

# Doing Business and Investing in Brazil\*



\*connectedthinking

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PRICEWATERHOUSECOOPERS 

## Information Guide Series

This Guide is one of a series on business conditions in the countries in which PricewaterhouseCoopers firms have offices or carry out work, and is based on the latest available information from these offices. Doing Business and Investing in Brazil is a publication of the PricewaterhouseCoopers ITS - International Tax Services Group and is published by PricewaterhouseCoopers Auditores Independentes.

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1. Capital (Economia) 2. Investimentos de capital - Brasil 3. Investimentos Estrangeiros - Brasil I. PricewaterhouseCoopers

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### Indices for systematic catalogue

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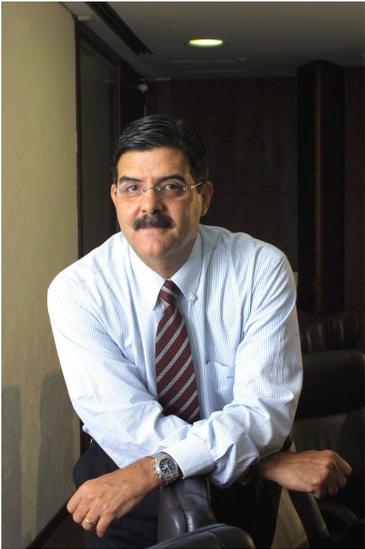
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# Foreword

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In 2005, PricewaterhouseCoopers completed 90 years of leadership in Brazil. It was established in Rio de Janeiro, in 1915, initially to serve multinational companies. Since then it has grown strongly, expanding its portfolio to Brazilian organizations of all sizes and to government and state entities.

Today PricewaterhouseCoopers is the leading professional services firm in Brazil, with 13 offices throughout the country and approximately 2,600 talented people. Our structure gives rise to a coordinated and business-oriented approach, with effective use of multidisciplinary teams who are joined in strategic segments.

PwC industry focus enhances our effectiveness, both as auditors and as wider business advisors. Clients benefit from access to people who have relevant industry knowledge and who can tailor solutions to specific needs. The industry programs cover the main economic sectors: Financial Services; Retail and Consumer, Industrial Products and Services; Technology, InfoComm, Entertainment and Media; and Government Services.

As a country and emerging economy, Brazil remains a very attractive market for foreign investment receiving 3% of the total global foreign direct investment in 2004<sup>(1)</sup>, representing the largest allocation in the last six years.

The investor's confidence in Brazil's growth potential and favorable economic conditions stimulates foreign investment. According to our merger and acquisition survey, 50% of such transactions in the first six months of 2005 involved foreign investment.

Despite the great interest, investors still encounter difficulties dealing with the complex regulatory and legal issues in the country. This publication has been prepared to assist those interested in doing business in Brazil. Our objective is to provide an outline of important legislation and operating issues that usually affect those contemplating investments in Brazil.

"Doing Business and Investing in Brazil" does not cover exhaustively the subjects, but is intended to answer some of the important, broad questions that may arise. When specific problems occur in practice, it will often be necessary to refer to the relevant Brazilian laws and regulations as well as obtaining appropriate accounting and legal advice.

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

Fernando Alves  
Territory Senior Partner  
PricewaterhouseCoopers - Brazil

<sup>(1)</sup> Source: Sobeet - Brazilian Society of Economic Globalization and Transnational Enterprises Studies.

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## Chapter 1

# Brazil - A profile

### Investor considerations

- Brazil is the fifth largest country in the world, has the ninth largest economy and a population of about 170 million (based on the latest census realized in 2000).
- The Brazilian economy is large by almost any standard.
- Abundant agricultural, mineral and energy potential.
- Enormous internal growth potential.
- Broad industrial base and infrastructure and a diversified economy.
- Volatile political environment.
- Fast-changing business conditions.
- Social extremes.
- Heavy bureaucracy.

### Geography and climate

Brazil is the fifth largest country in the world. It has an area of 3,287,000 square miles (8,514,000 square kilometers), which is equivalent to almost one-half of the entire South American continent. It borders all South American countries except Chile and Ecuador, a total of 9,777 miles (15,735 kilometers). The coastline runs for more than 4,578 miles (7,367 kilometers), almost all of it along the South Atlantic Ocean. Brazil comprises 26 states and the Federal District of Brasília, the capital city. Comparatively, its area is slightly smaller than the USA.

Geographically, Brazil consists of five basic regions:

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

More than half of Brazil lies at about 650 feet (200 meters) above sea level, but only a small part rises above 3,000 feet (915 meters). The highest peaks have an altitude of less than 10,000 feet (3,050 meters), only six of them exceeding 9,000 feet (2,745 meters), two in the far North and four in the Southeast. The Great Escarpment runs the length of the coast from the state of Bahia south and falls away inland at varying distances, most of the terrain being broken by fertile valleys.

Land use is approximately as follows:

- Arable -5%
- Permanent crops - 1%
- Meadows and pastures - 19%
- Forest and woodlands - 58%
- Other - 14%

## Extra official source

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

The Equator runs north of the Amazon River and the Tropic of Capricorn crosses the state of São Paulo. Most of Brazil is therefore in the tropical zone, with only the southern part in the temperate zone where there are occasional frosts. The North is hot, humid and rainy.

Along the coast the tropical heat is tempered by sea breezes whereas inland, especially along the Central Plateau, the altitude keeps the temperatures lower. Humidity is high all along the coast and rainfall is heavy. There is a drought area inland in the Northeast region.

Nearly every type of climate can be found except for very cold. The country is free from earthquakes, hurricanes and cyclones, but rainstorms, drought and frost occasionally cause considerable damage.

There are areas of great scenic beauty, particularly along the coastline.

## History

Brazil was discovered in 1500 by the Portuguese navigator Pedro Álvares Cabral and remained a Portuguese colony for over 300 years. In 1822, Brazil declared its independence when a constitutional monarchy was established and in 1889 a federal republic was proclaimed. Since that time democratic administrations were interrupted twice. From 1930 to 1945 the country was under the civilian dictatorship of Getúlio Vargas, and later in 1964, after political, economic and social unrest, a new government structure was installed by the armed forces and considerable economic growth and development was achieved during the next 20 years, although not without political and social repercussions. Democracy was re-established in 1985.

A new constitution was established by Brazil's National Congress in 1988. It confirmed the presidential system but at the same time promoted a decentralization of political power. The Constitution is lengthy, comprising 250 permanent articles and 94 temporary articles. In recognition of possible deficiencies in the text, the Constituent Assembly made express provision for its review. This review is behind schedule although several amendments have already been approved but have still to be regulated.

## Political system

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

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

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

The judicial branch consists of a system of federal, state and local courts throughout the country, headed by the Federal Supreme Court. The federal courts rule on the constitutionality of laws and decisions appealed from the lower courts in which the Federal Union is a party. There is no appeal against the Supreme Court's decisions. The state and municipal courts act independently of the federal courts within the bounds of the Constitution.

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

There are many political parties. However, ideologies are not well developed. Parties normally represent specific economic groups and interests within the country.

## Legal system

Historically, Brazil has used Napoleonic law. The principal source of Brazilian civil law is the Civil Code, which was reformed in 2002. The administration of justice is slow and cumbersome.

## Population and social patterns

### Population

The population is about at 170 million<sup>(1)</sup> and estimated to be growing at about 1.64<sup>(1)</sup> percent per year. About 40 percent of the population is under 20 years of age and less than 6 percent is over 65. The average life expectancy is 68,5 years. A major social problem of recent years has been the continuous influx of people to the urban centers.

The comparative distribution of population, area and GDP per capita by region is summarized in Table I. (based on latest information available - census 2000).

<sup>(1)</sup> Based on the latest census realized in 2000

## I - Population Distribution by Area and GDP per capita

Region	Population mass (2000)		Land	GDP per
	(In millions)	%	%	capita (1999)
North	13	8	45	3,380
Northeast	48	28	18	2,671
Southeast	72	42	11	7,843
South	25	15	7	6,878
Central-west	12	7	19	5,241
	<u>170</u>	<u>100</u>	<u>100</u>	<u>5,740 (average)</u>

Approximately 19 percent<sup>(1)</sup> of the population are rural dwellers and 81 percent<sup>(1)</sup> urban. About 30 percent live in the ten principal metropolitan areas. The metropolitan areas of São Paulo and Rio de Janeiro have populations of around 18 million and 11 million<sup>(1)</sup>, respectively. São Paulo is one of the fastest-growing cities in the world. Some 14 other metropolitan areas have populations of more than 1 million. The population growth is fairly evenly spread over all regions, but the North and Central-West are expected to grow at faster rates.

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

## Language

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

## Religion

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

## Education

Government-subsidized (free) and private educational facilities from primary school through university, offer full or part-time curricula. The government also subsidizes national apprenticeship training programs to develop manpower for various industrial and commercial sectors and an educational program to reduce illiteracy. About 87<sup>(1)</sup> percent of the adult population is considered to be literate. The general level of education requires much improvement. Approximately 5 percent of enrolled students go on to higher education.

<sup>(1)</sup> Based on the latest census realized in 2000

## Living standards

The standard of living of a large proportion of the population is very low, while that of the top stratum is extremely high. This income gap between rich and poor has been a constant preoccupation of successive governments. Basic social indicators underscore differences in regional development.

The gross domestic product (GDP) per capita in 2004 was the equivalent of about US\$ 3,336 per annum.

The percentage of home ownership is low. There is a chronic shortage of housing, especially for the working classes.

## Cultural and social life

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

## The Economy

### General description

The Brazilian economy is large by almost any standard and hosts diversified activities. There is still considerable state and semi state participation in various strategic sectors, such as transport and utilities. Brazil has passed through several state owned companies privatization, mostly in 1998 when the telecommunication companies

were sold. Although many sectors have been included in the privatization program, there have been delays in the preparation of certain electricity companies, state banks and petroleum industry, for sale, as well as some political resistance. Nevertheless, the program was, in general terms, rather successful. Thus, almost the totality of the former state companies is already controlled by the private sector.

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

Following the oil crises of the 1970s and early 1980s, Brazil developed its sugarcane-alcohol industry, which today fuels around 20 percent of the private-car fleet.

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

Major trends are summarized in Table II.

**II - Major Trends in the Economy**

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004<sup>(3)</sup></u>
GDP (US\$ Billion) - at year-end exchange rates	595	510	451	496	600
GDP real (inflation indexed) growth (% per year)	4,5%	1,4%	1,5%	0,2%	5,2%
Unemployment rate (% of labor force) <sup>(2)</sup>	7,8%	6,8%	7,9%	12,3%	10,5%
General price index - IGP-DI	9,8%	10,4%	26,4%	7,7%	12,4%
Consumer price index - IPCA	6,0%	7,7%	12,5%	9,3%	7,2%
Exchange rate at year-end	1,95	2,32	3,53	2,95	2,8
rate of currency devaluation	8,3%	19,0%	52,2%	(16,4%)	(5,1%)
public sector deficit (% of GDP)	3,6%	3,6%	4,7%	5,2%	3,0%
public sector debt (% of GDP)	48,8%	52,6%	56,5%	58,7%	54,5%

<sup>(2)</sup> A new methodology was introduced in 2002

**in US\$ billion**

Exports	55,1	58,2	60,4	73,1	96,0
Imports	55,8	55,6	47,2	48,3	61,5
trade balance	(0,7)	2,6	13,2	24,8	34,5
current-account balance	(24,2)	(23,2)	(7,8)	4,1	12,3
international reserves	33,0	35,9	37,8	54,4	49,7
foreign direct investment	30,8	24,7	14,1	9,9	16,5
total foreign debt	236,2	226,1	227,7	235,4	221,7

<sup>(3)</sup> certain 2004 figures are estimates

## Mineral and energy resources

Brazil is rich in natural resources. It has some of the largest iron ore deposits in the world and is now one of the biggest gold producers. Brazil is the world's largest producer of tin, quartz and niobium and one of the three largest producers of iron ore, manganese and tantalum. The Brazilian steel industry, now mostly under private ownership, ranks among the seven largest in the world. Many other metals, minerals and precious stones are also mined on an increasing scale. There is significant hydroelectric potential, which is slowly being harnessed as a source of energy. The Itaipu dam in the extreme south-west is the largest hydroelectric power producer in the world. Self-sufficiency in petroleum consumption in recent years has been around 70 percent. Participation of foreign investors in the mineral and energy sectors is now being encouraged.

## Agriculture, fisheries, forestry

Vast areas of land are suitable or adaptable for agriculture. The advance in land clearing is mainly in the Central-West and North regions. Brazil is a major exporter of soybeans and orange juice in addition to the traditional coffee and cocoa. Ownership of rural land by foreigners is restricted.

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

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

The principal agricultural products are summarized in Table III.

### III - Principal Agricultural Products, 2000 - 2004

	2000	2001	2002	2003	2004
	(In metric tons 000s)				
Banana (millions of bunches until 2000)	566	6.177	6.423	6.775	--
Oranges (millions of fruits until 2000)	106.651	16.983	18.531	16.903	18.271
Beans	3.056	2.453	3.064	3.310	2.965
Cocoa beans	197	186	174	170	195
Coffee beans	3.807	3.639	2.650	1.997	2.467

**III - Principal Agricultural Products, 2000 - 2004 (continued)**

	2000	2001	2002	2003	2004
	(In metric tons 000s)				
Cotton seed	2.007	2.644	2.166	2.230	3.790
Corn	32.321	41.955	35.933	47.988	41.806
Rice	11.135	10.184	10.457	10.320	13.277
Soybeans	32.821	37.881	42.125	51.482	49.522
Sugarcane	326.121	344.282	364.391	389.849	416.256
Tobacco in leaf	580	569	670	656	--
Wheat	1.726	3.365	3.106	6.029	5.726
Manioc	23.041	22.577	23.066	22.147	23.781
Potatoes	2.607	2.849	3.126	3.047	2.931
Tomatoes	3.005	3.103	3.653	3.694	--

## Manufacturing

Major manufacturing industries include petrochemicals, steel, automobiles, mining, cement, paper and allied products, agro-industry, and food processing. There is large potential for expansion in all areas. There are still restrictions on foreign investments in some sectors (See Chapter 3 for further details).

