4 hours on Saturdays.

For employees paid on a monthly basis, the number of hours per month is 220 hours and 30 days are always considered in computing the number of working days per month.

Transfer of Employees

An employee may be transferred to a new location if the arrangement is justified by the requirements of the organization. If the assignment is temporary, the employee must receive a payment increase of at least 25%. Moving expenses must also be paid by the employer.

Trial Period

Employees may be hired for a trial period, which cannot exceed 90 days.

Termination of Employment

After the experimental period, if an employee is dismissed without just cause, the employer must pay a penalty equivalent to 50% of the amount deposited in the employee's Government Severance Indemnity Fund for Employees (*FGTS*) account (retirement fund).

The employee will receive 40% of this amount and the other 10% will go to the government as a social contribution.

Litigation

Historically, Brazilian labor law has been notoriously partial to employees. Brazilian labor courts generally allow the admittance of oral evidence to prove the existence of an employment relationship and favor settlements as a means of resolving disputes.

Additionally, employees are not required to assume the costs of litigation. As a result, labor claims tend to cause expenses for the company involved.

Typically, a labor claim is filed against a company after an employee's contract is terminated. Brazilian labor law allows an employee to file a labor claim seeking rights for an employment during the 5 years period prior to the date the claim is filed and up to 2 years after the dismissal.

Employee Remuneration

Remuneration Frequency

Employees must be paid in Brazilian currency on a monthly basis or on a shorter time period if stipulated by the employment contract.

Therefore, salaries are generally referred to in terms of a monthly salary as opposed to an annual salary. The salary amount is paid 13 times during the year (see details below).

Employers may not reduce salaries except under extraordinary circumstances.

Fringe Benefits

Assuming certain requirements are met, some benefits such as transportation, meal payments, pension plans and insurance policy premiums are not considered part of employee remuneration and, therefore, are not subject to the payment of the labor rights or social security.

Additional Salary

In certain instances, additional remuneration is required, as follows:

- overtime rate must be at least 50% greater than regular pay;
- night shift work must be paid at a rate at least 20% higher than equivalent daytime work;
- for hazardous work, the salary must be increased by 30%;
- for work dangerous to health, the salary may be increased by 10% (minimum), 20% (medium), or 40% (maximum) depending on the level of potential harm to health and well-being.

Minimum Wage

The federal minimum monthly salary is currently equivalent to R\$ 540. Note that different minimum salary requirements may be granted to specific regions, states and for specific categories of professionals.

Equal Pay

There are general provisions in Brazilian law prohibiting employment discrimination based on gender, religion, race or other nonmaterial factors.

The only affirmative action programs relate to the employment of individuals with physical handicaps.

Labor law provides that all work of equal value must be paid at the same rate regardless of the nationality, age, gender or marital status of the employee performing the function.

However, differences in length of service, if over 2 years, may be taken into account to justify different salary levels. Companies that have a career track plan may have differences in salary levels in accordance with seniority and merit; however, such career plans need to be registered with the Brazilian Ministry of Labor.

Labor Rights

Vacation

Upon completion of each 12 month work period, employees are entitled to paid vacation of up to 30 calendar days. The employee can choose to have up to 10 days of vacation paid in cash. Vacation compensation is equivalent to one month salary, plus a 1/3 monthly salary as a vacation bonus. Vacation bonuses must be included in the basis for calculating unemployment insurance and social security contributions.

Employees should not accumulate 2 or more years of vacation entitlements, otherwise the excess must be compensated at twice the normal rate of pay.

If an employee is dismissed (other than with cause) he/ she must be compensated for unused vacation time, even if proportionally to the worked period.

13th Month's Salary (Christmas Bonus)

An additional one-month salary, also known as the 13th salary, is paid to employees as an annual bonus. Every year employers are obligated to pay a bonus in the month of December equal to 1/12 of the salary earned for each month of service during that calendar year. This bonus must be included in the basis for calculating unemployment insurance and social security contributions.

Part of the bonus must be paid during the year (normally when vacations are taken), and the remainder is paid in December.

Dismissed employees are entitled to receive proportionally to the period effectively worked during the year.

Profit Sharing

The legislation provides that agreements for profit sharing must be agreed upon by the employer and commissions appointed by the employees.

It is debatable on whether the payment of profit sharing is mandatory or optional, but there are several companies, which have not been paying it.

However, if a company has a profit sharing policy in place then pursuant to current legislation profit sharing payments are not subject to payroll taxes and are not included in labor rights calculation basis, but they do attract personal withholding income tax.¹³

Prior Notice on Dismissal

The employer or the employee wishing to terminate an employment relationship should give a thirty days notice. If the company wants to terminate the working contract without giving or before the end of prior notice, it must pay the related days to the dismissed employee.

Other labor rights agreed and payments may be also due, depending on the employment contract signed with the individual, his activities and on the Collective Bargain/Agreement negotiated with the respective labor union.

General Disclaimer

Note that the labor rights described above are those to which all employees are generally entitled to according to Brazilian labor laws. Other rights may exist that may be provided for in the labor convention applicable to a specific company.

Although detailing all possible rights that may be granted to employees in Brazil is outside the scope of this publication, the most significant issues are highlighted above.

Payroll Taxes

Retirement Fund (FGTS) - Government Severance Indemnity Fund for Employees

Each month, the employer must contribute the equivalent of 8% of total salary of each employee for *FGTS* purposes. This amount is deposited in each employee's name in a separate account with the bank designated by the government.

An employee may only use this fund in special circumstances, such as retirement or dismissal without just cause. In any case, the employer must pay the employee 40% of the actual balance of the *FGTS* account as well as an additional 10% to the federal government.

The contributions to *FGTS* are not applicable for payments to independent professionals and are not mandatory for compensation of directors that are not employees.

Social Security (*INSS*)

Employers Contributions

Social security contributions have to be paid monthly by the employer to the Federal Social Security Agency (*INSS*). The contribution rate of 20% is applied on gross salaries without limits.

The contribution is further increased by working accident insurance, education contribution and contributions to other governmental institutions such as National Service for Commercial Learning (*Senac*), Social Service Of Commerce (*Sesc*) and Service of Support to Micro and Small Companies (*Sebrae*), resulting in a total social security contribution rate of 27% to 29%.

Note that these rates may be higher depending upon a company's activity, number of employees and history of work related accidents.

Payments to independent contractors, directors or managing directors without an employment relationship with the company (e.g., service and management fees) are subject to *INSS* at a rate of 20%.

Employee Contributions

Employee contributions are made at lower rates (between 8% and 11%) based on a specific progressive table and must be withheld monthly and paid to *INSS* by the employer.

For instance, the monthly social security contributions paid by employees who receive salaries equal to, or higher than, approximately R\$ 3,689.66 per month are limited to 11% of the salary amount.

Withholding Income Tax

Income taxes on Brazilian source payments made to individuals as remuneration for services must be withheld on a monthly basis in accordance with a specific progressive table, as further listed below. The withholding rate for individual income taxes ranges from 7.5% to 27.5%.

Income – from (R\$)	Income – to (R\$)	%	Portion to be deducted (R\$)
0.00	1,499.15	0.00	0.00
1,499.16	2,246.75	7.50	112.43
2,246.76	2,995.70	15.00	280.94
2,995.71	3,743.19	22.50	505.62
3,743.20	-	27.50	692.78

For more information of individual taxation please refer to the specific topic below.

Social Security Benefits

The Brazilian social security system provides minimal benefits. Health, disability and senior pension benefits are very small for the vast majority of Brazilians. In addition, a significant proportion of the population is engaged in occupations where access to the social security system is limited.

The state health care system is rudimentary and is generally overloaded. Accordingly, the majority of employees have access to private health insurance plans provided by corporate employers or trade unions.

Basis for Calculation

Benefits paid by the state are calculated based on the “benefit wage”. The benefit wage is that part of an employee salary on which the employer’s social security contributions are calculated.

The specific rules to calculate may vary in accordance with the nature of the benefit.

Health Insurance

During the first 15 days of sick leave the employer pays the employee salary. If the insured is unable to work for a period longer than 15 day, the benefit wage is paid to the insured by the *INSS* for the remaining duration of the sick leave. This insurance may be converted into a disability pension.

Retirement Pension

This benefit is paid to men over 65 and to women over 60 years old, provided they have made 180 monthly contributions. For farm workers, the age threshold drops to 60 years for male and 55 years for female workers.

An early retirement pension may be granted if a man has worked for at least 30 years and a woman for at least 25 years. The maximum pension is available after 35 years of service for men and 30 years for women.

Other Benefits

Other benefits are available to employees in Brazil. These include, among others, maternity insurance, funeral insurance and disability pension, all of which are calculated in a similar manner to the 13th month salary.

Government Inspection

Employers must submit all accounting records and other documentation to government inspectors, upon their request, to demonstrate compliance with social security rules.

Union Contributions

Employers’ contributions to labor unions are paid in January of each year and are calculated on the basis of a company’s registered capital per a progressive chart prepared by the union.

All employees must pay union contributions equal to one day’s wages. This contribution is deducted from employee salary in March.



Chapter 11

Taxation of Individuals

Foreign Workers

Two thirds of the employees of all companies must be Brazilian citizens, both in terms of numbers and total payroll. Exceptions may be made for skilled professionals and technicians in the event that Brazilian nationals are not available for a particular position.

All foreigners coming to work in Brazil must obtain a valid visa. Generally, visas are issued to directors and employees of a foreign company, an individual establishing a significant new investment in Brazil and to new transfers of a foreign company with existing operations in Brazil, where the transfer has skills not available in the Brazilian labor market. In practice, the latter requirement is not rigidly applied. Experience required for the job varies depending on the position, the industry in which the company operates and the current labor policy.