## High-tech industries

The high-tech sector comprises mainly the assembly of imported components and parts. Multinationals dominate, but there are several large Brazilian groups. In the past couple of years, as in other parts of the world, Brazil is experiencing new start-up businesses in the Internet area and also the increase in venture capitals being invested in these businesses.

## Service industries

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

## Transport and communications

Since the inclusion of government-controlled railroads in Brazilian National Privatization Program, there has been significant investment in development and modernization of the railroad network, which is mainly comprised in the Southeast and South Regions, although there are plans for some major extensions in the North and Central-West regions. For the Northeast region urgent investment is foreseen. However, road transport still dominates both for long-distance and intercity traffic. Also, most of the major federal and state highways have not been well maintained. Nearly all road transport and haulage companies are privately owned. In addition, government intends to privatize the remaining roads which were not privatized yet.

The airline network is well developed and the majority of the voting stock of airline companies is held by the private sector. Urban transport continues to present significant problems in major centers. Limited subway systems are now functioning in Rio de Janeiro and São Paulo, mainly the last one that has expanded its network. However, until a more extensive network is developed, subways will not significantly alleviate the problems of urban transport. Many companies provide private bus services for their employees. The potential of the waterways and coastal transport has not been developed.

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

The telecommunications system, as mentioned before, is now controlled by the private sector. It should be noted that besides being controlled by the private sector, the telecommunication companies are controlled and supervised by the National Agency of Telecommunications (ANATEL) (See chapter 3 for further details).

## Trade balance and foreign trade

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

### IV - Trade Balance

	<b>(US\$ billions)</b>			
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Trade Balance - FOB	2,6	13,2	24,8	34,5
Export	58,2	60,4	73,1	96,0
Import	55,6	47,2	48,3	61,5

## V - Principal Foreign Trade Products

Exports	(US\$ billions)			
	2001	2002	2003	2004
<b>Primary products</b>				
Cocoa	0,10	0,14	0,22	0,20
Coffee	1,4	1,4	1,5	2,1
Iron and ores	3,1	3,2	3,6	5,2
Meat	2,9	3,1	4,1	6,2
Orange juice	0,8	1,0	1,2	1,1
Soybean	5,3	6,0	8,1	10,0
Sugarcane	2,3	2,1	2,1	2,6
Tobacco	0,9	0,9	1,0	1,3
Other primary	3,4	3,5	4,2	5,5
<b>Total</b>	<b>20,2</b>	<b>21,3</b>	<b>26,0</b>	<b>34,2</b>
<b>Industrialized products</b>				
Chemical products	3,6	3,9	4,8	6,0
Electric and electronic equipment	3,2	3,1	3,2	3,3
Footwear and leather products	2,6	2,6	2,8	3,3
Machines and mechanical instruments	3,3	3,1	4,1	5,8
Metallurgical products	5,3	6,1	7,7	10,7
Oil derivatives	2,2	3,1	4,0	4,6
Paper and pulps	2,2	2,1	2,9	3,0
Textile products	1,3	1,2	1,7	2,1
Transport equipment and components	9,5	8,9	10,1	15,5
Wood	1,5	1,8	2,1	3,0
Industrialized other	3,2	3,2	3,7	4,9
<b>Total</b>	<b>37,9</b>	<b>39,1</b>	<b>47,1</b>	<b>62,2</b>
<b>Total geral</b>	<b>58,1</b>	<b>60,4</b>	<b>73,1</b>	<b>96,4</b>

Imports	(US\$ billions)			
	2001	2002	2003	2004
<b>Capital Goods</b>				
Machines and electric materials	21,6	17,1	16,5	20,5
Transport equipment and components	4,7	3,5	3,3	4,2
	<b>26,3</b>	<b>20,6</b>	<b>19,8</b>	<b>24,7</b>
<b>Consumer goods</b>				
Foodstuffs	1,2	1,2	1,1	1,2
Apparel	1,9	1,6	1,6	2,1
Other consumer goods	0,3	0,3	0,3	0,3
	<b>3,4</b>	<b>3,1</b>	<b>3,0</b>	<b>3,6</b>
<b>Oil and derivatives</b>				
Crude Oil	3,2	3,2	3,8	6,8
Refined products	4,0	3,1	3,0	3,8
	<b>7,2</b>	<b>6,3</b>	<b>6,8</b>	<b>10,6</b>
<b>Raw materials</b>				
Cast Iron and steel	1,1	0,9	1,0	1,3
Chemical products	7,6	7,1	7,5	9,5
Coal	0,6	0,6	0,6	0,9
Grains and grinding products	1,5	1,5	1,9	1,4
Fertilizers	1,2	1,2	1,7	2,6
Non-ferrous metals	1,4	1,2	1,3	1,9
Other raw materials	5,2	4,7	4,8	6,4
	<b>18,6</b>	<b>17,2</b>	<b>18,8</b>	<b>24,0</b>
<b>Total</b>	<b>55,5</b>	<b>47,2</b>	<b>48,4</b>	<b>62,9</b>

The principal trading partners in 2004 are shown in Table VI.

### VI - Principal Trading Partners, 2004

	<b>FOB (US\$ billions)</b>		
	Exports	Imports	Balance
<b>North America</b>			
US	20,0	11,3	8,7
Mexico	4,0	0,7	3,3
Canada	1,2	0,9	0,3
Total	25,2	12,9	12,3
<b>Europe</b>			
Netherlands	5,9	0,6	5,3
Germany	4,0	5,1	(1,0)
Italy	2,9	2,1	0,9
United Kingdom	2,1	1,4	0,8
Belgium	1,9	0,6	1,3
France	2,2	2,3	(0,1)
Spain	2,0	1,2	0,8
Switzerland	0,4	1,1	(0,7)
Sweden	0,5	0,8	(0,3)
Other	6,0	3,7	2,3
Total	27,9	18,8	9,1

### Asia - Oceania - ME

China	5,4	3,7	1,7
Japan	2,8	2,9	(0,1)
Russia	1,7	0,8	0,9
South Korea	1,4	1,7	(0,3)
Iran	1,1	-	1,1
Taiwan	0,8	1,0	(0,2)
Saudi Arabia	0,8	1,2	(0,4)
Other	4,3	3,7	0,6
Total	18,4	15,0	3,4

### Latin America (except Mexico)

Argentina	7,4	5,6	1,8
Chile	2,6	1,4	1,2
Colombia	1,0	0,1	0,9
Uruguay	0,7	0,5	0,2
Other	7,3	2,3	4,9
Total	18,9	10,0	8,9

### Africa

South Africa	1,0	0,3	0,8
Nigeria	0,5	3,5	(3,0)
Argelia	0,4	1,9	(1,6)
Other	2,9	0,5	2,5
Total	4,8	6,2	(1,4)

Other	1,3	-	1,3
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<b>Total</b>	<b>96,5</b>	<b>62,8</b>	<b>33,7</b>
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## Hints for the business visitor

### Visitors' visas

Several foreigners seeking entry to Brazil as non-immigrants must first obtain an appropriate visa. Application should typically be made to a consular office in the applicant's country of origin or current residence. A businessman's visa is normally valid for a period of up to 90 days. Brazil also grants temporary visa valid for the labor contract period, limited to two years.

Visas are not required for citizens of those countries with which Brazil has reciprocal arrangements.

### Currency

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

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

The official bank selling exchange rates as at June 30, 2005 are as follows.

	<u>R\$</u>
US\$ 1	2.35
£ 1	4.20
€ 1	2.85

The parallel exchange rate at the same date was  
US\$ 1 = R\$ 2.72

### International time

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

<u>Zone</u>	<u>Hours</u>	
	<u>Behind GMT</u>	<u>Ahead of EST</u>
Eastern Brazil	3	2
Western Brazil	4	1

Daylight saving time is observed between October and February by advancing clocks one hour.

### Business hours

The working day is normally eight hours for commercial offices, typically from 8:30 a.m. or 9:00 a.m. to 5:30 p.m. or 6:00 p.m., Monday to Friday, with a lunch break of one to one-and-one-half hours. A few factories still work on Saturday morning. Most retail outlets open on Saturday and Sunday. Generally, banks are open to the public from 10:00 a.m. to 4:00 p.m. while government offices are open from 9:00 a.m. to 5:00 p.m. Both are closed on Saturdays.

## Statutory holidays

Official holidays are as follows.

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

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

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

## Weights and measures

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

## Dates and numbers

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

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

## Local customs

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

## Research Sources

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 Brazilian Central Bank  
 Agribusiness sites  
 Terrestrial Transport National Agency

<sup>(1)</sup> Based on the latest census realized in 2000

## Chapter 2 Business environment

### Investor considerations

- Fast-changing business conditions.
- Generally free enterprise.
- Privatization plan is in advanced stage.
- Considerable bureaucratic interference and regulation.
- Multiple and high taxes.
- Inflation under control.
- Abundance of semiskilled and unskilled labor.
- Many basic raw materials and food products.
- Some geographic incentives.
- Import duties being reduced gradually.
- Medium industrial investment and modernization during the last decade.

### Industrial climate

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

Generally speaking, Brazil was a relatively closed economy in the 1970s and 1980s. However, trade liberalization took place in the 1990s, resulting in the reduction of trade barriers and protective practices, and local manufacturers are now more competitive internationally. In 2004 exports and imports were about 16 and 10.4 percent of GDP, respectively (in 2003 14.4 and 9.5 percent).

## Framework of industry

The Brazilian economy is fairly broad-based, including almost every type of industry imaginable. It is a mixed economy and includes listed companies, state monopolies, state-participation companies, foreign-owned companies, joint ventures, closely-held companies, family enterprises, and many small businesses operating through various formats. Active stock market exists in the city of São Paulo, although share ownership is not widespread.

## Aims of government policy

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

## Economic development plans

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

- Achieving a more even distribution of income and wealth, on both an individual and a regional basis.
- Maintaining inflation to manageable levels through containment of government expenditure and control of monetary expansion.

- Negotiating the foreign debt (servicing and repayment).
- Continuing foreign trade surpluses.
- Establishing an energy expansion program.
- Developing the agricultural sector.
- Upgrading the labor force by intensifying educational, training, health and social welfare programs.
- Strengthening the local capital market by attracting personal savings and foreign capital.
- Privatizing certain public sector companies.
- Reducing the so-called "Brazil Cost", which consists of the costs related to doing business in Brazil and which may shrink investment opportunities.

There is general recognition that the uncertain political and economic climate over the years has deprived Brazilian business of the necessary investment to modernize and become internationally competitive.

## Privatization

The National Privatization Program, which started in 1991, was administered by the National Bank for Economic and Social Development (BNDES). Under this program various steel, petrochemical, fertilizer, telecommunication, electricity, banks (federal and state), gas and petroleum distribution companies have already been privatized. With regard to foreign participation in these privatizations see Chapter 3.

## Regional/special industry development

The government and most states promote the attraction of new investments, generally for all types of industry, and offer assistance in obtaining financing and advisory services.

## Free-trade zones

Brazil has a long-established free-trade zone in Manaus (Zona Franca de Manaus e Amazônia Ocidental) until 2023. Some multinational companies have operations in Manaus, principally in the electronics sector (see "Free-trade zones" in Chapter 4).

## Financial services

Brazil encourages providers of special financial services for business customers. Moreover, government has adopted several financial support credit lines to help development and modernization of key sectors. For information on available banking and financial services, see Chapter 7. However, financial center operations and offshore financial services are not available.

## Public-private sector cooperation

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

## Labor/management relations

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

Labor unions are a significant economic force in the country and can be quite militant. Fringe benefits and social security costs are a significant element of total labor costs. For more details of labor/management relations, see Chapter 10.

## Overseas trade relations

### Membership in trade blocs

Brazil is a member of the association for Latin-American Integration (ALADI), the World Trade Organization (WTO), formerly the General Agreement on Tariffs and Trade (GATT) and the Common Market of the Southern Cone (MERCOSUL) which is currently composed of Brazil, Argentina, Paraguay, and Uruguay, with Chile and Bolivia as associated countries. Under the MERCOSUL treaty agreement, tariffs are reduced to zero; movement of labor, goods and services are unrestricted; capital investment encouraged; macroeconomic policies coordinated; and foreign trade policies and tariffs for nonmember countries harmonized.

### Exports

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

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

## Trade barriers

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

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

# Chapter 3 Foreign investment and trade opportunities

## Investor considerations

- Foreign investment is generally welcome.
- Debt for equity swaps can be a valid investment option.
- Brazil is a favorable site for South American expansion programs.
- There is a large potential consumer market.
- Export orientation is generally favored.
- Foreign investors are eligible for most available incentives.
- Restrictions on foreign ownership exist in certain strategic sectors specifically with regard to Air Transport and Publishing.
- Exchange controls are extensive.

## Investment climate

### Government attitude toward foreign investment

The Constitution establishes that foreign investments should be in the national interest, and foreign investment is welcome to the extent that it represents a long-term commitment to contribute to economic development, particularly in those areas that are high on the government's priority list. These include the development of agriculture and technology and of labor-intensive industries and the manufacture of products that are currently imported and those that will increase exports.

Foreign direct investments have increased until the year 2000. Nevertheless, a considerable decrease has been noticed over the 3 following years. A recovery can be noticed in 2004, as shown on the table below in million dollars.

2000	2001	2002	2003	2004
30.8	24.7	14.1	9.9	16.5

All forms of investments are welcome as long as they are not contrary to the country policy for foreign investment and national security.

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

There are also some restrictions on participation in the financial and informatics sectors and the ownership of rural land. The term "informatics" covers computer hardware and software, industrial automation, and electronics in general. It does not cover the media or communication industries except insofar as it relates to their information technology. For further details on restrictions on foreign investment and investors, see Chapter 5.

## Trade policy

Brazil is generally supportive of free trade, but high tariffs exist on many imports and some sectors are still protected from foreign competition. For more information concerning overseas trade relations, see Chapter 2.

## Taxation policy

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

## Local competitor attitude toward foreign investment

In general, the attitude of local businessmen toward foreign investment is welcoming. Certain sectors have exerted strong lobbying pressure to protect their activities by various means, including the imposition of trade barriers and the establishment of restrictions on foreign investment. In the past, such political pressure was quite successful,

nevertheless late governments have gradually changed this situation as it seeks more efficiency and competitiveness.

## Labor attitude toward foreign investment

If foreign investment and management can be seen to bring jobs and compete on an equal basis with Brazilian business, labor's attitude tends to be welcoming. (For details on Foreign Individuals see the Chapter 20 - Taxation of Individuals and Chapter 10 - Labor relations and Social Security under title Expatriate Personnel in Brazil)

## Special investment opportunities

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

- Tapping the considerable local market potential. There are still many unsatisfied consumers.
- Taking advantage of the abundant raw materials and natural resources.
- Using the sizable and growing labor force.
- Producing locally items that are currently imported.
- Using Brazil as a manufacturing base for exports specially regarding Mercosul opportunities.

An attractive method of investing in recent years has been to acquire rights to Brazilian foreign debts, which trade outside the country at a substantial discount but can give local registration rights up to the full face value in certain circumstances. However, the regulations governing these transactions are subject to constant change and interested users should acquaint themselves with the latest situation.

Imports of vital components/inputs are generally possible where there is no or inadequate local production, although there are restrictions in specific areas (see "Government attitude toward foreign investment" above) bureaucratic delays and high import duties can nullify the advantages. However, regardless the points outlined above, the imports of most of products is possible, provided that local legislation is observed.

## Planning guide for the foreign investor

### National and local government policy considerations

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

## Investment possibilities/restrictions

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

## Prior approval or registration

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

## Possible business structure

- For foreign investors, the most common form of doing business is through an incorporated subsidiary or limited liability company.
- Branches are difficult to form and depend on Presidential Decree approvals, whereas corporations ("sociedades por ações") and private limited liability companies ("limitadas") are easier to be established in terms of bureaucracy and approvals.

- In general, there are no nominal minimum capital requirements; except financial institutions. Additionally, a minimum capital of US\$ 200,000 is required for companies managed by foreigners acting as General Managers.
- While joint venture operations do not require participation by a local venturer, it is generally helpful to have one.

## Setting up or acquiring

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

## Investment incentives

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

## Location/industries

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

## Finance

- Foreigners are expected to import funds for major fixed capital requirements.
- Debt-equity swaps have been a favored method of importing funds.
- Foreign-controlled companies can list on the stock exchanges and raise capital through public subscriptions or debenture issues.
- A wide range of credit and financial services is available from local and foreign banks operating in Brazil.
- Long-term financing is available from investment companies and state investment banks.

## Repatriation of capital and profits

- Capital and earnings may generally be repatriated on a tax-free basis.

## Labor and labor costs

- A plentiful labor supply exists, but many of the workers are semiskilled or unskilled.
- Labor costs tend to be low when compared with other countries.

## Market studies

- Market studies are advisable. PricewaterhouseCoopers Brazil can assist in such studies and in other phases of setting up Brazilian operations.

## International financial center

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

## Information and assistance

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

## Trends

- An overall modernization of the economy.
- Reduction of government involvement in business.
- Relaxation of price and exchange controls, and gradual elimination of restrictive and protectionist practices.
- Reduction of trade barriers against foreign competition

## Chapter 4 Investment incentives

### Investor considerations

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

### Investment policy

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

There is a wide variety of federal programs designed to encourage the economic development of Brazil and also to promote regional development. They tend to favor new operations in the poorer Northeast (ADENE) and Amazon (ADA) regions. Incentives for export promotion are provided through several programs.

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

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

## Tax concessions

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

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

## Regional incentives

### Regions affected

The following regional superintendencies have responsibility for development in the listed states:

#### ADENE (Northeast region)

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

#### ADA (Amazon region)

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

## Eligibility

In general, incentives are available to both local and foreign-controlled companies. However, the granting of incentives depends on approval by the federal government agencies, ADENE and ADA, for industrial projects or planned expansion of an existing industry. ADENE and ADA evaluate a project not only for its technical and economic feasibility, but also for its suitability in the overall economic development of the region.

## Tax incentives

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

- Gradual reduction of the income tax, ranging from 75% to 25% from January, 1998 up to December 2013, on the exploitation profit ("lucro de exploração") for all new industrial and agricultural enterprises installed on the incentives areas and provided that its projects are registered and approved by local authorities, for a maximum period of ten years.
- Gradual reduction of the income tax, ranging from 37,5% to 12,5% from January, 1998 up to December 2013, for industrial and agricultural enterprises installed on the incentive areas and provided that its projects are considered a priority for the area or are established in the Manaus Free Trade Zone.

The amount corresponding to the reduction of corporate income tax cannot be distributed to the quotaholders / shareholders of the legal entity. Such amount must be booked and kept as a subsidy reserve (capital reserve), to be used only for capital increase or for purposes of offsetting existing losses.

Total or partial exemption from state ICMS (value-added tax on sales and services) may also be granted for a certain period of time, but almost exclusively to new enterprises. Certain states have granted the maximum exemption permitted, stipulating that the amount corresponding to the exemption should be deposited in a state development bank for investment in projects approved by the state government, either as reinvestment in the depositing company itself or as new investment in projects of third parties. Tax payment terms may also be extended with financial advantages.

## Nontax incentives

For companies in the Northeast and Amazon regions, nontax incentives are as follows:

- Right to receive as capital contributions the fiscal incentive investments, described below, of other corporate investors, provided a matching amount of capital is obtained from other sources in proportions that vary depending on the importance attributed to the project. The amount received from other corporate investors under fiscal incentive plans is considered local capital, and consequently no income attributed to it may be remitted abroad nor does it qualify for registration in foreign currency if reinvested.
- Granting of low-cost loans or loan guarantees from government development banks, such as the Bank of Northeast Brazil and the National Bank for Social & Economic Development.

## Earnings

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

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

## Industry incentives

Importation of capital goods, which are not available in the Brazilian market, might be subject to a reduction of the Import Duty, subject to governmental approval, as to stimulate the broadening, modernization, and restructure of the Brazilian industrial park. The Brazilian government is also undergoing a policy to reduce the excise tax (IPI) imposed on capital goods.

The National Bank for Social & Economic Development (BNDES) offers low-cost financing, in order to support the implementation, expansion, modernization or relocation of plant, including capital goods acquisition and associated working capital.

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

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

## Fiscal incentive investments

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

The mechanism is to channel the investment amounts through the Northeast Development Fund (FDN) or the Amazon Development Fund (FDA). These funds are administered by government-owned banks. However, up to 18% percent of the income tax due by enterprises located in these areas may instead be invested directly in projects considered by ADENE or ADA to further the economic development of the Northeast and Amazon regions (see "Regional incentives" above).

A company whose registered head office is located in the state of Espírito Santo may invest up to 25 percent of the income tax otherwise payable in FUNRES, a fund for the development of that state.

## Special-use company incentives

Special-use company incentives do not exist in Brazil.

## Free-trade zones

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

## Export processing zones

These zones (Zonas de Processamento de Exportação) are characterized as free-trade areas and are located in certain less-developed regions in need of investments. An authorized company must produce or process merchandise exclusively for export. Imports and exports are exempt from import and excise taxes. There is also favorable income tax treatment. These zones were created in 1988.

## International financial center operations

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

## Export incentives

The various incentives available to exporters include the following:

- Under the Special Customs Drawback Regime, suspension and exemption of import duties, excise tax and value-added tax on sales and services as well as other taxes and charges, normally for up to two years, is available on those imported goods to be used in the manufacture of products for export.
- Exemption from withholding tax, under certain conditions, on export commissions paid to overseas agents, except when paid to countries considered as tax havens (total income tax lower or equal to 20%), case in which the tax will be levied at the rate of 25%.
- Exemption from excise tax (IPI), value-added tax on sales and services (ICMS), social contribution on billings (COFINS) and contributions to the social integration program (PIS) on exports of manufactured products.
- Low-cost export financing.
- Availability of land for industrial development at reduced prices, provided an undertaking is made to maintain agreed levels of employment within the municipality that made the grant.

Export credit guarantee insurance is provided mainly by banks on issuing letters of credit for export transactions. The "Instituto de Resseguros do Brasil" (IRB) also provides this insurance.

## Incentives to invest in other countries

Brazil offers no specific incentives to individuals and companies wishing to invest abroad. However, to the extent that such investments result in greater export income for Brazil, various benefits are available, as described above in "Export incentives".

## Incentives and foreign investment strategy

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

## Constitutional Investment Fund

The Constitutional Investment Fund was created to promote national integration through economic and social development and to reduce regional differences. The funds are invested in projects approved and managed by operator banks in the areas of East-Center, Northeast and North Region.

## Chapter 5

# Restrictions on foreign investment and investors

### Investor considerations

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

### Regulatory climate

#### Regulatory authorities

The National Monetary Council ("Conselho Monetário Nacional") is the exchange control and foreign investment authority. Control and supervision of the foreign exchange policy are implemented by the Brazilian Central Bank.

#### Regulatory legislation

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

Foreign investment legislation is found in Law 4131 of 1962 as amended. The exchange control regulations are contained in rules, directives and circulars issued by the Central Bank and by the Federal Revenue Service.

Exchange control and foreign investment policies are established by the National Monetary Council, whose president is the Minister of Finance. The legislative, executive and administrative aspects of these policies are the responsibility of the Central Bank, which includes a number of departments specifically concerned with foreign investments and exchange. They operate normally by means of internal directives that are not published. The Foreign Trade Department (DECEX) of the Bank of Brazil is responsible for foreign trade policies.

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

In general, tight control of foreign-currency transactions is exercised by the authorities. The fine for infringement of exchange control regulations is limited to fifty times the minimal wage (currently at R\$ 300.00). Operations in foreign currency may be effected only through authorized financial institutions.

Foreign currency is exchanged at different rates, depending on the nature of a transaction. The official commercial (import and export) rate is used for most trade and financial transactions. Central Bank may intervene to control this rate. As from the beginning of 1999 the National Monetary Council has decided to implement the liberation of the exchange control leaving it up to the commercial operations swings.

There is also an openly used (although illegal) parallel exchange market. Traditionally, this rate has been higher than the commercial rate, in the recent past by about 10 percent.

## Exchange controls

### Inward investment

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

## Registration of foreign capital and technology

- Foreign capital

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

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

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

Investments structured as advances for future capitalization are prohibited by Central Bank, except those exclusively related to participation in National Privatization Program and public services concession, or under specific authorization by Central Bank for projects of interest of the Brazilian government.

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

Also the Central Bank has recognized that foreign investments directly or indirectly applied in holding companies can be registered under the terms of Law 4131/62.

Prior approval of the Central Bank is no longer required for all foreign currency loans received, but they must be documented by a formal contract in which the interest rate is stipulated and Brazilian Central Bank will have to be informed of all the conditions of the loan as approval is granted or not, after the loan transaction has actually been implemented. The bank may refuse to accept contracts where the interest rates are in excess of those prevailing in the country of origin. It is also necessary to obtain prior approval of Central Bank for operations relating to the conversion of some liabilities into investment.

- Technology

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

## Currency accounts

The use of foreign currency bank accounts by local or foreign investors and traders is not allowed. However, banks authorized to deal in foreign exchange may hold local currency funds for nonresident individuals or entities. Such bank accounts may be operated in the name of the nonresidents and are often used to hold blocked local currency funds.

## Repatriation of capital and earnings

Capital may be repatriated without payment of tax up to the amount registered in foreign currency with the Central Bank. Amounts in excess are considered as capital gain under exchange disposition and, therefore are subject to withholding income tax of 15 percent (25 percent in case beneficiaries are domiciled in jurisdictions considered as tax havens).

Profits may be remitted abroad without limit, to the extent there is foreign registered capital and available retained earnings. As from January 1, 1996 profits/dividends distributed to nonresident beneficiaries relating to periods beginning on or after this date are not subject to withholding income tax. However, distributions from earnings or profits relating to periods ended up to December 31, 1995 are subject to withholding income tax at the rate of 25 percent or 15 percent, depending on the year they relate to.

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

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

Exchange currency for imports may be freely remitted, provided an import license has been obtained. In certain cases, an import license will be granted only if payment of the purchase price of the imports is deferred for varying periods.

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

Bilateral or multilateral netting payment deals are not permitted.

## Guarantees against inconvertibility

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

## Restrictions on foreign investment

### Industries closed to private enterprise

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

Government permission is required before the operation of certain other types of business, such as banks and financial institutions, mining companies, oil refineries, maritime, road and air transport companies and companies involved in health products and health care.

## Restrictions on foreign ownership

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

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

Communications:

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

Aviation:

Foreign ownership of Brazilian airlines is restricted.

Classified government contracts:

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

Coastal and freshwater shipping:

Such shipping may be carried out only by Brazilian companies.

Mining and hydroelectric energy:

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

## Other types of restrictions

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

## Policy trends

### Effect on foreign investment

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

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

# Chapter 6 Regulatory environment

## Investor considerations

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

## Regulation of business

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

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

## Competition policy

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

### Price controls

In the 1980s severe price and wage controls were imposed periodically in attempts to reduce high inflation, but they have now been completely eliminated.

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

Also, several government agencies are concerned with price controls in special areas, e.g., the National Telecomm Agency (ANATEL), for telecommunications, despite the concession contracts. Control is exercised in various ways, depending on the industry or product involved and the general economic situation.

## Monopolies and antitrust

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

The Antitrust Law (Law 8884/94) contains wide-ranging regulations in defense of free-market competition. The Economic Law Secretariat (SDE) is responsible for the enforcement of these regulations. Cartel, monopolistic and oligopolistic situations in various sectors are being constantly challenged.

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

## Acquisitions and mergers

Except as indicated in Chapter 5, there are no restrictions on acquisitions and mergers by foreign investors. The procedures are relatively simple. When listed companies are involved, permission of the Securities Commission (CVM) is required and when financial institutions are involved, permission of the Central Bank is required. Even though formal permission may not be required, large foreign investors normally keep government authorities informed as to their investment plans.

## Securities markets

The Central Bank and the Securities Commission (CVM) are the principal regulatory agencies concerned with the financial and securities markets. The principal stock exchange is in São Paulo. Each stock exchange has jurisdiction over its members and the securities negotiated therein.

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

A public issue of securities, including debentures, may not be made without prior registration with the CVM, which will normally require adequate disclosure of information to protect the interests of investors. Furthermore, only securities issued by companies registered with the CVM may be traded on stock exchanges and in the over-the-counter market.

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

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

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

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

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

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

Reporting and disclosure requirements are described in Chapter 11.