The Federal Constitution of 1988 ensures equal protection of the basic rights of liberty, personal security and property ownership to both Brazilian nationals and foreign residents. However, foreigners are prohibited from engaging in certain activities, and may not own property in frontier areas. In addition, the legislation limits the amount of rural land that a foreigner may acquire.

Split Payroll

Brazilian legislation does not expressly provide guidance on the treatment to be applied to cases in which a split payroll scheme is put in place.

Split payroll occurs when the employee's payment is partially made by the Brazilian employer and partially made by the foreign employer. In practical terms, due to the lack of specific provisions and considering that the general provisions of the social security legislation are broad, the authorities may argue that the social security contributions would be due in Brazil based on the total remuneration received.

Brazilian income tax must be paid on total income on a worldwide basis. Visa issuance consequences must also be considered.

Concept of Residence

Permanent Visa

Individuals transferring to Brazil on a permanent visa are subject to tax as residents from the date of arrival.

Permanent working visas are generally granted only to applicants who will perform management activities as business administrators, general managers or directors of Brazilian professional or business companies duly appointed as stated in their articles of incorporation.

In general, the Brazilian company has 2 options to formalize the recruitment of an individual requiring a permanent visa:

- a. with an employment contract, where the Brazilian company will pay a monthly salary, will include the individual in the payroll and will incur other labor charges for employing the foreign national; or
- b. without an employment contract, where the company will pay a *pro labore* remuneration in Brazil.

Temporary Visa

Individuals transferring to Brazil on a temporary visa to work as an employee of a Brazilian entity are considered residents for tax purposes as of the date of arrival and, as such, are taxable on their worldwide income.

If an individual enters for any other purpose on a temporary visa and does not have an employment contract with a Brazilian entity, the individual's tax status for the first 183 days of physical presence in Brazil will be that of a nonresident.

Business Visa

A business visa holder is allowed to remain in the country for a period of 90 days, which may be extended, and would only be able to conduct business as allowed under the rules applicable to the holder of this type of visa.

Repatriation Process

Upon departure from Brazil, a fiscal resident must report his or her income and pay any taxes due until that date.

The taxpayer must file a Notice of Departure from Brazil and Part Year Income Tax Return to Brazilian Federal Revenue. Further, the foreign national must obtain a tax clearance certificate (granting non-resident tax status) that will enable him or she to request permission from the Brazilian Central Bank (*BACEN*) to repatriate all assets held in local currency, provided these assets have been properly reported in the annual tax returns.

Basis of Assessment

Tax residents of Brazil, whether Brazilian or foreign nationals, are subject to tax on their worldwide income.

Individuals reporting foreign income received may recognize a foreign tax credit for any taxes paid to a foreign jurisdiction, provided there is a tax treaty or a reciprocity agreement in place between Brazil and the particular foreign country.

Income subject to tax includes all monetary compensation and fringe benefits.

For foreigners working in Brazil this includes, among others, the cost of travel for family home leave, as well as allowances for housing, education, automobiles, medical and other living expenses. In addition, any reimbursement of taxes paid should be included in taxable income.

Non-monetary fringe benefits, such as the use of a company car or country club membership, should be also included in taxable income.

No distinction is made between personal expenses reimbursed by the company to the employee and personal expenses paid directly to a third party by the company. Moving allowances are generally nontaxable but there may be cases requiring different treatment.

Tax Rates

Brazilian companies making payments to individuals must withhold the personal income tax on a monthly basis in accordance with the following progressive tax rates:

Income – from (R\$)	Income – to (R\$)	WHT %	Portion to be deducted (R\$)
0.00	1,499.15	0.00	0.00
1,499.16	2,246.75	7.50	112.43
2,246.76	2,995.70	15.00	280.94
2,995.71	3,743.19	22.50	505.62
3,743.20	-	27.50	692.78

Allowances and Deductions

In general, the following deductions, among others, from taxable income are allowed:

- dependents – up to R\$ 150.69 per month per dependent;
- social security contributions (*INSS*);
- alimony payments made in accordance with a divorce ruling issued by a Brazilian court;
- education expenses up to R\$ 2,830.84 per year per dependent;
- non-reimbursed medical and dental expenses;
- contributions to Brazilian private pension plans (limited to 12% of annual taxable income).

Please note that education and medical expenses as well as private pension plan contributions may only be deducted from taxable income on the annual income tax return.

These deductions are not considered when computing monthly withholding tax.

When preparing the annual personal income tax return, most taxpayers may elect to recognize the tax deductions as either: (a) according to actual expenses while observing the limitations set out in regulations, or (b) based on a presumed deduction method (i.e., deduction equivalent to 20% of the taxable income limited to R\$ 13,317.09).

An individual taxpayer may also reduce the amount of tax due for a taxable year (and not deduct from the calculation base) the following items, as applicable:

- donations made to official government, state or municipal child care entities;
- certain qualified contributions to cultural and sports projects;
- investments in audiovisual activities.

Note, however, that the deductions above are limited to 6% of total tax due for the taxable year.

Foreign Income *Carnê-leão*

The withholding tax mechanism only applies to payments made by Brazilian companies to individuals.

The tax due on foreign source income is calculated in accordance with the same progressive table, but the individual (or a service provider) must compute and pay the tax through a regime known as *Carnê-leão*.

Annual Income Tax Return

An annual income tax return must be filed by the last working day of the month of April of each year reporting the income earned in the previous calendar year (i.e., January 1st to December 31st).

All Brazilian tax residents are required to disclose their worldwide personal assets and liabilities held as of December 31st of each year.

Although part of the filing obligation there is no tax assessed on the gross or net assets of a fiscal resident.

Taxation of Capital Gains Related to Individuals

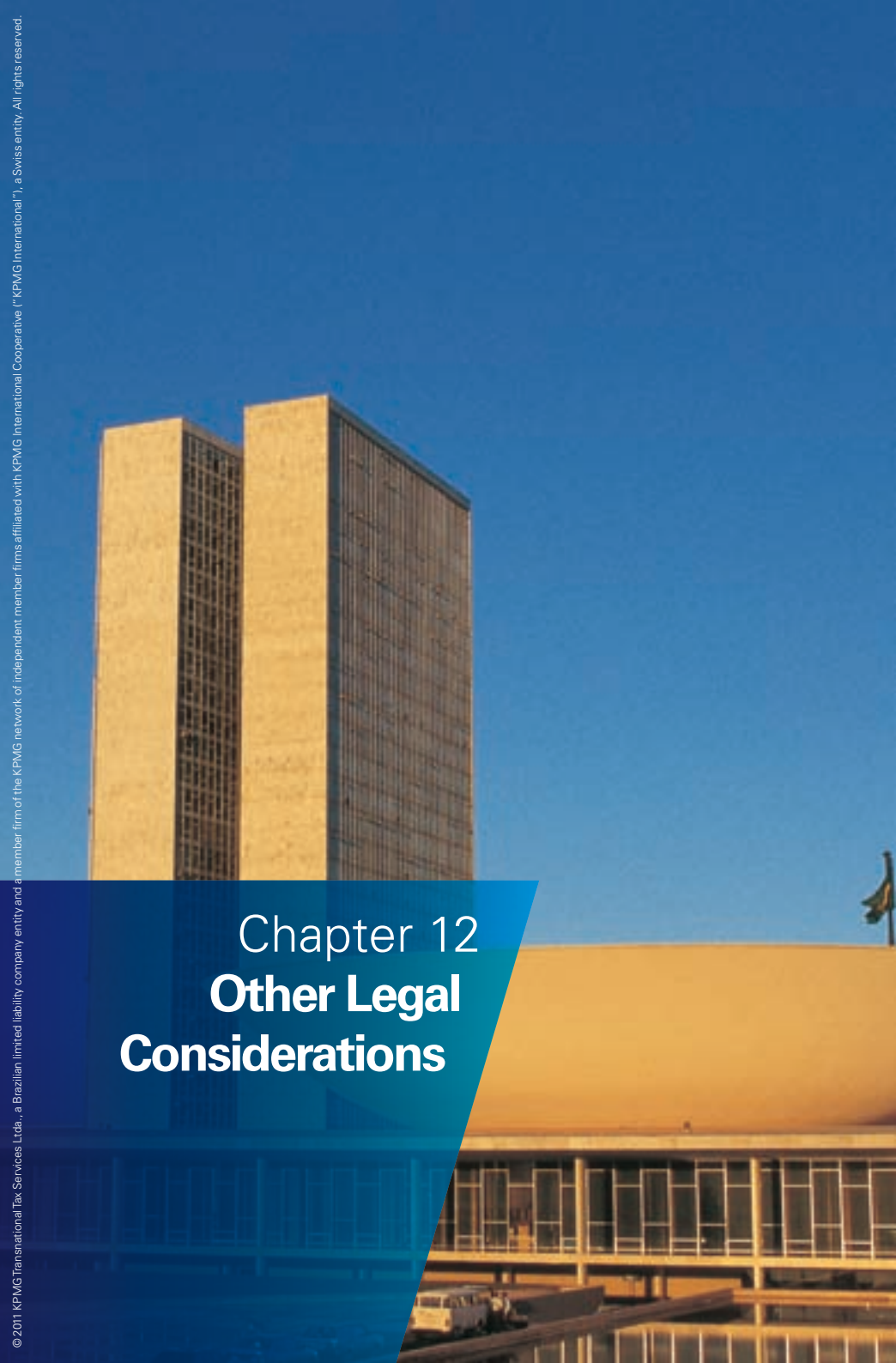
Real estate capital gains are taxable at a rate of 15%. Capital gains are exempt from taxation if all of the following conditions are met: a similar transaction has not occurred within the previous 5 years, the residential real estate is sold for a price lower than, or equal to, R\$ 440,000 and the individual does not own other real estate.