## Imports and exports

All importers and exporters must be duly registered with the Foreign Trade Department (DECEX) of the Bank of Brazil. Transportation in Brazilian vessels is obligatory for certain categories of imports, such as products enjoying exemptions from or reductions in import duties. For details on import restrictions and duties see Chapter 8. Exports are encouraged by several incentives summarized under "Export incentives" in Chapter 4. Normally there are no restrictions on exports. However, licenses are generally required for both imports and exports.

## Consumer protection

The 1990 Consumer Defense Code considerably strengthens the rights of customers.

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

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

## Pollution control

Pollution has become a serious problem in many areas and, consequently, is now one of the principal issues on both the political and the economic scene. Federal and state governments have developed programs and controls to prevent or reduce pollution, mainly in the more industrialized areas. The treatment of industrial residues and waste to avoid or reduce pollution must be considered in the installation of new plants.

Ecological preservation is a subject of public interest and a frequent topic for the local and international press.

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

## Special industries

There are specific regulations affecting the operations of financial institutions, as noted in Chapter 7, as also the insurance sector.

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

The Software Law (Law 9609/98) defines software and deals with the protection of software intellectual property and the marketing of software in Brazil, which contracts for the usage right, which may require registration with INPI.

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

## Patents, trademarks and copyrights

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

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

### Patents

The life of a patent of invention is 20 years and that of an industrial model or design is 15 years from the date of filing the application with the National Institute of Industrial Property (Instituto Nacional de Propriedade Industrial - INPI). Title to patents is transferable. Restrictive measures may not be taken against a patent during the first three years of its existence. An interested party can, however, apply for a compulsory license and/or for forfeiture of the patent when it can prove that the patent holder has not exercised the patent rights or has suspended exploration. Nonpayment of fees for the maintenance of patents will result in their cancellation. Patent holders in other countries with which Brazil has treaties or conventions covering such matters have priority rights for filing patent applications within the periods specified.

## Trademarks and trade names

Names, words, descriptions, emblems, designs and numerals used to identify products may be registered. Trademarks are registered with INPI and trade names with the local Commercial Register (Junta Comercial). There are a number of restrictions which are referred to in the Industrial Property Code (Código de Propriedade Industrial) regarding trademarks. Registration is valid for ten years and may be renewed for similar periods indefinitely. Renewal applications must be filed during the last year.

## Industrial Drawings

The term of the register is ten years and may be renewed three times, by five years each time. Register's holder is subject to retribution every five years for the maintenance of the register. Register is also transferable.

## Copyrights

As regards copyrights, Brazil is a signatory of the Berne Convention for the protection of artistic and literary works, the Paris Convention for the protection of industrial property, the Washington Patent Cooperation Treaty, and is a member of the World Organization of Intellectual Property.

# Chapter 7 Banking and finance

## Investor considerations

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

## Banking system

### National Finance System

The National Finance System is headed by the following government institutions:

- National Monetary Council ("Conselho Monetário Nacional" - CMN): Oversees the financial system as a whole. Members of the Council are the Minister of Finance (president of the CMN), the Minister of Budget and Planning and the president of the Central Bank.

- Central Bank (BACEN): Carries out traditional central banking functions and executes CMN's policies.
- Bank of Brazil: A mixed-capital federal company, it is the government's financial agency and handles all federal receipts and payments. It is also a commercial and agricultural bank.
- National Bank for Economic and Social Development (BNDES): Carries out the government's investment policy, granting loans and supervising government financing plans. It is also responsible for managing the National Privatization Program.
- Federal Savings and Loan Association (CEF): A savings and mortgage bank, it also administers the FGTS (Employees Severance Indemnity Fund), PIS/PASEP (Social Integration Program) and the national lotteries.
- Securities Commission (CVM): Responsible for the securities market and listed companies.

There are government controlled banks at both the federal and state level.

The major banks in the private sector have long been organized as financial conglomerates, able to offer a full range of financial services through subsidiary and associated companies as well as associations and mergers with foreign financial institutions.

Frequent directives are issued by the Central Bank, which has powers to control lending and capital limits, compulsory deposit levels, interest rates, etc.

The major banks are considered to be sophisticated and competitive and offer a broad-range of financial services, operating on-line.

## Banking market

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

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

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

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

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

Many foreign banks hold ownership positions in local banks. Several foreign banks of significance have subsidiaries or branches in Brazil. In addition, many foreign banks have representative offices to provide various services to the home office and its customers.

Foreign banks have played an important credit role in lending to local companies. However, under the 1988 Constitution, the conditions for foreign capital participation in financial institutions must be regulated by a complementary law which has not yet been enacted. Until conditions are established, authorization for the installation of new foreign-controlled financial institutions and for any increase in existing foreign capital participation being given based on special Presidential authorization.

## Specialized financial institutions

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

Lease finance is readily available from leasing companies.

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

Factoring financing is also available.

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

## Investment institutions

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

## Financial markets

### Securities markets

The development of the stock market is one of the government's objectives. The stock market is a source of financing for all listed companies in Brazil, regardless of ownership. All public issues require the approval of the Securities Commission (CVM). There are eight regional stock exchanges, although over 90 per cent of transactions are carried out in São Paulo. Share issues are not yet a primary source of corporate finance. The secondary or over-the-counter market is not very significant (see Chapter 6 for further information).

## Specialized financial markets

There is a strong commodities market on which commodity futures and options are traded. Investments in gold are permitted. Most financial institutions offer hedge instruments in gold or in hard currency.

## International financial market

Brazil is not an international financial center. Offshore banking, trust and financial services are not permitted.

## Sources of funds

### Local financing

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

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

- Subsidized interest for the financing of production for export, based on past export history and export potential.

Financing of exports is normally for not more than 360 days. Various other forms of special financing are available for exports, some of which are directed to special sectors.

### Availability to foreign investors

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

A foreign investor, as distinct from a foreign-controlled company doing business in Brazil, might not have access to the different financing instruments. However, a foreign investor has access to the Brazilian securities market through registered Brazilian investment funds. See "Portfolio investments" in Chapter 16 for further details.

## Chapter 8      Exporting to Brazil

### Tips for exporters

- Import duties are gradually being reduced.
- Trade barriers were wide-ranging in the past but are being relaxed gradually.
- Exporters to Brazil should seek advice from local trade and tax consultants before shipment.
- Having a local agent is advisable in order to obtain quicker customs clearance.
- Related-party sales may present problems with regard to pricing.
- Duty deferrals are available by using customs bonded warehouses/special tax regimes.
- Customs valuation assessments have increased over the past years.

### Import restrictions

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

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

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

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

A few imports are subject to license or permit. Import licenses are controlled by DECEX, the Brazilian Foreign Trade Department and the good's correspondent government body. Imports are not normally limited by absolute annual quotas with exceptions; however, actual imports are monitored against those authorized.

## Import duties

### Customs duties

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

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

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

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

Mail-order imports of up to US\$ 3,000 are subject to a 60 percent import duty. Exemptions are granted in case of medicine and imports under US\$ 50, provided that it is performed between individuals or it is for the individual's use. Alcoholic beverages and smoking products do not benefit from this import regime.

Import duties must be paid before customs clearance is given.

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

Export processing zones and special free-trade areas have been created to develop certain less-developed and frontier regions but to date, in general, they are not operational. (Also see Chapter 4)

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

### Other taxes and duties

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

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

## Documentation procedures

All importers must be registered with SECEX and, as a general rule, no import license must be obtained. In case a license is required, automatic licensing may be obtained on a few imports and under the drawback regime. Non-automatic licensing is required for imports granted special concessions, goods subject to governmental control or tax incentives and others. Imports may be performed either by fully prepaid letters of credit, which can be financed by local banks, or by arrangement of credit. Terms longer than 360 days are subject to special procedures in terms of documents attached to the import process.

The following is a brief summary of the documentation procedures:

- Filing of the application for a non-automatic import license, when applicable, before the goods shipment, which should include the required general information concerning the importer, exporter, manufacturer, country and port of origin, port of unloading, description of the merchandise, FOB price in foreign currency, and supplementary documents as required (automatic import license and import which do not require license do not need previous filings).
- Payment of the application fee.
- Issue of the import license.
- Completion of an import declaration, which is the document base for the customs clearance, containing all data related to the respective import, including duties and taxes incurred. This should be done after arrival of the merchandise but before customs inspection.
- Depending on the inspection line (green, yellow, red or grey), different inspection procedures may apply. For instance, green channel requires no inspection, yellow channel requires only

document inspection, red channel requires physical and documental inspection and grey channel requires physical and documental inspection, as well as special customs certification procedures, including prices control.

Finally, customs clearance takes place.

In certain cases, mainly for imports granted special concessions or tax incentives, other formalities such as the similarity test are required to determine if the imported item has an equivalent in the local market. Also, transport in Brazilian vessels may be required.

## Customs and storage

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

## Port of entry and inland transport

Generally, the choice of a port of entry by the importer will be honored. Inland transport is substantially by trucking and can pose problems at times of seasonal activity.

## Reexports

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

## Antidumping measures

Law 9019/95 and Decree 1602/95 set forth the antidumping measures. Dumping is defined as the entry of a product into the local market (including under drawbacks) at a price which is less than its normal price. If entry is considered a threat to the local market the antidumping measures will be employed.

## Local representation

### Market surveys

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

### Local agent

Because of the bureaucratic documentation procedures, and also because there is often language difficulty, it is essential to use a local customs agent or broker. They are particularly useful in dealing with the Customs and Tax authorities.

### Employee/salesperson

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

## Sales agent or subsidiary

As discussed under "Imports" in Chapter 16, products shipped to Brazil and billed directly by the foreign supplier to its customer in Brazil are subject to Brazilian corporate income tax, which will be calculated on a deemed profit, based on a percentage of gross income (percentage varies depending on the activity), plus an additional surcharge of 20 percent. It should be noted that the above income tax is payable only if the sales agent or representative domiciled in Brazil, who acts as an intermediary, has the authority to bind the overseas seller contractually. Accordingly, it is advisable that there be a formal representation agreement that expressly precludes the sales agent or representative from contractually binding the overseas principal in any sales contract.

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

## Sources of information

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

In Brazil, the following organizations provide assistance:

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

# Chapter 9 Business entities

## Guide to doing business entities

### Choice of entity

- The most common forms used by local and foreign investors are the corporation ("sociedade por ações") and the private limited liability company ("sociedade por quotas de responsabilidade limitada"), usually called a "limitada".

### Capital requirements

- In general, corporations and limitadas may be wholly foreign-owned
- All foreign investments must be registered with the Brazilian Central Bank
- There are no legal requirements as to minimum capital except for financial institutions, companies managed by expatriates and certain other specific enterprises. There is no upper limit.

### Founders' requirements

- The number of quotaholders for a limitada may not be less than two (legal entities or individuals), which may be of Brazilian or foreign nationality. In the case of a corporation, the number of shareholders may be only one, and as in the case of the limitada, the shareholder may be of Brazilian or foreign nationality. In the event of a foreign quotaholder or shareholder, a representative domiciled in Brazil must be appointed.
- It is usually a more complex procedure to form and keep a corporation than a limitada.

### Foreign ownership participation in management

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

## Repatriation of funds

- Dividends remitted to nonresident shareholders or quotaholders are not subject to any withholding tax. However, distributions from earnings or profits related to periods previous to December 31, 1995 are subject to withholding income tax at the rate of 25 percent or 15 percent, depending on the year they refer to.
- On interest and some other remittances the withholding tax rate is generally 15 percent or lower treaty rate.
- For remittances of service fees, the withholding tax rate is generally 15 percent.
- The initial investment may be repatriated upon liquidation on a sale to a resident without any taxation.
- Capital gains on sale of shares or quotas may also be remitted abroad, subject to payment of income and/or capital gains taxes, normally at the rate of 15 percent.
- Payments to a beneficiary resident in a country or location considered as a tax haven will be generally subject to 25 percent withholding income tax.
- Some outflows of foreign currencies require prior Brazilian Central Bank permission.

## Liquidating an investment

- A foreign shareholder or quotaholder may liquidate the investment at any time by selling the shares or quotas or upon liquidation. It should be noted that in order to repatriate investment, the local company must present clearances relating to labor, tax and social security liabilities.

## Tax considerations

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

## Professional advice

- It is advisable to retain professional advice at an early stage to ensure a smooth setup and regulatory compliance.
- Statutory audits are required only for publicly traded corporations and for entities operating in the banking and financial sector.

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

## Forms of business enterprise

Both business enterprises and those engaged in providing professional services are governed by the Civil Code. The only exception is the corporation, which is governed by the Civil Code and the corporate legislation.

The forms in which a business may be conducted are as follows:

1. Corporation (publicly-held or closely-held):

This corporate entity ("sociedade por ações"), commonly known as a S.A., most closely resembles a corporation in the United States and other countries and a public limited company (PLC) in the United Kingdom.

2. Company (private):

A private limited liability company ("sociedade por quotas de responsabilidade limitada"), commonly known as a "limitada" (Ltda.), resembles a closely-held company in the United States and a private limited liability company in the United Kingdom.

3. Mixed-capital company:

This corporate entity ("sociedade de economia mista") is owned by the government as well as investors from the private sector, with the government having a controlling interest.

4. Partnerships:

a. General partnership:

This type of partnership ("sociedade em nome coletivo") and those referred to below, except for the regulated professional partnership, are formed for economical activities purposes. They have unlimited liability. The two or more partners may take part in management. Only the partnership can be declared bankrupt.

b. Special partnership:

This type of partnership ("sociedade em conta de participação") is formed to carry out one or more specific business ventures. The partnership is not organized as a firm and therefore has no legal identity. It is in effect a participation account registered in the books of one of the partners.

c. Limited partnership:

This type of partnership ("sociedade em comandita simples") comprises two or more partners of two types: unlimited (active) and limited (passive) liability quotaholders.

d. Incorporated partnership:

This partnership ("sociedade em comandita por ações") comprises at least one managing shareholder who has unlimited liability and limited shareholder whose liability is limited to invested capital, whether or not paid up.

f. Regulated professional partnership:

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

5. Joint venture:

A joint venture may be set up in several ways, but will always be incorporated under one of the legal vehicles include in item 4, above.

6. Branch of a foreign company:

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

## Foreign enterprise entities

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

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

## Corporation

### Formation procedures

A corporation ("sociedade por ações", usually abbreviated to S.A.) whether publicly or closely-held is formed in accordance with Law 6404/76. If the corporation is constituted by public subscription it is also subject to Law 6385/76 and its amendments. A corporation may have either subscribed capital or authorized capital. A corporation with subscribed capital is the type more often encountered. An authorized capital corporation may increase its capital up to the limit established in its bylaws without complying with the formalities required by those corporations with subscribed capital and without requiring an amendment to its bylaws.

- Approval of bylaws

An inaugural meeting of prospective shareholders must be held to approve the bylaws, which enumerate the basic business purposes of the corporation, as well as to elect management, determine capital, registered office, and distribution of shares, among others. The constitution of the corporation depends on compliance with the following preliminary requisites.

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

Corporations may be constituted by public or private subscription. Formation by public subscription or subsequent transformation to a publicly held corporation requires the following:

- Registration of the proposed share issue with the Securities Commission (CVM).
- Intermediation of a financial institution for the subscription.

Registration of the issue by the CVM must be supported by the following:

- A financial and economic feasibility study.
- The proposed bylaws.
- The prospectus prepared and signed by the founders and by the intermediating financial institution.

The CVM may require modification of the bylaws or of the prospectus and may refuse registration if it considers the risk factors excessive.

- **General meeting of subscribers**

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

- Contract the appraisal of any assets contributed by shareholders in payment of subscribed capital.
- Approve the formation.

A quorum of subscribers to at least one-half of the capital is required for the meeting to approve the formation of a corporation. If a quorum is not obtained, a second meeting may be held with any number of subscribers. At either of these meetings the bank deposit receipt relating to payment of 10 percent or more of the subscribed capital must be read and the projected bylaws discussed and voted on, each share having the right to one vote, regardless of its class or type. The majority does not have the right to alter the proposed bylaws and, if these are not accepted, the corporation will not be formed.

- **Election of management bodies**

Upon approval of the bylaws, the shareholders elect the management bodies. At the termination of the meeting, the minutes should be read for the subscribers' approval. After being read and approved, the minutes of the meeting must be signed in duplicate by all subscribers present or by the number required to validate the resolutions. One copy of the minutes must remain with the corporation, and the other must be filed with the Commercial Registry.

- **Formalities**

A newly formed corporation acquires legal recognition with the filing of its constitutive documents with the Commercial Registry and the subsequent publication of the location of its head office in the official press. The certificate of the Commercial Registry confirming the filing of the constitutive documents serves as a legal document for transfer of assets subscribed as capital and becomes a matter of public record.

The first officers elected at the inaugural meeting are legally responsible for the new corporation from its inaugural meeting until the required documents are filed. They are also responsible to the corporation for losses caused by delays in complying with the constitutional formalities. The corporation is not liable for acts of the first officers until all required formalities are complied with, unless the minutes of the first general meeting stipulate otherwise.

A minimum of one month would be required to complete formation by private cash subscription. Corporations are not normally formed directly as publicly held entities. The normal practice is to apply for public status after the corporation has started operations.

Based on the complexity of the statutes and capital structure, the cost of forming a corporation is variable but for a closed entity, the related costs would not be less than US\$10,000.

Since minutes of meetings are required to be published, the proposed formation of a corporation is public knowledge.

## Capital structure

- **Share capital**

There is no minimum share capital requirement for a corporation except for financial institutions and insurance, utility, export trading companies and companies managed by expatriates. Share capital must be expressed in local currency and may be subscribed in cash or by assignment of debt and/or any type of asset. The monetary value of an asset should be based on an appraisal report which must indicate the criteria and comparative data used to formulate its conclusions, to be approved by the shareholders' assembly as well as the capital subscriber.

Shares may be issued with or without par value. The issue of common shares with no par value would not preclude issuance of one or more classes of preferred shares with a par value. Where, however, common shares are assigned a par value, all classes of shares must have the same par value. Shares may not be issued at a price below their assigned par value and the minimum shares value fixed by the CVM.

A corporation, in general, has at least two shareholders. The CVM may specify a minimum number of shareholders in order to grant listed status and may also fix a minimum par value. There is no statutory maximum number of shareholders.

Shares, common or preferred, must be nominative and evidenced by a share certificate or registered (book entry shares). The issue of bearer shares is prohibited. The right to conversion between types depends on the bylaws.

Share ownership and transfer can be evidenced by the following:

- Recording the name of the shareholder in the share register when the shares are registered.
- Registration of the shareholder's name by a financial institution that acts as register. In such cases, no share certificate is issued and the shares are legally classified as being registered (book entry share).

- **Classes of shares**

The capital of a corporation is normally represented by common and preferred shares. Corporate law also provides for the issuance of founders' shares ("partes beneficiárias", best translated as profit participation rights), since they carry the right to participate in net income without forming part of the capital.

The law permits corporations to create more than one class of common share. These may be distinguished by the following.

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

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

- **Receipt of dividends, reimbursement of capital**

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

1. Dividends even though fixed and cumulative, may not be distributed in detriment to a corporation's capital, unless this is expressly stated in the case of liquidation. However, the law does allow the bylaws to authorize preferred shareholders to receive cumulative dividends paid out of capital reserves arising from:
  - a. Premiums on issue of shares and debentures;
  - b. Sales proceeds of subscription rights and profit participation rights ("partes beneficiárias");
  - c. Special donations and subventions for investment. It should be noted that a dividend distribution from these sources would give rise to an income tax liability, since these capital reserves are free of tax only if they are capitalized.
2. Preferred shareholders, with exception of those with fixed dividends, cannot be precluded from participating in capital increases arising from capitalization of retained earnings or reserves.
3. Preferred shares cannot be created nor have their existing rights altered in detriment to the rights of convertible debenture holders without the prior authorization of the debenture holders.
4. Preferred shares with restricted or no voting rights cannot exceed in number half of the total outstanding capital shares.

5. Unless the bylaws specifically provide otherwise, preferred dividends are not cumulative. Shares with rights to fixed dividends are not entitled to any further participation in profits. Shares with rights to a minimum dividend are entitled to the same participation in profits as the common shares after the latter have received a dividend equal to the minimum preferred dividend.
6. Preferred shareholders may be given the right to elect one or more representatives to each of a corporation's administrative bodies and to veto bylaw modifications.
7. Preferred shares have the right of profit participation at least 10% higher than common shares have, when not previously fixed, whether cumulative or not.

- **Profit participation rights**

Profit participation rights ("partes beneficiárias") may be issued only by closely held corporations, if the bylaws so provide. These rights have no par value and can be issued only in one class. The participation of these rights in net income, together with the reserve for their redemption, may not exceed 10 percent of annual net income after offsetting prior years' losses.

A closely held corporation may sell profit participation rights or issue them free to its founders as remuneration for services rendered. Rights given free of charge to founders are valid for only ten years. Those sold may be issued for a specific but unlimited period, which must be established in the bylaws.

If the bylaws provide that profit participation rights will be redeemed, the corporation should make a special reserve for this purpose. The bylaws may also establish that profit participation rights may be converted into capital stock by capitalization of a specific reserve for this purpose.

- **Debentures**

Corporations may issue debentures that grant credit rights to their holders in accordance with the terms of a debenture deed and debenture certificate. The law with respect to the conditions for issue of debentures and the rights of debenture holders is extensive and may be summarized as follows.

1. The issue of debentures and the details of each issue must be authorized by the shareholders in general meeting.
2. A formal debenture deed must be drawn up and a trustee nominated.
3. With certain exceptions:
  - a. Where the debentures have no prior claim on a corporation's assets, the total debentures outstanding may not exceed corporate capital;
  - b. Where there is a specific claim, outstanding debentures may not exceed 80 percent of the value of assets pledged;
  - c. Where there is a floating charge, outstanding debentures may not exceed 70 percent of the book value of assets less secured liabilities.
4. Debentures must be denominated in local currency unless issued overseas with Central Bank approval.
5. Interest may be fixed or variable, and holders may be entitled to participate in profits.
6. Redemption may be on a stipulated date or conditional upon the occurrence of specific events. Provisions may be made for prepayments.

7. Convertible debentures may be issued, but debenture holders must vote on any resolutions that would affect conversion rights.
8. The trustee must report annually to the debenture holders and is responsible to them for losses that may result from negligence or failure to carry out duties, which cannot be restricted by the debenture deed.
9. Debenture holders may meet at any time to consider matters of interest.

- **Capital increases**

The bylaws may authorize the administrative council or the board of directors to increase capital within specified limits without the need to call a shareholders' meeting. In such event, the corporation is required by law to elect an administrative council and the bylaws should define the following:

1. The authorized capital, i.e., the amount of capital and the series and classes of shares that may be issued.
2. Body authorized to approve the issues.
3. Conditions to which the issues are subject.
4. Circumstances under which the shareholders would have preferential subscription rights.

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

1. Conversions of debentures or profit participation rights into common or preferred shares.
2. Conversion of debt into equity.

3. Exercise of rights acquired to subscribe to shares.
4. Exercise of an option to purchase shares.
5. Capitalization of profits and/or reserves.

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

Shareholders have a proportional right of first refusal to subscribe to, or purchase, additional shares in the event of a capital increase in any other form. The period for exercising this right cannot be less than 30 days and will be established by the shareholders if it is not established in the bylaws.

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

- **Capital reduction**

Capital may be reduced for the following reasons:

1. If it is judged by the shareholders to be excessive;
2. If share issues are not fully subscribed;
3. To offset accumulated losses;
4. To redeem shares;
5. To reimburse shares to dissenting shareholders.

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

In the event of reduction of capital deemed to be excessive or redemption of shares, the reduction will not become effective before 60 days after the publication of the minutes of the meeting in which the decision to reduce capital was made. During this period, secondary creditors for securities issued prior to the date of the publication of the minutes may oppose the capital reduction. The law further provides that if debentures issued by the corporation are in circulation, the capital reduction may be effected only with the prior approval of the majority of debenture holders at an extraordinary general meeting.

- **Other**

Amounts subscribed in excess of the par value of shares issued must be classified as capital reserves, which can be used only for specific purposes (see Provisions and reserves in Chapter 12).

Shares are generally freely transferable by the shareholders, but caution must be exercised where there are nationality requirements, e.g., in the banking sector.

Shareholders' liability is limited to their investment in the corporation.

## Relationship of shareholders, directors and officers

- **Board of directors, administrative council, fiscal council**

With regard to the responsibilities of directors and that of other supervisory bodies, the corporation's bylaws should establish who is responsible for its administration. This may be carried out either through an administrative council and a board of directors or through a board of directors only. An administrative council is required in the case of publicly held and closely held corporations with authorized capital.

The administrative council is responsible for defining corporate policy and appointing directors and independent auditors. The council does not have any executive function and representation of the corporation is limited to the directors. The council must have a minimum of three members, who must be individuals and shareholders. The members of the administrative council need not to be resident in Brazil, however a representative must be appointed for a term extended by three years to the member's term for the council office. This representative must have specific powers that allow for full representation of the council member.

The board of directors must consist of two or more individuals, all of whom must be resident, whether shareholders or not. The board is elected by the administrative council or by the shareholders. Up to one-third of the board members may also serve as members of the administrative council. There is no requirement that workers be represented on the board or in management. The board elects one of its members to be chairman and the quorum is generally a majority of the directors in office. Resolutions are approved with an absolute majority vote, unless the statutes or bylaws provide otherwise. The most important duties of the board correspond to the responsibility of representing the company before third parties and public agencies as well as for the selection and approval of corporate officers.

Corporations may appoint a fiscal council ("conselho fiscal"), responsible for overseeing the administrative council and the board of directors, with broad powers and authority. The bylaws should determine whether the fiscal council will have permanent status or whether it will be appointed only when requested by the shareholders. Generally, this body is appointed only in the latter circumstance. The fiscal council must have a minimum of three members and a maximum of five, with equal numbers of alternates, all resident, shareholders or not, elected at a shareholders' meeting.

The remuneration of the board of directors and of the administrative and fiscal councils must be fixed by the shareholders.

Directors are not personally liable for the obligations they contract in the name of the corporation and in the normal course of business. However, they are liable for losses and damages caused by negligent or fraudulent acts or when violating the law or the corporation's bylaws.

Officers are appointed by the directors and serve for specified terms. They derive their authority from the articles and bylaws of the corporation or from the resolutions of directors. Officers can be shareholders.

- **Calling meetings**

The administrative and fiscal councils, shareholders, directors and debentures holders may call for shareholders' meetings. The fiscal council may call a meeting if there is any matter requiring urgent resolution or if the administrative council or the board delays more than one month in calling the annual ordinary general meeting. If the delay exceeds 60 days, any shareholder may call a meeting. Holders of a minimum of 5 percent of the voting capital may call a shareholders' meeting where a request to do so has not been acted upon by the directors after eight days. Also, holders representing at least 5% of the voting capital or 5% of the non voting capital may also call the meeting for the establishment of the fiscal council when the administrators fail to do so within eight days of the request for such.

Meetings must normally be called by publication of an appropriate announcement at least three times in the Official Gazette ("Jornal Oficial") and in a newspaper of wide circulation in the locality of the head office. Shareholders must be advised in advance of any change in the newspaper in which notice will be published. If all shareholders are present at a meeting, the notice and publication requirements may be waived. Closely held corporations with less than 20 shareholders may call a meeting by announcement delivered personally, proved by acknowledgment of receipt, provided all the shares are nominative and the net worth of the corporation is less than R\$ 1 million.

Resolutions of shareholders' meetings must be recorded in the minutes, which may be published in summary form. Subsequently, the minutes must be transcribed in the appropriate register and filed with the Commercial Registry.

- **Types of meeting**

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

1. **Inaugural meetings:**

See "Formation procedures" above.

2. **Ordinary shareholders' meetings:**

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

- a. Approve the annual financial statements and the directors' report;
- b. Approve the proposed distribution of net income for the year;

- c. Elect officers and members of the fiscal council, where applicable, and approve where applicable, authorized capital, minimum or fixed dividends and premiums on reimbursements.

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

The directors must advise shareholders at least one month before the date of the ordinary meeting as to the availability of:

- a. The directors' report on the corporation's business activities and principal administrative events of the past year;
- b. The annual financial statements;
- c. The opinion of the independent auditors, which is mandatory only in the case of publicly held corporations, banking and financial institutions, insurance companies, and some companies enjoying tax incentives.

A representative of the independent auditors must be present at the meeting to answer questions.