An exemption is also available if the taxpayer uses the sales proceeds to purchase another piece of real estate within the following 6 months.

Capital gains from the sale of stock negotiated on the *BM&F Bovespa* Brazilian Stock Exchange (*BM&F*) are exempt from tax if the proceeds are lower than R\$ 20,000 in a particular month. If the proceeds from sales in a particular month exceed this threshold, the capital gains are subject to either a 15% or 20% tax rate. Capital losses may be used to offset capital gains on a monthly basis. Any unused losses may be carried forward.

Capital gains from stock not negotiated on the Brazilian Stock Exchange are subject to a tax rate of 15% if the proceeds in a particular month exceed R\$ 35,000. Capital losses from such stock may not be used to offset capital gains.

Capital gains on the sale of all other personal property, whether held in Brazil or abroad, are subject to a tax rate of 15% if the proceeds exceed R\$ 35,000 in a particular month.



Chapter 12

Other Legal Considerations

It is also important to highlight some other significant legal considerations, useful in understanding the general legal environment of doing business in Brazil.

Regulatory Agencies

Considering that in Brazil some of the public services are transferred to the private sector, the State reserves the right to control and monitor those services by creating special agencies, known as regulatory agencies (*agências reguladoras*).

As per the monitoring and controlling activity of the State, below is a list of most significant regulatory agencies established in Brazil and their respective activity:

- i. Electric Power National Agency (*ANEEL*), founded by Law 9,427/1996 and respective amendments, to regulate and supervise the sector of generation, transmission and distribution of electricity;
- ii. Telecommunication National Agency (*ANATEL*), founded by Law 9,472/1997 and respective amendments, to regulate and supervise the telecommunication sector;
- iii. Oil, Natural Gas and Biofuels National Agency (*ANP*), founded by Law 9,478/1997 and respective amendments, to regulate and supervise the economic activities of all companies operating in this sector, by means of a concession or permission;
- iv. Sanitary National Agency (*ANVISA*), founded by Law 9,782/1999 and respective amendments, acting as an independent administrative entity with the purpose of protecting the health of the population, by means of controlling the production and commercialization of sanitation products and services submitted to the sanitation sector (medicines, food, cosmetics, laboratories, health insurance, and others);
- v. Supplementary Health National Agency (*ANS*), founded by Law 9,961/2000 and respective amendments, to regulate, standardize, control and supervise the activities that guarantee the supplementary health assistance. In this sense, such agency will ensure that the agreements executed by the private health insurance companies are duly accomplished;
- vi. Water National Agency (*ANA*), founded by Law 9,984/2000 and respective amendments, to supervise, control and evaluate the activities derived of the usage of the water resources, as well as grant, by means of an authorization, the right to use the water in the rivers of federal domain;

- vii. Ground Transportation National Agency (*ANTT*), and Waterway Transport National Agency (*ANTAQ*), founded by Law 10,233/2001 and respective amendments, to regulate and supervise, in its respective sectors, the activities of service rendering and exploration of the infrastructure exercised by third parties;
- viii. Civil Aviation National Agency (*ANAC*), founded by Law 11,182/2005 and respective amendments, to regulate and supervise the civil aviation, aeronautics and airport infrastructure; and
- ix. Cinema National Agency (*ANCINE*), founded by the provisional measure n. 2,228-1/2001 and respective amendments, to promote, regulate and supervise the cinematographical industry.

Consumer Rights

The Consumer Protection Code (*CDC*) was approved in 1990, by Law 8,078/90. Although legal provisions governing the liability of manufacturers and retailers for the safety of their products existed previously there was no specific law dealing with consumer rights until this legislation.

The *CDC* defines a consumer as “any legal entity or individual who acquires or uses a product or service as final user.”

Other sections of the *CDC* expand this definition to include, in the protective scope of the law, any victim of an event that causes a loss (“innocent bystander”). In this sense, legislation protects not only the original purchaser, but any user of the product.

The doctrines of “strict liability” and “disregard of legal entity” have been adopted by the *CDC*. Among the parties that may be liable are those responsible for the design, manufacture, distribution, sale, and import of the product.

Other important matters covered by the *CDC* are briefly summarized below:

Information

The consumer must be fully informed about the purchased products and services. In addition, the manufacturer is required to provide the public with clear and precise information regarding any dangers related to its products.

Even if the manufacturer discovers a danger after the release of the product, he must advise authorities and publish warnings in the media. Otherwise, the company may suffer administrative sanctions and criminal action.

All information on imported products must be provided in Portuguese, along with the full name and address of the importer.

Credit Reports

A consumer has the right to correct erroneous or outdated credit data.

Publicity

The *CDC* provides for fines, prison terms and counter-publicity, which entails the publishing of advertisements in the same media used to divulge false or misleading advertising.

Contracts

Public agencies have the right to the first review of standard form contracts.

In addition, the *CDC* establishes specific rules for sales contracts. For example, "small print" has been barred, and any restrictions to a consumer's rights must be conspicuous, e.g., in larger font than standard type.

Furthermore, if a product is purchased outside the commercial establishment of the seller, the consumer may cancel the sale within 7 days, return the product, and receive his money back. Tying arrangements are prohibited.

Class Actions

These actions are restricted to consumer protection cases. Of particular interest to foreigners are cases where Brazilian courts have ruled that the Brazilian subsidiary or representative is responsible for the repair of products under warranty, even though they were purchased abroad from the foreign parent entity.

Intellectual Property

Industrial Property

Industrial property protection in Brazil is currently governed by Law 9,279/96 Industrial Property Law (IPL). The main innovations of this law include patents for medicines, chemical, pharmaceutical, and food products.

At the international level, the protection of industrial property in Brazil is enhanced by the Berne Convention, the Patent Cooperation Treaty (PCT), the Paris Convention, and the Agreement on Trade Related Aspects of Intellectual Property Rights (*TRIPS*) for which, Brazil is a signatory.

The federal government established the National Institute of Industry Property (*INPI*) in 1970, to regulate and enforce industrial property rights, including patents, trademarks, and other such registrations of intangibles.

Trademarks

The registration of a trademark with the *INPI* is required to guarantee the protection of ownership rights in Brazil.

There are 4 kinds of trademarks legally protected: (i) industry trademarks used by manufacturers to distinguish their products; (ii) trademarks used by merchants to identify their merchandise; (iii) service marks used to protect services or activities; and (iv) general marks used to identify the origin of a series of products or services that are individually distinguished by specific marks.

Brazilian and foreign individuals as well as entities may apply for a trademark, upon presentation of supporting documents to the *INPI*.

The registration process may take from 2 to 5 years.

The protection of a trademark by the applicant is effective in Brazil as of the filing of the documents with the *INPI*. However, only upon the issuance of the registration certificate, will the applicant be entitled to full exclusive trademark rights and the use of the registration symbol.

Owners may negotiate the rights to trademarks or license them to others, subject to the registration of the respective agreement with the *INPI*.

Worldwide well known trademarks are protected by the IPL, regardless of registration with the *INPI*.

Unless the lack of use can be justified, the nonuse of a registered trademark for an uninterrupted five year period will invalidate the registration.

The Paris Convention established an exclusive priority right whereby an applicant from one country can use the original filing date as the effective date of filing in other countries, signatories of the Paris Convention, provided the applicant files another application within 6 months. This provision is applicable in Brazil.

Trade names, unlike trademarks, are registered with the local state Commercial Registry or with the local Civil Registry of Legal Entities, depending on the objectives of the entity.

Patents

In order to establish legal protection for inventions, utility models, and industrial designs, according to the IPL, they must be patented in Brazil. The essential elements required for the granting of a patent in Brazil are: absolute novelty, industrial application and inventive activity.

Since Brazil is a signatory of the Paris Convention, citizens of other signatory countries, which have filed for patents in their home country, have the exclusive right to apply for patents during a certain time period from the date of registration in the country of origin in order to keep the original date as the effective filing date in Brazil.

This exclusive period depends on the nature of the industrial property: industrial designs and models – 6 months; inventions and utility models – 12 months.

A foreign patent is considered to be in the public domain and cannot be registered in Brazil once it has been published in the foreign country.

A patent is valid for the following periods starting from the filing date of the request for protection: inventions – 20 years; utility models – 15 years; and industrial designs – 10 years

A patent holder must either use the patent commercially within 2 years following registration with the *INPI*, or authorize others to do so, otherwise risk the penalty of forced licensing or expiration of the patent.

The following items cannot be patented: (i) products which violate morals, good customs, security, as well as public order or health; (ii) products which result from the transformation of an atomic nucleus; (iii) living beings, except microorganisms; (iv) scientific theories and surgical techniques; and (v) computer software (see “Software” section below), among others.

A patent terminates and enters the public domain in the following cases: (i) at the expiration of its legal term; (ii) the owner waives the patent; (iii) failure to lawfully use the patented material; (iv) lack of payment of applicable annual contributions; (v) absence of an attorney to represent the foreign owner in Brazil; or (iv) if it is administratively cancelled or judicially annulled.

Patents may be licensed or assigned by their owners. The IPL provides that the manufacturing of a product or use of processes covered by a patent, without authorization of the patent owner, shall constitute a patent infringement.

Technology Transfer

All of the acts or agreements involving the transfer of technology, such as patent license agreements, trademark license agreements, technology transfer agreements and contracts for the rendering of technical and scientific assistance services, must be registered with the *INPI*, in order to be enforceable.

Royalty and fee payments may not be remitted abroad, unless the underlying agreements are approved by the *INPI* and are registered with the Central Bank of Brazil (*BACEN*).

INPI registration is also required for the tax deductibility of corresponding expenses.

Copyrights

Law 9,610/98 (Copyright Law) governs copyrights in Brazil. It protects creative works of inspiration expressed by any means as intellectual property.

The registration of a copyright is optional in Brazil. Hence, although recommended, it is not required for the enforceability of the copyright against third parties. Copyright infringement is punishable by imprisonment and civil damages may be awarded to the plaintiff for violations of Copyright Law.

Software

Legal protection for computer programs is currently governed by Law 9,609/98 and also by Copyright Law. Foreign software may qualify for protection, regardless of registration, as long as its country of origin grants similar rights to Brazilian software.

The registration of foreign software prior to marketing is no longer required. However, registration with the *INPI* is usually recommended to facilitate the protection of the underlying copyright against third parties.

Software protection is granted for 50 years as of January 1 of the year following its publication, release or creation, regardless of its registration with the *INPI*. During this term, the owner or licensee will be required to provide technical assistance.

Franchising

Franchising activities are governed in Brazil by Law 8,955/94. Franchising agreements must be registered with the *INPI* in order to be enforceable against third parties.

Antitrust Rules

The Federal Antitrust Agency (*CADE*) is the Brazilian agency responsible for protecting the free market economy and ensuring fair competition.

There are 2 other agencies that assist *CADE* in examining administrative cases: the Economic Law Secretariat (*SDE*) and the Economic Supervision Secretariat (*SEAE*). The *SDE*, an agency of the Justice Ministry, is responsible for initiating investigations and issuing an opinion on the legal aspects of a case.

The *SEAE*, an agency of the Economy Ministry, issues opinions on the economic topics of a case. Final decision on antitrust cases is a *CADE* prerogative.

The Antitrust Law (Law 8,884/94) defines 24 antitrust violations, including tying arrangements, boycott and price fixing, market division, combined bids, underselling, dumping, overpricing and abusive profits.

In addition, the Antitrust Law states that a company or group of companies is presumed to hold a dominant position when it controls 20% of its market.

Although dominance of a particular market is considered a violation, the law allows the company to justify its position through proof that greater efficiency or productivity led to this situation.

Merger and acquisition contracts that may limit or harm competition and any other form of corporate arrangement, in which any of the participants has annual gross revenue greater than R\$ 400 million, must be submitted to *CADE* for examination within 15 days after the occurrence.

Private parties may seek redress in court, concurrently with the administrative proceeding.

The Antitrust Law has adopted the “consent decree” concept from the U.S. antitrust laws and also allows preliminary injunctions. Sanctions include substantial fines, which may be imposed on companies and managers who are directly or indirectly responsible for their company’s violation.

Arbitration

Individuals and entities capable of entering into contracts can have disputes related to negotiable rights resolved through arbitration, according to the terms of Law 9,307/96 (Brazilian Arbitration Law).

This law states that arbitration can be initiated by the parties through: (i) an arbitration clause in a contract; or (ii) an arbitration commitment .

The arbitration clause provides that the parties agree to submit to the arbitration of eventual disputes that may arise from their contractual relationship.

The arbitration commitment is an agreement prepared after a specific dispute has arisen whereby the parties agree to take an issue to an arbitration court.

It can be judicial, i.e., through a specific instrument to be attached to the court files, or extrajudicial, i.e., through a public instrument or a private agreement signed by the parties.

Arbitrators may be appointed by the parties or selected by the arbitration court at the request of the parties and may rule on matters of fact or law. The decision issued by the arbitrators cannot be subject to judicial review, appeal or ratification.

Foreign Arbitral Decisions

Brazil is a signatory of the Convention of New York of June 10, 1958, on the recognition and enforcement of foreign arbitration decisions. In order for a foreign arbitration court decision to be enforced in Brazil, it must be ratified by the Brazilian Supreme Court (*STF*).

The ratification may be denied in exceptional cases, such as when the dispute matter may not be decided by arbitration according to Brazilian law, and when the arbitration decision violates Brazilian public policy.

Bankruptcy

Law 11,101/05 is the Brazilian Bankruptcy Law, also known as the Corporate Recovery Law. Enforceable since June 9, 2005, it governs judicial and extrajudicial recovery, as well as the bankruptcies of legal entities and individuals engaged in business activities.

The preference order for claims is: (i) labor credits, limited to 150 minimum wages per creditor; (ii) secured guarantee credits (up to the value of the secured asset); (iii) tax credits, except for tax penalties; (iv) credits with special privilege; (v) credits with general privilege; (vi) unsecured credits; (vii) contractual, legal, criminal, administrative and tax penalties; and (viii) subordinated credits.

Purposes and Innovations

The bankruptcy law prioritizes creditors' recovery when a debtor is in bankruptcy, provided that the continuance of their activities is economically viable.

This innovation aims to safeguard the interests of the creditors, to preserve jobs and to protect the social function of the companies.

In general, the purchaser of the assets that formerly belonged to a bankrupt business will not be responsible for the tax, labor, and civil obligations of a debtor in bankruptcy or judicial recovery.

Judicial Recovery

When judicial recovery is granted, the debtor is entitled to a period of 180 days during which almost all lawsuits and collection procedures against the debtor are suspended.

Within 60 days of the approval date of a judicial recovery request, the debtor must submit a judicial recovery plan to the court detailing the proposed recovery process.

If specific legal requirements are not met, or if one or more creditors present formal opposition to the terms of the plan, the plan may not be approved as drafted.

A judicial recovery proceeding will be converted into bankruptcy when: (i) the debtor fails to submit a recovery plan within the deadline set forth in the law; (ii) a General Meeting of Creditors rejects the judicial recovery plan; and (iii) the debtor fails to satisfy any of its legal obligations related to the judicial recovery plan within a two-year period from the judicial recovery approval date set by the judge.

Extrajudicial Recovery

In the extrajudicial recovery proceeding, the debtor proposes a recovery plan to some or all of his creditors. Some liabilities are not suitable for extrajudicial recovery plans, such as tax, labor and prepayment of foreign exchange contracts obligations.

The extrajudicial recovery plan may be submitted to a court of law for ratification, where the involvement of the judge is limited to the verification of the legality of the procedures adopted by the parties.

The ratification of the extrajudicial recovery plan by a judge does not prevent eventual lawsuits or collection procedures against the debtor, or bar the filing of a bankruptcy petition by creditors not contemplated in the plan.

Corporate Governance¹⁴

Once the investment is settled, it is important to be aware of the overall business environment and entrepreneur conduct currently performed in Brazil, especially in regards to the Corporate Governance practices.

Corporate Governance is currently one of the most important items being discussed in the capital markets around the world.

Brazil, as an emerging market with large potential for foreign investment has to have its corporations being highly scrutinized by investors, banks and other stakeholders about their corporate governance practices.

¹⁴ The Audit Committee Institute (ACI) Brazil has been created to serve audit committees, board of directors and fiscal council members and help them adapt to their changing roles. Sponsored by KPMG, the ACI provides knowledge and experience and is a resource to which these groups can turn for information and to share knowledge. To get more information about the Brazilian KPMG's Audit Committee Institute access www.kpmg.com.br/acif/.

Several initiatives have been developed and established by regulators, such as the Brazilian Securities Exchange Commission (*CVM*), the *BACEN*, and the *BM&F – Bovespa* Stock Exchange (*BM&F*) and by groups specialized in the subject, including the Brazilian Institute of Corporate Governance (*IBGC*) and the Audit Committee Institute – *ACI* of KPMG in Brazil.

The *IBGC* is a non-profit cultural entity of national scope and is one of the parties responsible for the introduction and dissemination of the corporate governance principles in Brazil.

According to *IBGC*, corporate governance is a system by which companies are directed and monitored, and includes the shareholders, the board of directors, the independent auditors and the fiscal council (which responsibility in accordance with Brazilian corporate law is to oversee the acts of the board of directors and officers, on behalf of shareholders).

These components, together with practices such as equal treatment of shareholders, full disclosure, accountability and corporate responsibility, are considered to be the best practices in corporate governance, with the intention of increasing the value of a company, facilitate its access to capital, and contribute to the sustainability of its business and operations.

Additionally, in order to create more effective and updated corporate governance practices in Brazil, *CVM* and *BM&F* have been thoroughly studying and discussing corporate governance practices for public companies in order to improve its regulations and applicability.

Based on the principles of the Shelf Registration System from International Organization of Securities Commissions (*IOSCO*), the *CVM* created the regulation Instruction *CVM* 480 (*ICVM* 480), as of January 1st, 2010. This regulation establishes new rules for the registration of issuers of securities admitted to be traded on regulated securities markets.

One of the key changes was the creation of a new periodic document denominated Reference Form (*Formulário de Referência*, equivalent to the 20F from SEC).

The Reference Form, which constitutes the main source of information about the issuer, expands the quantity and quality of information that will be available to investors and market, bringing the Brazilian rules near to the standards recommended by international institutions specialized in the securities market.

Furthermore, the *BM&F* has been very innovative by creating differentiated levels of corporate governance practices, which are a set of rules of conduct for companies, their management, and their controlling shareholders that *BM&F* considers important for increasing the value of shares and other securities issued by publicly held companies.

A photograph of four offshore wind turbines in a row, extending into the distance over a calm blue sea. The turbines are white with yellow bases. The sky is clear and blue.

Chapter 13 Sustainability

Sustainable development, according to the Brundtland Commission Report¹⁵, “is development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.

Since development involves progressive transformation of economy and society, this concept has been unraveling to comprise sustainability as a conjunction of good social, economic and environmental practices.