Unqualified approval of the report and financial statements submitted to shareholders relieves the directors and fiscal councilors from responsibility, except in the case of error, bad faith or fraud, for which they remain responsible for two years from the date of the meeting that approved them.

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

### 3. Extraordinary shareholders' meetings:

Among the various matters that can be dealt with only at an extraordinary meeting are the following:

- a. Amendments of the bylaws;
- b. Special elections of directors and fiscal council members outside the normal elections at ordinary shareholders' meetings;
- c. Authorization to issue debentures and profit participation rights;
- d. Approval of spontaneous appraisals of property, plant and equipment (see Chapter 12) contributed by shareholders to pay subscribed capital;
- e. Approval of corporate transformations, consolidations, mergers, splits or spin-offs, dissolution or liquidation, and election of liquidators and approval of their accounts;
- f. Authorization for directors to declare bankruptcy ("falência") or to request an arrangement with creditors ("concordata").

Ordinary and extraordinary meetings may be called and held at the same place, date and time and be documented in the same minutes. In practice, ordinary and extraordinary meetings are normally held one immediately following the other, with the order of such meetings dependent on the matters to be discussed.

- Voting procedures, quorums

Except for meetings called to amend a corporation's bylaws, which require at the first call the presence of shareholders representing at least two-thirds of the voting capital, other general meetings can

proceed at the first call with the presence of shareholders representing one-quarter of the voting capital. At a second calling, usually one hour after the first calling, meetings may be held with any number of shareholders present.

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

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

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

Each common share is entitled to one vote, except for election of the administrative council, when multiple voting may be used. For this purpose, shareholders representing a minimum of 10 percent of the voting capital may use multiple voting, whether or not authorized by the bylaws, by attributing to each share as many votes as there are members of the council. These votes may be used to support one candidate or be divided between various candidates.

Any resolution voted on by a shareholder whose interest conflicts with that of the corporation may be annulled. Furthermore, such shareholder is responsible for damages caused and must transfer the advantages obtained to the corporation.

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

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

Minority shareholders have the following rights.

- If they represent 5 percent of the voting capital, they may call a general meeting if within eight days of a properly formulated request the directors do not do so.
- If they represent 10 percent of the voting capital, they may elect a member of the fiscal council and may utilize a multiple vote in electing members of the administrative council.
- If they represent 5 percent of the ordinary shares or 5 percent of the preferred shares without voting rights of a corporation affiliated with a group, they may require the appointment of a fiscal council.
- If they represent 5 percent of total capital, they may request access to the corporation's books through a court petition.
- Bylaws may establish whether conflicts between controlling shareholders and minority shareholders may be settled through arbitration.

- The choice and destitution of independent auditor is subject to well grounded disapproval of counselors appointed by minority shareholders.

Shareholders' agreements are valid in relation to third parties for specific performance when filed at the head office of the corporation. These may deal with the following:

- Purchase and sale of shares;
- Preferential share acquisition rights;
- Exercise of voting rights or control power.

Shares covered by a shareholders' agreement cannot be negotiated in a stock exchange or over-the-counter market. In the annual directors' report a publicly held corporation must inform shareholders of the provisions of all shareholders' agreements affecting the distribution of dividends and reinvestment of earnings.

#### • Withdrawal

Shareholders dissenting from decisions on fundamental questions have the right to withdraw and have the value of their shares reimbursed by the corporation at a price that can never be less than the net worth of the shares as based on the latest balance sheet approved by the shareholders at an ordinary general meeting. In case the meeting occurs after 60 days as of the latter, a special balance sheet may be prepared at the shareholder's request. These fundamental questions include the following.

1. Creation of preferred shares or increase in any class of existing shares out of proportion to the others, unless already provided for in the bylaws.
2. Alterations of the conditions attached to preferred shares or the creation of a more favored class.

3. Alteration of the corporation's objectives.
4. Alteration of the obligatory dividend.
5. Dissolution of the corporation or termination of the state of liquidation.
6. Acquisition by a publicly held corporation of control of another entity for an amount greater than that established by the law.
7. Transformation of a corporation into a private limited liability company ("limitada").
8. Passing of control of the corporation to a mixed-capital company through expropriation.

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

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

- **Dividend distributions**

Dividends may be paid from net income of the current year or prior years and from unrestricted reserves. In any event, they can be paid only out of surplus. Preferred dividends may be paid out of certain capital reserves, subject to authorization in the bylaws. Shareholders have the right to receive the obligatory dividend established in the bylaws or, if the bylaws are silent, one-half of annual net income. The obligatory dividend may not be less than 25 percent of net income for the year unless otherwise stipulated in the bylaws. The obligatory dividend need not be paid by a closely held corporation when there is unanimous agreement of the shareholders and need not be paid when

payment would be incompatible with the financial situation, whether the corporation is publicly or closely held. Net income retained for the latter reason must be transferred to a special reserve and, if not absorbed by subsequent losses, be distributed as dividends as soon as the financial situation permits. Capitalization of such special reserve is prohibited.

A revaluation surplus cannot be used to pay dividends.

## Transformation

A corporation may be transformed into a "limitada" or vice-versa. If transformation is not provided for in the bylaws or articles of incorporation, unanimous approval must be obtained from holders of the capital stock. Thus, dissenting shareholders are entitled to exercise their right to withdraw from the corporation (see above). Creditors are not jeopardized by transformations, since they continue to hold the same rights.

## Liquidation, receivership

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

1. By termination of the life of the corporation in the circumstances provided for in the bylaws.
2. By resolutions of shareholders.
3. By termination of the authorization to operate.

Judicial dissolution may occur in the following circumstances.

1. When the constitution of the corporation is annulled by an action brought by any shareholder.
2. When an action brought by shareholders representing 5 percent or more of the corporate capital confirms that the corporation cannot achieve its business objectives.
3. As a result of bankruptcy in a judicial liquidation.
4. In case of existence of a sole shareholder, if the minimum of two is not reestablished until the following year shareholder's meeting.

A temporary voluntary receivership, called a "concordata" is available when a corporation is in financial difficulties and applies for a court order to suspend the payment of its debts and obligations for a definite period of time not to exceed two years. Application for temporary receivership must indicate how and when it will meet its obligations. It will generally be granted favorable financial conditions in order to meet its obligations, but it must comply with strict conditions concerning the conduct of the business during the temporary receivership period.

Liquidation may also occur in special cases by decision of the administrative authorities and in the manner provided for by the appropriate special legislation.

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

The liquidator has the same responsibilities as a director of the corporation. The duties of the directors, fiscal councilors and shareholders continue until the termination of the corporation.

After all creditors have been paid, the shareholders may, to the extent that the assets have been realized, approve a distribution to themselves before completion of the liquidation. Specific assets may be distributed to shareholders if this is not prejudicial to the creditors or the minority 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. On approval of these accounts, the liquidation is considered to be complete and the corporation is automatically extinguished.

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

## Books and records

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

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

## Statutory audit

Except for publicly held corporations, banks, insurance companies and other financial institutions, corporations are not required to be audited by independent registered public accountants (see Chapter 11).

# Company and partnership

## Formation procedures

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

Where the deed is silent, civil law serves to govern limitadas and partnerships. Corporation law serves complementarily if disposed in the deed.

The formation deeds and any subsequent deeds in which alterations are made in the provisions governing the entity, including transfers of capital quotas, must be filed with the Commercial Registry and thus become a matter of public record. There are no further disclosure requirements.

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

## Capital structure

There is no minimum capital requirement for a "limitada" or for a partnership and no deposit is necessary for their formation, with few exceptions such as if it has a foreign director (administrator) or performs certain financial transactions, among others. There is no ceiling on the number of quotaholders or partners each entity may have. However, there must be at least two quotaholders or partners.

Nominees, generally lawyers or the general manager, are frequently used to provide the second quotaholder for a "limitada". There are no statutory provisions regarding time limits for the paying in of capital but the Commercial Registry has been known to request that such a plan be filed.

A nonresident can be a partner in a commercial partnership but not in a regulated professional partnership.

Capital is in the form of quotas of equal or unequal value as specified in the deed ("contrato social"). Usually, the capital is divided into quotas of equal par value. Holdings and the amounts thereof must be clearly stated. Quotas are not issued and therefore bearer quotas are not permitted.

Increases and decreases in capital are made by alterations to the deed.

Provided the deed permits, quotas may be transferred between quotaholders or to third parties by making alterations in the partnership deed. Liability of quotaholders of a "limitada" is limited to their quotas, when fully paid in and secondarily to the total capital amount when not paid in. Partners in general have unlimited liability for the partnership debts.

## Relationship of quotaholders, partners and managers

The administration of a "limitada" may be entrusted to one or more quotaholders and the deed or a specific agreement should indicate which of them will serve as the manager, or alternatively, the quotaholders may delegate their powers to one or more individuals. It should be noted that the delegate manager does not need to be a quotaholder. The management of partnerships generally follows similar rules.

The responsibilities and duties of managers are similar to those of corporate officers and they are personally liable, thus, having a subsidiary responsible for misleading or unlawful actions.

An annual meeting of quotaholders is not required, nor does the law require a minute book to be kept.

Limitadas and partnerships are not required to publish financial statements.

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

As noted earlier, a "limitada" may be transformed into a corporation or vice versa.

## Liquidation, receivership

"Limitadas" and partnerships may go into liquidation as a result of provisions in the deed, by agreement between the quotaholders/partners, end of term, extinction of license or by judicial action. Bankruptcy declared in a judicial liquidation is also a reason for liquidation. The conditions for withdrawal, as well as the basis and timing of repayment of quotas/partners, must be clearly established in the deed.

A temporary receivership ("concordata") is also applicable to limitadas and to commercial partnerships.

## Books and records

See Chapter 11 for requirements on books and records.

## Statutory audit

There are no statutory audit requirements.

## Joint venture

A joint venture may be accomplished by a capital association through the formation of any chosen form of business entity, usually a corporation or a "limitada". There are few formalities for entering into a joint venture agreement and, as a rule, few disclosure requirements. Foreign companies and individuals may form a joint venture with or without local participation.

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

There are no statutory audit requirements for joint ventures.

## Branch of foreign company

In order to operate a branch, a foreign company must apply for permission from the federal government. Approval must also be obtained for any change in the branch organization as a result of an amendment to the bylaws of the head office or for any other reason. Only the President of Brazil may authorize a branch operation.

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

The authorization decree and other official notices are published in the Federal Gazette. These should be filed with the Commercial Registry for the state in which the branch will be located.

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

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

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

The books and records are kept in the same manner as for a corporation (see above and Chapter 11). The foreign company must publish in the Official Gazette its financial reports as in its country of origin, as well as the branches' financial reports, under penalty of authorization loss.

Any bylaws or deed amendments are subject to Executive Power's approval.

The accounts relating to the operations of a branch must be published and filed in accordance with the prescribed procedures for a corporation, as they are governed by corporate law.

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

There are no statutory audit requirements.

## Mixed-capital company

The Brazilian government has a controlling interest in this type of company, the other stockholders being private investors. They are subject to corporate law and also specific federal laws. They are restricted to the activities specified in the law authorizing their formation.

## Entrepreneur

An entrepreneur is that who acts professionally at an organized economic activity with the production of goods or the rendering of services. The entrepreneur must have civil capacity. Registration with Public Register is mandatory before the beginning of activities. By operating in this form, all of the sole proprietors' assets, personal or business, are at risk.

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

# Chapter 10 Labor relations and social security

## Investor considerations

- The labor markets are regulated in Brazil.
- An adequate and growing work force is available but it is mainly semiskilled and unskilled.
- Labor disputes are mainly resolved through collective bargaining but government influence is significant.
- Labor legislation is paternalistic toward employees.
- Labor unions are quite active.
- All employees must be paid an additional month's salary each year as a compulsory bonus.
- Employers must contribute to various federal social security and welfare institutions.
- The social security system covers main employee risks but employers may need to increase certain benefits for middle and top management.
- Discrimination in employment is prohibited.

- Requests for bringing in foreign personnel are scrutinized by federal authorities.
- Employee dismissal is regulated by the federal government.

## Labor relations

### Availability of labor

The labor force is approximately 83.243 million, or 49 percent of the total population, with about 9.15 percent employed in agriculture, 6.26 percent in industry, 6.35 percent in commerce and 19.28 percent in services. Women comprised about 41.87 percent of this force in 2001. A significant part of the work force is not formally registered.

In general, adequate labor is available. Semiskilled and unskilled labor is fairly easy to obtain, is recognized for its capacity for hard work and willingness to learn, and is fairly mobile. Skilled labor tends to be in short supply. Personnel with proven technical, professional or management skills are growing as company in-house training and other courses take effect, and they are highly sought after.

## Employer/employee relations

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

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

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

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

- An employee may be withdrawn from a position of trust and responsibility without compensation, provided the status previously held is restored.
- Employees may not normally be transferred from one place of work to another if this involves a change of residence, unless the employee holds a position of trust and responsibility or the transfer results from the closing down of an establishment.

- Notwithstanding the above, an employee who is not in a position of trust and responsibility may be transferred if this is justified by the requirements of the employer. A 25 percent remuneration increase must be granted upon transfer and all expenses incidental to the transfer must be paid by the employer.

Lockouts are mentioned in the labor laws as acts subject to penalty if undertaken without prior legal authorization or in case it should be considered as abusive by labor judicial authorities.

An employee who leaves to fulfill a military or civic obligation must be permitted to return to the former position with the benefits corresponding to the position that would otherwise have been attained. The employee's intent to return must be communicated to the employer within 30 days following the termination of the outside activity.

An employee whose term of service is interrupted by illness is entitled to receive an allowance from the Social Security authorities and upon recovery may reassume the former position together with all accrued benefits.

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

All industrial enterprises are required to employ apprentices and enroll them in National Apprentice Services. Their number may not be less than 5 percent, neither more than 15 percent of the total skilled workers. Relatives of employees must be given preference.

## Unions

Labor unions are active. They are more militant in the metallurgical, automobile, banking and transport sectors.

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

Among the prerogatives of labor unions are the rights to do the following.

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

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

Union representation at places of work with more than 200 employees is specified in the Constitution. However, appropriate legislation has not yet been enacted and, consequently, representation exists only on an informal basis.

## Employee training programs

Government-sponsored training to improve the standards of labor include the following.