The sustainability scenario in Brazil has experienced significant changes in the past few years. Brazilian companies are increasing the disclosure of sustainability information, Brazilian market institutions incorporated sustainability issues to their day-to-day activities and Brazilian governments, at federal, state and municipal levels, are enacting legislation covering a variety of themes related to sustainability, from climate change to deforestation and waste disposal.

These changes reflect the sustainability momentum in Brazil, in which regulation – or the threat of its creation – can be considered the main driver of the adoption of sustainability strategies and policies, and stakeholders’ expectations of minimizing reputational and operational risks may be the other important driver, among others.

Nevertheless, Brazil still faces complex challenges to alleviate poverty, foster social inclusion and address deforestation and biodiversity loss. The country is struggling to find the perfect equation between economic growth and sustainable development, and the role of business is certainly pivotal in this task.

Sustainability is a strategic issue for companies and can reveal if they are really prepared to race in the future low carbon economy, in which intangible assets, such as brand value and reputation, will play a significant role, jointly with the capacity to deal with contemporary issues, such as climate change and natural resources depletion.

In order to get a better understanding of the sustainability scenario in Brazil, it is relevant to analyze its context and main actors.

Government

The Brazilian government has been taking the lead at the international negotiations about climate changes and other environmental issues for the last few years.

15 The Brundtland Commission was convened by the United Nations in 1983 and is formally known as the World Commission on Environment and Development- WCED.

During the past Conferences of the Parties (COPs) of the United Nations Framework Convention on Climate Change (UNFCCC) the Brazilian delegation pushed for a common agreement between the various countries and tried to lead by example, presenting some interesting pieces of legislation during these meetings.¹⁶

In 2009, at COP15 in Copenhagen, the former Brazilian president, Mr. Lula da Silva, personally presented the recently approved Brazilian National Policy on Climate Change together with a commitment for emission reductions between 36% and 39% by year 2020 and a commitment to reduce deforestation of the Amazon area by 80% by 2020.¹⁷

This policy was the result of a dense civil society mobilization, including NGOs, scientists and experts, who elaborated a draft document presented as proposed legislation to the Congress and approved by the President several days before going to Copenhagen.

Such initiatives characterize the momentum that environmental issues have gained in the country over the past years, forcing the Brazilian government to act proactively in limiting its greenhouse gases (GHG) emissions. In this area Brazil is maintaining a leadership position internationally, even if such commitment is not required from developing countries yet.

One year later, during COP16 in Cancun in December 2010, the Brazilian government issued a decree to regulate its National Policy on Climate Change, establishing its strategies on meeting emission reduction targets set earlier.

Brazil has been dedicated to its commitments and has implemented strategies to reduce emissions both at the federal and state levels.¹⁸

Among strategies to meet GHG emission commitments are plans to foster the development of renewable energy, the recovery of 15 million hectares of degraded land, the reforestation of additional 3 million hectares as well as decreasing the deforestation in the Amazon and Cerrado regions and increasing the use of vegetal coal in the steel industry.

16 UNFCCC is the United Nations convention, which, among other measures, through its Kyoto Protocol limits greenhouse gases (GHG) emissions of industrialized countries by circa 5% by 2012.

17 This GHG reduction commitment is based on 1990 emissions.

18 The state of São Paulo, for example, established a target of 20% GHG emission reduction by 2020 and set programs related to technology innovation, civil construction, energy and mapping of its vulnerabilities to meet its commitment.

It is unclear at this time the role that each sector will play, however, it is expected that 12 specific sector plans will be implemented by the end of 2011, with specific emission reduction targets for each sector.

In addition to climate changes, recurring themes around payments for environmental services, financial incentives for good environmental performance and waste disposal management are gaining importance in governmental agenda. For instance, after several years of discussion the National Waste Policy was approved in 2010.¹⁹

All in all, although it is still uncertain how these different policies are going to be implemented and what kind of constraints and opportunities they are going to impose on the Brazilian business sector, it is evident that the sustainability scenario is still going to face significant changes during the near future. Companies that understand these different challenges and are able to react properly will certainly be in advantage.

Aside from the legislative environment, governments are implementing sustainability projects in different spheres of their activities.

One example is the recently announced federal government's project to retrofit 16 ministerial buildings in Brasilia and to build another 7 adhering to sustainable standards, such as energy efficiency, water reuse schemes and use of sustainable material, among others.

The overall cost of the project is estimated in R\$ 3.5 billion and it aims at building capacity in the civil construction sector to act in the new market of retrofitting and sustainable building.

Market and Financial Initiatives

Market initiatives related to sustainability have become more common over the recent years and are gaining importance in the overall market performance. Such initiatives can help Brazilian companies prepare for increased competition in a low carbon economy.

In 2005, the BM&F – *Bovespa* Stock Exchange (*BM&F*), the Brazilian stock exchange, created its Corporate Sustainability Index (*ISE*), which is a benchmark for socially and environmentally responsible investment in the Brazilian market. The index was created due to investor needs for a more reliable portfolio of companies to invest in.

¹⁹ This policy imposes product stewardship and extended producer responsibilities for Brazilian companies.

The *ISE* index compiles a maximum of 40 companies and bases its evaluation on issues such as transparency, accountability, sustainability performance and reporting. It is interesting to note that during the 2008 financial crisis the index performed better than the Bovespa Index (the main indicator of the stock market's average performance), presenting less losses and a faster recovery.

Another initiative taken by the Brazilian stock market was the launch of the Efficient Carbon Index 2 (*ICO2*) on December 2010, elaborated in partnership with the Brazilian Development Bank (*BNDES*). This index intends to encourage disclosing information related to GHG emissions.

Companies are asked to disclose their GHG inventory and their participation in the index is increased or decreased in accordance with their overall GHG emission ranking against the average GHG emission of all companies.

With a still modest role and great opportunities to explore, financial institutions are starting to incorporate sustainable standards into their daily practices, such as the Equator Principles and specific projects, for example, housing and agricultural financing policies.²⁰

Other initiatives include financing incentives for real estate development companies that meet certain sustainability criteria in their operations, such as implementing policies on waste and water management, use of renewable energy and capacity building schemes.

Business and Multi-stakeholder Initiatives

As a result of all the mobilization around sustainability issues, a great number of organizations active in this field are flourishing in Brazil: Brazilian Sustainable Construction Council (*CBCS*), Center for Sustainability Studies of the Getulio Vargas Foundation (*GVces*), Brazilian Corporate Governance Institute (*IBGC*), Brazilian GHG Protocol Program (*Programa Brasileiro GHG Protocol*), and many others.

These organizations aim at producing and disseminating knowledge about current sustainability issues, providing an open environment for best practice sharing and straightening the relationship between the various stakeholders.

20 The Equator Principles are intended to act as a sustainable framework to project financing over \$10 million and have as main objective to guarantee that loans are only provided to projects that meet social responsible requirements and apply sound environmental management schemes. Four Brazilian banks have adopted these principles and, thus, incorporated environmental and social standards to their financing processes.

As a direct response to the different drivers presented earlier (e.g., regulation, easier access to credit, new market opportunities, risk management) Brazilian companies are increasingly concerned about sustainability issues and are disclosing social and environmental information in a broader spectrum.

According to a recent research, sustainability reports issued by Brazilian companies doubled from 2008 to 2009 and represented 3.5% of the reports published in the world that year.²¹

With respect to GHG emission inventories, the number of companies disclosing this information in accordance with the GHG Protocol framework has increased from 23 in 2008 to 36 in 2009. Moreover, Brazilian companies won all the awards at the 2010 Readers Choice Award organized by the Global Reporting Initiative (GRI) and comprised 70% of participating companies.

However, despite the growing number of reports and disclosures, there is constant criticism on the materiality and completeness of the disclosed information. Such criticism raises questions about transparency and accountability that still need to be addressed in further detail.

The path to be followed in the sustainability environment is still under construction and there is no right or wrong solution to be implemented. Sustainability can impose severe constraints or create great opportunities to businesses and governments.

The decision on how to proceed rests heavily on information access and proactive behavior. However, it is imperative for companies that want to succeed in the upcoming low carbon economy to incorporate sustainability issues into their core businesses.

This will also help companies face future regulations and meet stakeholder expectations.

21 Sustainability Ltd., Fundação Brasileira para o Desenvolvimento Sustentável (*FBDS*) and United Nations Environment Program (UNEP). Road to Credibility: A study of sustainability reports in Brazil. A release of Global Reporters program. Second edition 2010.

A low-angle, upward-looking photograph of the Christ the Redeemer statue in Rio de Janeiro, Brazil. The statue is white and stands on a dark, textured pedestal. Its right arm is raised high, pointing towards the sky, while its left arm is extended horizontally. The background is a clear, bright blue sky. A dark blue, semi-transparent triangular graphic element is overlaid on the bottom left of the image, containing the chapter title.

Chapter 14 KPMG in Brazil

KPMG is a global network of professional firms providing Audit, Tax, and Advisory services. We operate in 150 countries and have more than 138,000 professionals working in member firms around the world.

In Brazil, KPMG mission is to grow and strengthen its presence in the domestic market, with special attention to the so-called Middle Market companies and to attract and develop talents.

KPMG stands out by offering services based on a strong knowledge of the industrial sectors - financial services, retail, energy, oil and gas, mining, communications and media, electronics, software, among others – which result of experience and qualification added to the information obtained through comprehensive market research.

The purpose is to anticipate client's needs and help them overcome the complexities of current global market.

The convergence to international accounting standards, Basel regulations, to projects related to sports events and business support for companies preparing for IPO, booking for inward and external investment, are demands that require a strong qualification.

With strong investment in training, professional development, attraction and retention of talents, KPMG encourages professionals not only to enhance their performance in business, but also on how they interact with the client, with each other and with the society.

Audit

A commitment to quality, transparency and independence, and the provision of inputs for better decision making by managers, strengthens the role of rendering independent audit services for the reliability of the information compiled.

The audit is based on a methodology developed to meet international and local auditing standards, with an approach aligned with the principles related to professional integrity, independence and ethical behavior, that all team members must follow.

This approach is developed through an established set of standards and technologies of surveillance, analysis and consultation, and tools that help teams to access knowledge - including exclusive computed techniques of audit at KPMG.

Tax

The knowledge and experience obtained from national and international studies help to anticipate the tax changes and respond to them. The behavior and actions of professionals, in order to establish a strong, lasting relationship and to meet the needs from the perspectives of clients, define the success of the Tax sector and makes all the difference within the market.

The work is based on advice on different types of taxes levied in various operations and on those that focus directly onto specific sectors of the economy.

Aware of the range of taxes in Brazil, the professionals, members of multidisciplinary teams, aim to meet the needs of corporate governance, in establishing policies and processes capable to reduce the tax burden, to achieve compliance with tax obligations, better structure their operations, manage tax risk and control costs.

Advisory

Risk Consulting: Preserving the Value

Good governance practice means managing risks, establishing effective internal control systems and communicating the corporate wealth to owners, stakeholders and the market in general. It is also about preventing fraud, to ensure compliance with all regulations and, ultimately, generate value from the compliance framework.

The Risk Consulting practice helps clients to deal with the risks inherent in business through the construction of its corporate governance structure, helping them to manage the regulatory environment and improve the organizational risk.

Management Consulting: Performance Improvement, Strategic Use of Technology and Innovation

Practice focused on issues of performance improvement, strategic use of technology and innovation processes, with emphasis on Financial Services, Consumer Markets, Telecom, Government & Infrastructure and Energy & Natural Resources. Supports customers in the implementation of its objectives, identifying and designing actions with an integrated view of processes, information technology and people.

Transactions & Restructuring: Qualified Knowledge and Consolidated Experience

Our Transactions and Restructuring group is focused on continually enhancing and preserving value for clients across the deal and economic cycle. Our teams comprise of specialists capable of helping clients right through from conceptual thinking of buying a business to turning their business around in times of difficulty.

Transactions and Restructuring comprises of three service lines:

Corporate Finance

You can help clients through acquisitions, divestitures, mergers, buy-outs, major projects, initial public offerings (IPOs), structured finance, debt structuring and issuance, and complex re-financings, distressed M&A and with business and company valuations and fairness opinions.

Our advice is independent of any product, market or bank – independence of which we're fiercely proud. It's the quality of our experience and deep sector knowledge that really make a big difference for our client's transaction.

Restructuring

Our work falls into two broad categories: advisory, often working with lenders or corporates to stressed and distressed businesses to assess the position of the business and seek solutions for the issues identified; or insolvency, where we may trade a business for a number of months whilst we look to sell it, giving the staff on these assignments an opportunity to make executory decisions and see how a business operates. These are often fast moving situations where we work closely with the stakeholders to achieve a pragmatic solution.

Transaction Services

We research the issues which matter to our clients and embed the latest knowledge in the services we provide. We advise a broad client base on a range of deals and support them through the processes – from pre-bid due diligence evaluation to post-deal completion and integration.

Strategic & Commercial Intelligence

Aside from traditional due diligence assistance services, our Transactions Services practice has a dedicated transaction focused strategy group specialized in advising clients through key business decisions by providing market, competitor and customer insights. Services are grouped into four core offerings:

- Market entry and competitive intelligence: analysis to help underpin strategic investment / divestment decisions or to inform wider strategic assessments.
- Strategic options and decision making: defining future strategy through objective assessment of challenges and potential solutions.
- Business modeling: driving preferred options into competitive business models that position our clients for future success.
- Integration advisory: assisting clients in integration or separation exercises through the deal cycle from pre-deal synergy assessment and planning, to post-deal execution support.

Legal

The legal considerations were elaborated jointly to Frignani & Andrade Advogados, the law firm associated with KPMG in Brazil.

Corporate Citizenship in KPMG

KPMG is not leaving behind all those changes in the corporate scenario. We are connected to a new path based on joint collaboration and ethic conduct towards the environment and we believe that, especially here in Brazil, we can benefit from all the conducive circumstances that encourage ourselves to act with responsibility and conscientiousness.

Through our services, we turn knowledge into value for the benefit of our clients, our professionals and our communities.

This gives us a clear role and responsibility within the business community. We help companies grow and help to establish trust between organizations and investors.

Many KPMG member firms around the world support the reform of public sectors and the training of various government agencies, promoting integrity and transparency in these areas.

The member firms of KPMG are committed a common set of values. All the firms have the responsibility to comply with policies and regulations of KPMG International, including quality standards that govern the provision of services to clients.

This includes the maintenance of a structure that ensures its continuity and stability, with the ability to adopt global and regional strategies, share resources, provide service to multinational clients, manage risks and implement methodologies and tools for KPMG.

Each member firm is responsible for its own management and the quality of the respective work. In accordance with the Code of Conduct of KPMG International, partners and professionals working in member firms are required to act with integrity at all moments and this is how we base our vision and values:

Our Vision

We will build and sustain our reputation as the best firm to work with by ensuring that our people, our clients and our communities achieve their full potential.

Our Values

- We lead by example
- We work together
- We respect the individual
- We seek the facts and provide insight
- We are open and honest in our communication
- We are committed with our communities
- Above all, we act with integrity

The Corporate Citizenship derives from KPMG's vision and values. It influences our strategies and our choices as well as the way we relate with our stakeholders.

As leaders, we need to focus on the future. And this is the time to renew our commitment to operate and promote the business culture based on ethic, integrity, trust and transparency, and based on recognition of the roles and responsibilities we all have within the capital market and the communities in which we operate.

Our vision is that by leveraging the skills that people use at KPMG on a daily basis and applying them to the world that surrounds us, the member firms can contribute to positive changes that will also allow the flourishing of the communities in which we live and work.

We are determined to act as responsible corporate citizens, because we believe society is interested in our abilities and resources to help facing the current problems of the world. Responsible business practices contribute to the development of sustainable markets.

KPMG role in the society is defined by the services we provide and how we engage and commit ourselves to the communities in which we operate.

The member firms of KPMG work to build the trusting in the capital markets through transparency and accurateness of the financial statements and in order to help companies to improve their management and governance and, therefore, their performance.

Accordingly, the member firms of KPMG contribute to the improvement of market economy, which, in turn, creates and distributes wealth among society.

We understand, however, that we can also leverage the development of our communities. With this purpose, KPMG International is signatory of the United Nations Global Compact since 2002 and presents the report of progress to the institution annually.

Being signatory of the Global Compact provides the member firms of KPMG International the commitment with 10 principles mentioned below, that cover 4 main areas: Human Rights, Labor Law, Environment and Anti-Corruption Measures.

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

Principle 2: make sure that they are not complicit in human rights abuses.

Labor

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labor;

Principle 5: the effective abolition of child labor; and

Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

For this matter, Brazil is signatory of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transaction and the United Nations Convention against Corruption, demonstrating its commitment and efforts to actively combat corruption.

In addition, the Draft Bill 6826/2010 was submitted to the Congress by the President of the Republic which establishes the direct liability of legal entities for acts of corruption committed against the National and Foreign Public Administration.

Also, KPMG International adopts the 8 United Nations Millennium Development Goals as the focal point of the acting strategies in the communities of all member firms.

From these goals derives 2 global projects of KPMG International: The Global Development Initiative, program to face the issues related to development and social justice and the Global Green Initiative, which addresses questions related to the environment and the climate changes.

Both global programs orient the actions of each member firm in distinct countries and, therefore, with equally diverse needs.

However, there are some issues that unite us globally. And they guide our action in 3 common pillars: Education, Environment and Climate Change and Development.

Following, we bring some examples of KPMG performance in Brazil in the 3 strategic pillars.

The Corporate Citizenship in Practice

Think global and act locally. In Brazil, we align our strategies to the global pillar of action in Corporate Citizenship, in order to propose the most relevant questions within our reality.

Below, there is a brief comment of our actions on the 3 pillars mentioned: Education, Environment and Climate Change and Development.

Education: Strengthen children and adolescent's skills, promote cohesion between educational institutions, entrepreneur sector and communities.

- *Pequeno Cidadão*
- SIFE
- Junior Achievement
- Global Fellowship Program

Environment and Climate Change: Improve the environmental performance of our business and influence positively our professionals, clients and communities.

- Global commitment to reduce the emission of carbon dioxide
- Environmental policy
- Environmental Goals in the Dialogue (KPMG personal evaluation tool)
- Educational and awareness internal campaigns
- Investment in technologies to perform trainings and meetings via video/ web conference.

Development: Foster social justice and development of sustainable business enterprises.

- Services in benefit of the third sector.
- Support to social, educational and environmental campaigns
- KPMG Community Day (volunteer annual action in KPMG Brazil)
- Trainee's Challenge (presenting the corporate citizenship concept to the new members of the company and propose the voluntary project in the community.

All those actions provide benefits not only to the communities supported but enhance the pride of our professionals to be part of KPMG and build solutions for a fairer and sustainable society.

We believe the world needs this involvement and this. KPMG will certainly sustain this level of commitment, for the benefit of our professionals, our clients and our communities.

KPMG Global Business Group

As Brazil appears to be one of the most promising markets in the world currently, it is not surprising many international companies are interested in entering the market. To attend these multinational companies, KPMG in Brazil has created the Global Business Group to meet the demand for new projects involving foreign investors interested in entering in Brazil and Brazilian multinationals expanding their business internationally. The multidisciplinary team focuses on assisting national and international investors to gain an understanding of what is needed to establish a successful business in Brazil or abroad, evaluating the attractiveness of the sector and whether the opportunity is realistic.