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

SENAI and SENAC are funded by a payroll levy of 1 percent of the gross payroll. Companies that can prove they provide satisfactory in-house training schemes are liable to only 1/5 of the above-mentioned rate.

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

## Workers' councils

For employers with more than 200 employees, an employee representative must be elected for the exclusive purpose of ensuring direct employer/employee agreements. However, in practice, this kind of representation is not significant.

## Profit sharing

Law 10.101/00 obliges companies to distribute part of their annual net income to employees. Participations must be negotiated company by company and disputes settled by arbitration. Amounts distributed are deductible for corporate income tax purposes and not subject to labor and social security contributions, but they are taxable to beneficiaries.

## Working conditions

### Wages and salaries

All work of equal value must be remunerated at the same rate, irrespective of the nationality, age, sex, or marital status of the employee, but services rendered for more than two consecutive years may be taken into account.

A minimum wage is established by law and is currently set at approximately US\$ 100 per month. It should be noted that the minimum wage serves mainly as a base index for adjusting wages and certain prices. In practice, it is paid only to some rural, unskilled and migrant workers.

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

- **National Salary Policy**

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

- **Deductions**

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

- **Overtime**

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

- **Night work**

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

- **Payment**

Payment must be made in local currency within five working days of each month-end. Gaps exceeding one month between successive payment dates are not permissible. The remuneration of foreign technicians contracted from abroad on a temporary basis to render specialized services may be stipulated in foreign currency, but payment must be made in local currency.

- **Obligatory annual bonus**

Employers must pay an annual bonus, known as the 13th month salary and equivalent to the normal remuneration of December, in two parts: the first when the employee takes a vacation or before November 30 and the second in early December. Employers' contributions to the Employees Severance Indemnity Fund (see "Termination of employment" below) and to social security funds are also payable on this bonus.

- **Family allowance**

The INSS (National Institute of Social Security) pays a small supplementary monthly allowance for each of a worker's child under 14 years of age.

## Fringe benefits

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

All employers are obliged to make reasonable provision for the comfort and convenience of their employees. The authorities may require that other special facilities be made available where unusual conditions exist. No industrial enterprise may commence operations until working conditions have been inspected and approved by the authorities.

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

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

The benefits provided as part of the social security system are discussed below.

## Hours worked

Generally, a five-day workweek is the norm. Legally, the working week may not exceed 8 hours daily or 44 hours weekly. In the case of employers with continuous working shifts, the workday may not exceed 6 hours. In both cases, this requirement can be resolved by means of a collective bargaining agreement. Unions are working toward reducing the workweek to 40 hours with some success, and many companies already work a five-day, 8-hours-per-day week.

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

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

## Paid holidays and vacations

Statutory paid holidays are listed in "Hints for the business visitor" at the end of Chapter 1.

Upon completion of every 12 months of service, employees are entitled to a paid vacation of 30 consecutive days to be taken during the next 12-month period. This annual vacation must be paid with an increase of one-third of the related pay. If a vacation is not granted within this period, the employee must be compensated at double the remuneration. Up to one-third of a vacation period may instead be paid in cash, at the employee's option. In addition, employees are entitled to receive 50 percent of their 13th month salary (see "Obligatory annual bonus" above) at the beginning of their vacation period.

## Health and safety

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

It should also be noted that the activities listed as dangerous or unhealthy to employees has special provisions in terms of salaries, resting periods and others.

## Termination of employment

All employers must contribute to the Employees Severance Indemnity Fund (FGTS) an amount equivalent to 8 percent of the gross monthly remuneration of each employee. An additional 0.5 percent of the gross monthly remuneration must be paid for the Social Security Institute.

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

- Dismissal without just cause, or where the employer and employee are considered to be mutually at fault. In the case of dismissal without just cause, the employer is obliged to pay to the employee an additional penalty equivalent to 40 percent of the accumulated balance in the employee's FGTS bank account. If employer and employee are mutually at fault, the additional amount payable is 20 percent of the FGTS balance.
- Liquidation of the enterprise or termination of operations resulting in cancellation of the employment contract.
- Retirement in accordance with the social security regulations.
- An employer may insist on retirement when a male employee reaches 70 or a female employee 65.
- Death of the employee, in which event the balance in the FGTS account is included in the estate of the deceased.

An employee is allowed to use the FGTS balance at any time to purchase a personal residence under a government approved housing financing scheme.

When an employee voluntarily resigns or is dismissed with fair cause and is then employed elsewhere, the balance in his account is transferred to the new employment.

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

Accrued vacation pay is also payable upon termination of employment, even if the employee has not completed 12 months service

## Social security

### Social security system

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

There is an official unemployment insurance program.

### Coverage

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

## Contributions

Employees contribute monthly to the social security system at the rate of 7,65% to 11 percent of a progressive-scale base salary with a maximum monthly contribution based on 10 base salaries. These contributions are withheld from the payroll. Employer monthly contributions correspond to 20 percent of the gross payroll. In addition, employers are required to make monthly contributions to other funds, which currently could amount to as much as 17.3 percent of the gross payroll. Employees' and employers' contributions are deductible for income tax purposes. For further details see Appendix XII.

Certificates showing that employers are up to date in their contributions are required before they can engage in certain business activities, such as public bids and mortgage or sale of real estate, capital reduction, merges, spin-off among others.

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

## Benefits

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

The main benefits are as follows. For further details see Appendix XII.

- Old-age pension

Old-age pensions are available from the age of 65 (60 for women) if at least 180 monthly contributions have been made. The company may, at its own will, retire an employee older than 70 years.

- Retirement pension

Retirement pensions are ordinarily available if an employee has worked 35 years (30 for women). For certain types of work, e.g., dangerous, unhealthy or fatiguing labor, the qualifying period of service is reduced, provided at least fifteen years' contributions have been paid. An employee who is entitled to receive the retirement pension may continue to work for the same employer, or for another employer

- Invalid pension

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

- Sickness benefit

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

- Accident insurance benefit

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

- Maternity leave

The period of maternity leave is 120 days at full pay. Husbands are allowed paternity leave of five days with full pay.

- Other benefits

Other social security benefits include dependents' pensions in respect of deceased beneficiaries, assistance to dependents of insured prisoners, and the family allowance for each child under 14 years of age.

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

## Unemployment relief

Unemployment pay is granted under certain conditions for a period of 3 months. Agricultural and domestic workers are not generally eligible, nor are those employed by nonprofit organizations or members of an employer's family who work for him. Also, unemployment pay is not granted to those dismissed from work for misconduct, those who stopped working without reason or those unable or unwilling to work.

## Totalization agreements

Agreements with other countries regarding social security system coordination are listed in Appendix V.

## Payroll costs

As element in total production costs

Labor costs (wages, salaries, fringe benefits, termination payments, payroll taxes, social security and welfare contributions, etc.) represent a significant element of total production costs, as they have risen considerably as successive governments have increased contributions and benefits. As a percentage of total production costs, labor costs are generally lower in Brazil than those in North American and most European countries but are higher than in many Asian countries.

## Expatriate personnel in Brazil

### Work permits

There are three types of visas for foreign personnel:

- Business visa:

Holders will be able to enter Brazil at any time and the visa is effective for a stay of not more than 90 days, and up to 180 days per year. They cannot be registered employees of a Brazilian entity.

- Temporary residence visa:

Similar to a business visa except that the holder is entitled to work in Brazil for two years, renewable for as long as the contract regarding the holder permanence in the country is valid

- Permanent visa:

May be granted to those contracted to work in Brazil for an indefinite period. It is generally issued to top executives of foreign companies being transferred to Brazil, those with specialized skills not readily available in Brazil and those who marry Brazilians or have Brazilian-born children. In other circumstances it is difficult to obtain a permanent visa.

Foreigners who do not hold one of the above visas may not work in Brazil. It is advisable to apply well in advance for any type of visa.

Also, a foreigner must hold a permanent visa and be domiciled in Brazil to be able to serve as a director of a Brazilian company

### Special arrangements or concessions

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

Foreigners arriving with permanent visas may bring in duty free otherwise dutiable household goods. Duties may be imposed if these goods are sold inside Brazil before the expiration of certain time limits. The same applies for holders of temporary residence visas, except that they are required to repatriate all otherwise dutiable household goods when they leave.

## Living conditions

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

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

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

# Chapter 11      Audit requirements and practices

## Investor considerations

- Only "S.A." corporations are required to publish their annual financial statements.
- The annual financial statements of listed corporations must be audited.
- Audited annual financial statements are not required for closely-held corporations, private limited liability companies ("limitadas"), partnerships and other business entities.
- Financial institutions, other entities controlled by or registered with the Central Bank and insurance companies are required to publish annual and semi-annual audited financial statements.
- The quarterly financial information of listed corporations filed with the Securities Commission must be reviewed by independent auditors if the gross annual revenue is greater than R\$ 100 million.

## Statutory requirements

### Books and records

All legal entities engaged in business are required to do the following:

- Maintain proper books of account in Brazil.
- Record transactions in these books as required by law.
- Retain accounting records during the required legal periods. Duly registered microfilm copies of records are allowable.
- Prepare annual financial statements as required by law, the bylaws or partnership deeds and transcribe these in the general journal ("diário geral").

There is a long list of legally required accounting records. Tax legislation requires many registers to evidence the payment and collection of indirect taxes and a special book reconciling accounting net income with taxable income (LALUR) must also be kept (for tax returns, please refer to Chapter 14).

A qualified and registered accountant ("contador responsável") is responsible for the proper maintenance of the books and records, preparation of financial statements and filing of tax returns.

The following general rules must be observed in keeping the books and records:

- The official books must be written up in Portuguese and in local currency. There are no objections to foreign currency equivalents also being shown, although such figures are regarded merely as a memorandum record, except where the origin of transactions is in foreign currency.
- Blank lines, interlining or alterations of any kind are prohibited and invalidate the records as proof of particular transactions in the event of claims or lawsuits.
- All transactions must be recorded in the general journal in chronological order, though in practice this book may be used to record monthly totals of transactions entered in subsidiary journals, such as cash, sales and purchase books, etc., provided they are duly registered. Computerized records are now generally used but these must be bound and subsequently registered.
- Companies are required to prepare and make available computer files in a specific layout for the tax authorities.
- Account codes (numbers instead of titles) for accounting entries in the general journal can be used, provided the codes have been filed with the Commercial Registry ("Junta Comercial").

## Audited financial statements

The financial statements of the following entities must be audited by independent auditors registered with the Securities Commission (CVM), Central Bank and other government agencies:

- Listed corporations.

- Financial institutions, investment funds etc.
- Stock exchanges.
- Insurance companies.
- Private pension funds.

For listed corporations only, the annual financial statements must be audited. Financial institutions and the other entities mentioned above must also have their semiannual financial statements audited. In addition, the quarterly financial information of listed corporations which is submitted to the Securities Commission must be reviewed by independent auditors if the annual gross revenue is greater than R\$ 100 million.

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

Proposed changes to Corporate law would require closely-held corporations and "limitadas" (private limited liability companies - see Chapter 9), considered as "large companies", to contract independent auditors. In addition, banks and other credit grantors frequently require audited financial statements from borrowers, even if not required by law.

The tax authorities do not require audited financial statements.

Consolidated group accounts are required only for listed corporations with subsidiaries.

Internal auditors cannot be used as statutory auditors.

## Accounting profession

The accounting profession is controlled by a quasi-official organization called the Federal Accounting Council ("Conselho Federal de Contabilidade" - CFC) which is composed of members elected by representatives of the various Regional Accounting Councils ("Conselhos Regionais de Contabilidade" - CRCs). The elected members of the CFC then elect their president.

There are two classes of accountants:

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

No accountants may practice until their qualification has been recognized and registered by the appropriate CRC. An examination has been established and, since 2000, all accountants must undertake it for his/her registration at the respective Regional Accounting Council. Only "contadores" may act as auditors.

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

The Institute of Brazilian Accountants ("Instituto dos Auditores Independentes do Brasil" - IBRACON) is a private institution and is a complement to, not a substitute for, the Federal Accounting Council, basically for technical matters. One of its responsibilities is to promulgate accounting, auditing and reporting pronouncements. These are gradually being built into a reference manual. Basic

standards established by the Institute as to concepts, audit performance and reporting have been endorsed by the Securities Commission (CVM). CFC and IBRACON are affiliated with the International Federation of Accountants and with the Interamerican Association of Accountants.

Holders of non-Brazilian university degrees in accountancy may request to have these validated in order to practice in Brazil. This requires sitting for examinations on subjects that the state or federal universities considers as not being covered in the courses taken outside Brazil.

## Auditing standards

Financial statements and the accounting principles reflected therein are representations of management. The independent auditors confirm whether the financial statements conform to published accounting principles. To do so, they must examine the financial statements in accordance with approved auditing standards in Brazil. The auditing standards and procedures in Brazil are contained in NBC T11 "Normas de Auditoria Independente das Demonstrações Contábeis", and technical interpretations issued by the CFC and NPA - "Normas e Procedimentos de Auditoria" issued by the IBRACON.

A typical short-form audit report, freely translated into English, would read as follows:

Report of Independent Auditors

(Date)

To the Board of Directors and Shareholders  
ABC Company

We have audited the accompanying balance sheets of ABC Company as of December 31, 20X1 and 20X0 and the related statements of income, of changes in shareholders' equity and of changes in financial position for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements.

We conducted our audits in accordance with Brazilian approved auditing standards which require that we perform the audits to obtain reasonable assurance about whether the financial statements are fairly presented in all material respects. Accordingly, our work included, among other procedures (a) planning our audits taking into consideration the significance of balances, the volume of transactions and the accounting and internal control systems of the company; (b) examining, on a test basis, evidence and records supporting the amounts and disclosures in the financial statements; and (c) assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, the financial statements present fairly, in all material respects, the financial position of ABC Company at December 31, 20X1 and 20X0 and the results of its operations, the changes in shareholders' equity and the changes in its financial position for the years then ended, in conformity with accounting principles prescribed by the Brazilian Corporate legislation (or generally accepted accounting principles in Brazil).

Modifications to this unqualified opinion (qualification, adverse opinion or disclaimer) would be required if the auditors disagree with or are unable to satisfy themselves as to any of the statements made therein.