“Our goal is to provide a complete framework for the potential investor to understand the country. Therefore, we investigate the market for business, identify local businesses for M&A or local partners for joint ventures and then provide due diligence to understand the financial, legal, fiscal and labor for these companies”

Augusto Sales

“We evaluate various options for structuring an investment, taking into account the client’s business interests. Moreover, it is essential to understand the geography, logistics, taxes levied and tax incentives before settling in the country. And more important than knowing the theory is understanding the practice.”

Marienne Coutinho

Growing with strength and solidity

São Paulo

Belo Horizonte

Brasília

Campinas

Campo Grande

Curitiba

Florianópolis

Fortaleza

Goiânia

Joinville

Londrina

Manaus

Osasco

Porto Alegre

Recife

Ribeirão Preto

Rio de Janeiro

Salvador

São Carlos

São José dos Campos

Uberlândia



Glossary

ABDIB	<i>Associação Brasileira da Infraestrutura e Indústria de Base</i>	Brazilian Association of Infrastructure and Basic Industry
ACI	<i>Comitê de Auditoria</i>	Audit Committee Institute
ALADI	<i>Associação Latino-Americana de Integração</i>	Latin American Integration Association
ALCA/FTTA	<i>Área de Livre Comércio das Américas</i>	Free Trade Area of the Americas
ANA	<i>Agência Nacional de Águas</i>	Water National Agency
ANAC	<i>Agência Nacional de Aviação Civil</i>	Civil Aviation National Agency
ANATEL	<i>Agência Nacional de Telecomunicações</i>	Telecommunication National Agency
ANCINE	<i>Agência Nacional do Cinema</i>	Cinema National Agency
ANEEL	<i>Agência Nacional de Energia Elétrica</i>	Electric Power National Agency Financial Reporting Standards
ANP	<i>Agência Nacional do Petróleo</i>	Brazilian Agency for Petroleum, Natural Gas and Biofuels
ANP	<i>Agência Nacional do Petróleo, Gás Natural e Biocombustíveis</i>	Oil, Natural Gas and Biofuels National Agency
ANS	<i>Agência Nacional de Saúde Suplementar</i>	Supplementary Health National Agency
ANTAQ	<i>Nacional de Transportes Aquaviários</i>	Waterway Transport National Agency
ANTT	<i>Agência Nacional de Transportes Terrestres</i>	Ground Transportation National Agency
ANVISA	<i>Agência Nacional de Vigilância Sanitária</i>	Sanitary National Agency
APAs	<i>Acordos Prévios Sobre Preços de Transferência</i>	Advanced Pricing Agreements
BACEN	<i>Banco Central do Brasil</i>	Brazilian Central Bank
BCC	<i>Código Civil Brasileiro</i>	Brazilian Civil Code
BDI	<i>Investimento Direto Brasileiro</i>	Brazilian Direct Investment
BM&F	<i>Bolsa de Mercadorias & Futuros</i>	Brazilian Stock Exchange
BNDES	<i>Banco Nacional de Desenvolvimento</i>	Federal Development Bank
Brazilian GAAP	<i>Princípios Contábeis Normalmente Aceitos – Brasileiros</i>	Brazilian Generally Accepted Accounting Principles
CADE	<i>Conselho Administrativo de Defesa Econômica</i>	Federal Antitrust Agency
CAMEX	<i>Câmara do Comércio Exterior</i>	Chamber of Foreign Trade
CBCS	<i>Conselho Brasileiro de Construção Sustentável</i>	Brazilian Sustainable Construction Council
CDC	<i>Código de Defesa do Consumidor</i>	Consumer Protection Code

CFC	<i>Sociedade Estrangeira Controlada</i>	Controlled Foreign Company
CFC	<i>Conselho Federal de Contabilidade</i>	Federal Board of Accountancy
CIDE	<i>Contribuição de Intervenção no Domínio Econômico</i>	Contribution for Intervention in the Economy
CIF	<i>Custo, Seguro e Frete</i>	Cost, Insurance and Freight
CLT	<i>Consolidação das Leis do Trabalho</i>	Consolidation of Labor Laws
CMN	<i>Conselho Monetário Nacional</i>	National Monetary Council
CNPJ	<i>Cadastro Nacional de Pessoa Jurídica</i>	National Registry of Legal Entities
COFINS	<i>Contribuição para o Financiamento da Seguridade Social</i>	Social Security Contribution
COP	<i>Conferência das Partes</i>	Conferences of the Parties
CPC	<i>Comitê de Pronunciamentos Contábeis</i>	Committee of Accounting Pronouncements
CPF	<i>Cadastro de Pessoa Física</i>	Individual Taxpayer's Registry
CPL	<i>Custo de Produção mais Lucro</i>	Cost Plus Method
CSLL	<i>Contribuição Social sobre o Lucro Líquido</i>	Social Contribution Tax on Profits
CTPS	<i>Carteira de Trabalho e Previdência Social</i>	Employment Record Card and Social Security Card
CVM	<i>Comissão de Valores Mobiliários</i>	Securities Exchange Commission
CVRD	<i>Companhia Vale do Rio Doce</i>	Vale do Rio Doce Company
DAC	<i>Depósito Alfandegado Certificado</i>	Bonded Customs Deposit
DACON	<i>Demonstrativo de Apuração de Contribuições Sociais</i>	PIS and Cofins Return
DCBE	<i>Declaração de Capitais Brasileiros no Exterior</i>	Brazilian Capital Abroad Return
DCTF	<i>Declaração de Débitos e Créditos Tributários Federais</i>	Federal Tax Settlement Return
DI	<i>Declaração de Importação</i>	Import Declaration
DIEESE	<i>Departamento Intersindical de Estatística e Estudos Econômicos</i>	Department of Statistics and Economic Studies
DIPJ	<i>Declaração de Informações Econômico-Fiscais da Pessoa Jurídica</i>	Corporate Income Tax Return
DTT's	<i>Acordos de Bitributação</i>	Double Taxation Treaties
FC	<i>Constituição Federal</i>	Federal Constitution
FCONT	<i>Controle Fiscal Contábil de Transição</i>	Transitory accounting adjustments

FDI	<i>Investment Direto Estrangeiro</i>	Foreign Direct Investment
FGTS	<i>Fundo de Garantia por Tempo de Serviço</i>	Government Severance Indemnity Fund for Employees
FIEE	<i>Fundo de Investimento em Empresas Emergentes</i>	Emerging Companies Investment Funds
FIP	<i>Fundo de Investimento em Participações</i>	Investment in Partnership Investment Fund
FMIEE	<i>Fundo Mútuo de Investimento em Empresas Emergentes</i>	Investment Funds in Emerging Entities
FUNDAP	<i>Fundo de Desenvolvimento das Atividades Portuárias</i>	Development Fund of Port Activities
GATT	<i>Acordo Geral sobre Tarifas e Comércio</i>	General Agreement on Trade and Tariffs
GDP	<i>Produto Interno Bruto</i>	Gross Domestic Product
GHG	<i>Gases do Efeito Estufa</i>	Greenhouse Gases
GIA	<i>Guia de Informação e Apuração</i>	Guide for Information and Analysis
GRI	<i>Iniciativa Global de Relatório</i>	Global Reporting Initiative
GVces	<i>Centro de Estudos em Sustentabilidade da Fundação Getúlio Vargas</i>	Center for Sustainability Studies of the Getulio Vargas Foundation
IASB	<i>Comitê de Normas Internacionais de Contabilidade</i>	International Accounting Standards Board
IBGC	<i>Instituto Brasileiro de Governança Corporativa</i>	Brazilian Corporate Governance Institute
IBGE	<i>Instituto Brasileiro de Geografia e Estatística</i>	Brazilian Geography and Statistics Institute
ICMS	<i>Imposto sobre Circulação de Mercadorias e Serviços</i>	State Value-Added Tax
ICO2	<i>Índice de Carbono Eficiente</i>	Efficient Carbon Index
ICT	<i>Empresa Exportadora Internacional</i>	International Trading Company
IFRS	<i>Normas Internacionais de Informação Financeira</i>	International Financial Reporting Standards
IHC	<i>Empresa Controladora Internacional</i>	International Holding Company
II	<i>Imposto de Importação</i>	Import Tax
INPI	<i>Instituto Nacional da Propriedade Industrial</i>	National Institute of Industry Property
INSS	<i>Instituto Nacional do Seguro Social</i>	Social Security Contributions
IOF	<i>Imposto sobre Operações Financeiras</i>	Tax on Financial Operations

IOSCO	<i>Organização Internacional das Comissões de Valores</i>	International Organization of Securities Commissions
IPI	<i>Imposto Sobre Produtos Industrializados</i>	Excise Tax
IPL	<i>Lei de Propriedade Industrial</i>	Industrial Property Law
IPTU	<i>Imposto sobre Propriedade Territorial Urbana</i>	Real Estate Tax
IPVA	<i>Imposto sobre a Propriedade de Veículos Automotores</i>	Vehicle Tax
IRPJ	<i>Imposto de Renda Pessoa Jurídica</i>	Corporate Income Tax
IRRF	<i>Imposto de Renda Retido na Fonte</i>	Withholding Tax
ISE	<i>Índice de Sustentabilidade Empresarial</i>	Corporate Sustainability Index
ISS	<i>Imposto sobre Serviço</i>	Service Tax
IT	<i>Tecnologia da Informação</i>	Information Technology
ITBI	<i>Imposto sobre a Transmissão de Bens Imóveis</i>	Property Transfer Tax
ITCMD	<i>Imposto sobre Transmissão "Causa Mortis" e Doação de Quaisquer Bens ou Direitos</i>	Tax on Transfer of Property by Donation/ Succession
ITR	<i>Imposto sobre a Propriedade Territorial Rural</i>	Rural Land Tax
LALUR	<i>Livro de Apuração de Lucro Real</i>	Taxable Income Control Register
M&A	<i>Fusões e Aquisições</i>	Mergers & Acquisitions
MDIC	<i>Ministério do Desenvolvimento, Indústria e Comércio</i>	Ministry of Development, Industry and Commerce
MTC	<i>Ministério de Tecnologia e Ciência</i>	Ministry of Technology and Science
MFTZ	<i>Zona Franca de Manaus</i>	Manaus Free Trade Zone
NF-e	<i>Nota Fiscal Eletrônica</i>	Electronic Fiscal Invoice
NGO	<i>Organização Não Governamental</i>	Non-governmental Organization
NPAE	<i>Empresas que Não são Publicamente Responsáveis</i>	Non-Publicly Accountable Enterprises
OECD	<i>Organização de Cooperação e de Desenvolvimento Econômico</i>	Organization for Economic Cooperation and Development
PAE	<i>Empresas Publicamente Responsáveis</i>	Publicly Accountable Enterprises
PCT	<i>Tratado de Cooperação em Matéria de Patentes</i>	Patent Cooperation Treaty
PIC	<i>Preços Independentes Comparados</i>	Comparable Independent Prices
PIS	<i>Programa de Integração Social</i>	Social Integration Program

PPB	<i>Processo Produtivo Básico</i>	Minimum Manufacturing Process
PPP	<i>Parceria Público-Privada</i>	Public-Private Partnership
PRL	<i>Preço de Revenda menos o Lucro</i>	Resale Price Method
PVEx	<i>Preços de Vendas na Exportação</i>	Export Sales Price
R&D	<i>Pesquisa e Desenvolvimento</i>	Research and Development
RDE-IED	<i>Registro Declaratório Eletrônico de Investimentos Externos Diretos</i>	Electronic Declaratory Registration of Foreign Direct Investments
RDE-ROF	<i>Registro Declaratório Eletrônico de Operações Financeiras</i>	Electronic Declaratory Registration of Financial Operations
RECAP	<i>Regime Especial de Aquisição de Bens de Capital</i>	Special Acquisition Regime of Capital Goods
RECOF	<i>Regime de Entrepósito Industrial sob Controle Aduaneiro Informatizado</i>	Industrial Warehouse Regime under the Customs Computerized Control
RECOM	<i>Regime Aduaneiro Especial de Importação de Insumos</i>	Special Customs Regime for Imports of Inputs
REIDI	<i>Regime Especial de Incentivos para o Desenvolvimento da Infra-Estrutura</i>	Special Incentive Regime for Infrastructure Development
REMICEX	<i>Regime de Entrega de Embalagens no Mercado Interno</i>	Regime of Package Delivery in the Internal Market
REPENEC	<i>Regime Especial de Incentivos para o Desenvolvimento de Infraestrutura da Indústria Petrolífera nas Regiões Norte, Nordeste e Centro-Oeste</i>	Special Incentive Regime for Oil Companies Infrastructure Development in North, Northeast and Midwest Regions
REPES	<i>Regime Especial de Tributação para a Plataforma de Exportação de Serviços de Tecnologia da Informação</i>	Special Taxation for Export of Information Technology Services
REPETRO	<i>Regime Aduaneiro Especial de Exportação e Importação de Bens Destinados à Exploração e à Produção de Petróleo e Gás Natural</i>	Special Custom Regime for Exports and Imports of Goods Destined to Exploration and Production of Oil and Natural Gas
RETAERO	<i>Regime Especial para a Indústria Aeronáutica Brasileira</i>	Special Regime for Brazilian Aeronautics Industry
RFB	<i>Receita Federal do Brasil</i>	Brazilian Federal Revenue
RMCCI	<i>Regulamento do Mercado de Câmbio e Capitais Internacionais</i>	Regulation of Foreign Exchange Market and International Capital
RTT	<i>Regime Tributário de Transição</i>	Transition Tax Regime
SA	<i>Sociedade Anônima</i>	Corporations
SDE	<i>Secretaria do Direito Econômico</i>	Economic Law Secretariat
SEAE	<i>Secretaria de Acompanhamento Econômico</i>	Economic Supervision Secretariat

SEBRAE	<i>Serviço de Apoio às Micro e Pequenas Empresas</i>	Service of Support to Micro and Small Companies
SECEX	<i>Secretaria do Comércio Exterior</i>	Secretariat of Foreign Commerce
SELIC	<i>Sistema Especial de Liquidação e de Custódia</i>	Special System of Settlement and Custody
SENAC	<i>Serviço Nacional de Aprendizagem Comercial</i>	National Service for Commercial Learning
SESC	<i>Serviço Social do Comércio</i>	Social Service of Commerce
SISBACEN	<i>Sistema de Informações do Banco Central</i>	Brazilian Central Bank Information System
SISCOMEX	<i>Sistema Integrado de Comércio Exterior</i>	Integrated Foreigner Trade System
SME	<i>Pequenas e Médias Empresas</i>	Small and Medium-Sized Entity
SPED	<i>Sistema Público de Escrituração Digital</i>	Electronically Commercial and Fiscal Bookkeeping
STF	<i>Supremo Tribunal Federal</i>	Brazilian Supreme Court
SUDAM	<i>Superintendência de Desenvolvimento da Amazônia</i>	Superintendence of Amazonas Development
SUDENE	<i>Superintendência de Desenvolvimento do Nordeste</i>	Superintendence of Northeast Development
TEC	<i>Tarifa Externa do Mercado Comum do Sul</i>	Mercosur's Common External Tariff
TIPI	<i>Tabela de IPI</i>	<i>IPI</i> Tax Rates Table
TJLP	<i>Taxa de Juros a Longo Prazo</i>	Long-Term Interest Rate
TRIPS	<i>Acordo Relativo aos Aspectos do Direito da Propriedade Intelectual Relacionados com o Comércio</i>	Agreement on Trade Related Aspects of Intellectual Property Rights
UNFCCC	<i>Convenção das Nações Unidas sobre Mudanças Climáticas</i>	United Nations Framework Convention on Climate Change
UNFCCC	<i>Convenção das Nações Unidas sobre Mudanças Climáticas</i>	United Nations Framework Convention on Climate Change
Usiminas	<i>Usinas Siderúrgicas de Minas Gerais S/A</i>	Steel Manufacturer in Minas Gerais
WCED	<i>Comissão Mundial sobre Meio Ambiente e Desenvolvimento</i>	World Commission on Environment and Development
WCED	<i>Comissão Mundial sobre Meio Ambiente e Desenvolvimento</i>	World Commission on Environment and Development
WHT	<i>Imposto de Renda Retido na Fonte</i>	Withholding Income Tax
WTO	<i>Organização Mundial do Comércio</i>	World Trade Organization
ZPE	<i>Zona de Processamento de Exportação</i>	Export Processing Zones

Acknowledgments

We would like to thank the people below who have helped either in the preparation or revision of the text.

Agostinho Neto

Andre Coutinho

Augusto Sales

Beatriz Castro

Carolina Silbershmidt

Cristina Bonini

Cristiano Garcia

Danilo Simões

Dyane Silva

Edilberto Salge

Eliane Momesso

Eliete Ribeiro

Frederico Von Ah

Henrique Palma

John Harris

Luciana Pereira

Marcus Barbosa

Marcus Vinicius

Mauricio Endo

Michael Murphy

Patricia Quintas

Rachel Moreira

Ramon Jubels

Renata Foz

Ricardo Ono

Ricardo Zibas

Rodrigo Camargo

Sergio Schuindt

Sidney Ito

Tamer El Khatib

Thais Nakashima

Valentina Afanasii

Responsible for the publication:

**Marianne Mendonça Shiota
Coutinho**

**Partner, International Corporate Tax
& Transfer Pricing**

Global Business Group

T: +55 (11) 2183-3182

E: mmcoutinho@kpmg.com.br

Contacts

Pedro Melo

Chairman, Brazil

T: +55 (11) 2183-3135

E: pmelo@kpmg.com.br

David Bunce

Chairman, South America

T: +55 (11) 3245-8001

E: dbunce@kpmg.com.br

Charles Kriek

Partner in Charge, Audit

T: +55 (11) 2183-3102

E: ckriek@kpmg.com.br

Claudio de Leoni Ramos

Partner in Charge, Transactions & Restructuring

T: +55 (11) 3245-8313

E: crramos@kpmg.com.br

Carlos A. Gatti

Partner in Charge, Management Consulting

T: +55 (11) 2183-3110

E: cgatti@kpmg.com.br

Sidney Ito

Partner in Charge, Risk Consulting

T: +55 (11) 2183-3143

E: sito@kpmg.com.br

Cecilio Schiguematu

Partner in Charge, Tax

T: +55 (11) 2183-3106

E: cschiguematu@kpmg.com.br

Ricardo Anhesini

Partner in Charge, Markets

T: +55 (11) 2183-3141

E: rsouza@kpmg.com.br

Décio Frignani Júnior

Partner in Charge, Legal*

T: +55 (11) 3245-8016

E: dfrignani@fa-advogados.com.br

* Frignani Andrade Advogados
Associados

© 2011 KPMG Transnational Tax Services Ltda., a Brazilian limited liability company entity and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in the Brazil.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

Design by Índice Arte Gráfica e Editoração Ltda. (indice@indicecomunic.com.br)

ISBN 978-85-7531-382-4



9 788575 313824