Management of a closely-held corporation or a "limitada" might decide that a complete audit of its financial statements is not necessary, yet want a moderate level of assurance from an independent auditor. In such a case, an auditor can perform a limited review of the financial statements. A limited review is substantially more restricted in scope than an audit in accordance with Brazilian approved auditing standards and consists of applying inquiry and analytical procedures to provide the auditor with a reasonable basis to conclude that there are no known material modifications that should be made to the financial statements.

An independent auditor can also compile financial statements, that is, present in financial-statement format information that is the representation of management. In such a case, the auditor would not express any opinion or give any other form of assurance as to the financial statements.

# Chapter 12      Accounting principles and practices

## Investor considerations

- Accounting principles are evolving towards International Financial Reporting Standards, but there are still some material exceptions.
- All companies, except limitadas, must publish their annual financial statements in a major Brazilian newspaper.
- Listed companies with significant subsidiary companies must prepare and publish consolidated financial statements.
- The relationship with the parent company and related-party balances and transactions must be disclosed.
- There are various differences in the book and tax treatments of accounting income and expenses.

## Accounting principles

The 1976 Corporation Law (Law 6404) and its subsequent amendments are the primary reference source for accounting principles, together with subsequent rules issued by the Institute of Independent Auditors of Brazil (IBRACON). These, supplemented by regulations of the Securities Commission (CVM) and the Central Bank, have become the comprehensive basis recognized as the accounting practices adopted in Brazil ("Brazilian GAAP").

Companies in specialized business sectors such as banking, financial services and insurance, must comply with specific accounting practices established by their respective regulatory agencies.

International Financial Reporting Standards (IFRS) and other pronouncements of the International Accounting Standards Board (IASB) are not required to be followed, and they are not generally accepted accounting principles (GAAP) for meeting statutory and tax requirements.

## Differences between Brazilian and International Financial Reporting Standards (IFRS)

Brazilian GAAP are stated more generally than IFRS, and the body of pronouncements which form Brazilian GAAP is less comprehensive than IFRS. Major differences are described in the following paragraphs.

### Inflation accounting

Inflation accounting was mandatory under Brazilian GAAP through 1995. Two methods were acceptable - partial monetary correction, which included monetary restatement of balance sheet accounts but not of the income statement, and integral monetary correction, which was very similar to IAS 29. Effective January 1, 1996, the use of inflation accounting was prohibited for Brazilian tax and corporate reporting purposes.

Under IFRS, a system of price indexation of financial statements would generally be maintained until the cumulative inflation during the preceding three-year period was less than 100%. In Brazil, this reduction in inflation was not achieved until December 31, 1997. Although monetary restatement can no longer be recorded in the official accounting records, the Brazilian Securities Commission (CVM), in Instruction 248/96, allows companies to present supplementary financial statements under the integral monetary correction method.

### Borrowing costs

Under Brazilian GAAP, borrowing costs shall be capitalized when they are directly attributable to the acquisition, construction or production of assets that take a reasonable period of time to get ready for their intended use or sale. Under IFRS, capitalization of borrowing costs is permitted but not compulsory.

### Deferral of pre-operating Expenses

In Brazil, pre-operating expenses incurred in the construction or expansion of a new facility may be deferred until the facility begins commercial operations. The amount is amortized over a period of five to ten years. IFRS does not allow capitalization of such start-up costs.

### Business combinations

Business combinations under Brazilian GAAP are accounted for using the purchase or pooling of interest methods. Under IFRS all business combinations are accounted for using purchase method.

Under Brazilian GAAP, goodwill or negative goodwill on the acquisition of a company is comprised of the difference between the cost of acquisition and the underlying book value of the acquiree. The acquired assets and assumed liabilities are maintained at their predecessor book values. The goodwill or negative goodwill should be attributed to differences in asset valuation, expected profitability and/or other economic motives, with each portion subject to a separate amortization calculation.

Under IFRS goodwill or negative goodwill is determined based on the difference between the purchase price and the fair market value of the assets, liabilities and contingent liabilities acquired or assumed. Goodwill is not amortized but is subject to annual impairment test. Negative goodwill is recognized as income immediately. The general rules do not apply to certain business combinations such as transactions between companies under common control.

## Equity method of accounting and consolidation

Under the equity method of accounting, a company is required to record an original investment in the equity of another entity at cost, which is thereafter periodically adjusted to recognize the investor's share of the investee's earnings or losses after the date of original investment.

Under Brazilian GAAP, a Brazilian parent company is required to use the equity method of accounting to record investments in its subsidiaries (companies that are controlled by the parent company) and its associates (companies in which the parent company owns at least 10 per cent of the issued share capital without controlling it) over whose management it exerts influence or in which it owns 20 per cent more of the voting capital, if the aggregate book value of all such investments is equal to or greater than 15 per cent of the stockholders' equity of the parent company or if the book value of an investment in any single subsidiary or associate is equal to or greater than 10 per cent of the stockholders' equity of the parent company.

If the parent company is listed with the CVM, it is required to prepare consolidated financial statement if the aggregate book value of the subsidiaries exceeds 30 per cent of stockholders' equity of the parent company. Jointly-controlled subsidiaries and joint-ventures are accounted for using the proportional consolidation method.

IFRS is similar to Brazilian GAAP in relation to associates. All subsidiaries are required to be consolidated, and thus companies are required to prepare consolidated financial statements. IFRS considers potential voting rights when assessing whether an investee meets the definition of an associate or a subsidiary. Under IFRS, jointly-controlled subsidiaries and joint-ventures are accounted for using the proportional consolidation method or equity method.

## Discounting

Brazilian GAAP does not generally require long-term receivables and non-debt related long-term liabilities to be discounted to their net present value as at the balance sheet date.

IFRS requires such discounting to eliminate the effects of implicit interest income or expense.

## Related parties

Brazilian standards define related parties in a more limited manner and require fewer disclosures than IFRS. As a result, many of the disclosures required by the IFRS are not required under Brazilian GAAP.

## Employee pension costs and other benefits

Under Brazilian GAAP, in general the accounting for employee pension costs and other benefits is similar to IFRS. The disclosures required with respect to employee pensions and benefits are more detailed under IFRS than under Brazilian GAAP.

## Share-based payment

There is no guidance under Brazilian GAAP for share-based payment. Usually share-based payment programs are treated off-books and recognized in the balance sheet or income statement when it is settled.

Under IFRS, transactions involving share-based payments are recognized as assets or expenses, as appropriate. These transactions are measured at fair value.

## Income taxes

The methods adopted for the recording of income taxes under Brazilian and IFRS are similar in substance. Practical application may lead to different results in certain circumstances. For instance, IFRS has an exception for differences between tax base and carrying amounts generated upon the initial recognition of an asset, which does not exist under Brazilian GAAP. Also, under Brazilian GAAP, deferred tax shall not be recognized for differences generated in revaluations of land.

## Leasing

Under Brazilian GAAP, all leases are treated by lessees as operating leases, and the expense is recognized on an accrual basis. Under IFRS the treatment of leases is governed by IAS 17, and lease capitalization may be required if certain conditions are met.

## Tax incentive investments

These investments, approved by the government in underdeveloped regions of Brazil or in specific projects, may be acquired without additional cost upon the payment of income taxes. Under Brazilian GAAP the investment is recorded as an asset, with a corresponding credit to a reserve in stockholders' equity. Under IFRS, the credit would be made to income immediately or later, depending on the situation. Also, under IFRS, if the underlying value of the investment is uncertain, a provision would be made accordingly.

## Prior period adjustments

Under Brazilian GAAP, the cumulative effect of errors and changes in accounting principles are generally applied as an adjustment to the current year's opening retained earnings. Brazilian GAAP does not

permit restatement of previous financial statements to provide consistency in reporting.

Restatement of financial statements to correct errors is required under IFRS, if practicable.

## Extraordinary items

Under Brazilian GAAP, extraordinary items may be disclosed separately in the income statement, normally gross of the income tax effect.

The use and classification of transactions as extraordinary items are prohibited under IFRS.

## Earnings per share

Under Brazilian GAAP disclosure of earnings per share is required for all companies, regardless of whether their shares are publicly traded. Earnings per share is computed based on the number of shares outstanding at the end of the year.

Under IFRS, the earnings per share calculation is based on the weighted average number of shares outstanding during the period, taking into account common stock equivalents, and may have to be prepared both on a basic and diluted basis. Only listed companies are required to present such information.

## Financial instruments

Under Brazilian GAAP, except at financial institutions, financial instruments are not marked-to-market, and limited disclosure of additional information is required. Financial institutions, however, are required to mark most of the financial instruments to market.

Under IFRS, the applicable accounting practice for financial instruments depends on management's intention and may require adjustments to their market or fair values. Management have to classify these financial instruments within certain categories. This classification will drive measurement. Also, IFRS, more precisely IAS 32 and IAS 39, require more detailed disclosures.

Segregation between equity and financial liability under Brazilian GAAP is based on the form of the instrument. Under IFRS this segregation is based on the substance.

There is no guidance on hedge accounting in Brazilian GAAP, except for financial institutions. When a financial instrument has been identified as a hedge, it is usually carried at amortized cost. Under IFRS there are very restrictive rules to achieve hedge accounting. Hedge accounting usually leads the hedged item to be carried at fair value.

## Biological assets

There are no specific Brazilian GAAP standards on biological assets. In practice these assets are usually carried at historical cost. Under IFRS these assets are carried at fair value.

## Statement of cash flows

Under Brazilian GAAP, companies must present a statement of changes in financial position, which depicts the source and application of funds in terms of movement in working capital. The presentation of a cash flow statement as supplementary information is allowed.

Under IFRS, the presentation of a statement of cash flows describing the cash flows provided by or used in operating, investing and financing activities is required.

## Financial statement note disclosure

Brazilian GAAP, in general, requires less information to be disclosed in financial statement footnotes than IFRS. Disclosures required under IFRS but not typically found in Brazilian GAAP financial statements include, but are not limited to, the following:

- Off-balance sheet risks and commitments, concentration of credit risk and major customers.
- Information concerning the fair value of financial instruments.
- Analysis of sales by nature.
- Segment data.

## Form and content of financial statements

### Basic financial statements

Particular emphasis is placed on the accounting aspects of the annual financial statements. They must clearly define the equity position and any changes during the year, and include comparative figures for the preceding year.

The basic components of the annual financial statements are as follows:

- Directors' report (not necessary for limitadas).
- Balance sheet.
- Statement of income (profit and loss account).

- Statement of changes in shareholders' equity, including changes in retained earnings or accumulated losses.
- Statement of changes in financial position (source and application of funds).
- Explanatory notes to the financial statements.

The directors' report must contain the minimum contents indicated in the corporate legislation, but there is a growing tendency to give much greater detail. However, in practice, only listed companies present a reasonable level of information.

The financial statements of corporations (including banking and financial institutions), both listed and closely-held, must be published in a major Brazilian newspaper. The financial statements of limitadas generally are not required to be published.

## Balance sheet

The balance sheet differs from international standards only in that property, plant and equipment, long-term investments, and deferred charges must be classified under the general heading of permanent assets. Deferred tax assets or liabilities may be presented as current or non-current, depending on the expected realization.

Assets and liabilities must be shown in order of liquidity.

## Statement of income

This statement should disclose at least the following.

- Gross sales and services rendered.
- Sales deductions, discounts and taxes in sales.

- Net sales and services rendered.
- Cost of sales and services rendered.
- Gross profit (loss).
- Selling, general, administrative, financial, and other operating expenses.
- Operating (loss).
- Non-operating income and expenses.
- Income before income tax.
- Provision for income tax.
- Statutory participations in profits.
- Contributions to employee pension and welfare funds.
- Net income (loss) for the year.
- Net income (loss) per share.

## Shareholders' equity

In the shareholders' equity section of the balance sheet, unpaid capital must be shown as a deduction from the total capital subscribed. Details of each class of share should be given in an explanatory note to the financial statements. Capital must also be subdivided in the balance sheet between local and foreign capital.

Capital in excess of par should be shown as a capital reserve, together with the following.

- Share premiums, including those arising from the conversion of debentures and profit participation rights, and the unallocated part of the issue price of shares with no par value.
- Proceeds from the sale of profit participation rights and stock options.
- Premiums received from the issue of debentures.
- Donations and subventions for investment.

Stock dividends must be recorded with a credit to the share capital account in the amount agreed by the shareholders in general meeting, with a corresponding debit to the capital reserves, revenue reserves, and retained earnings that were capitalized. Details of splits and changes in the number of shares must be disclosed in the explanatory notes to the financial statements.

Treasury stock must be shown in the balance sheet as a deduction from the equity account related to its acquisition.

## Valuation of assets

All assets, except those classified as permanent assets, i.e., property, plant and equipment, long-term investments and deferred charges, should be stated at realizable values or the lower of cost or market. Permanent assets and related depreciation, amortization and depletion are recorded at historical cost. Up to December 31, 1995 the permanent assets, depreciation, amortization and depletion were indexed because of high inflation. However, as from January 1, 1996, with lower inflation rates, indexation has been abolished. The equity basis of accounting is mandatory for significant investments in subsidiary and associated companies.

Specific guidance is given as to the treatment of the following items.

### Inventories

The LIFO method of inventory valuation is not acceptable for tax purposes and, therefore, accounting purposes. When applying the cost-or-market test to inventories of raw materials and supplies, market is deemed to be replacement cost. In the case of work-in-progress, finished products and goods purchased for resale, market is deemed to be the net sales proceeds, less all direct taxes and selling expenses and, optionally, a profit margin. Commodities may be valued at market prices where this is the industry practice. There must be conformity between book and tax reporting of inventories.

### Long-term investments

Investments in subsidiary and associate companies must be adjusted on the equity accounting method, provided the investment is significant. This adjustment is taken to income.

Investments in subsidiaries are defined as those in which the investor, either directly or indirectly, can exercise a permanent predominant influence in shareholders' meetings and has the right to appoint the majority of the officers. An associate company is one in which the investor holds 20 percent or more of the voting capital without controlling it.

To be significant, an investment in a subsidiary or associate company must equal or exceed 10 percent of the investor's equity, or 15 percent in the case of investments in various related subsidiary and associate companies. In determining whether a particular investment meets the significance test, all advances to and accounts receivable from subsidiaries and associate companies must be added to the cost of the investment. The underlying equity value of an investment must be based on a balance sheet or trial balance as of the same date or, at most, 60 days prior to the investor's own balance sheet. In computing such equity, unrealized profits of the investee with respect to transactions with the investor or other associates must be eliminated.

The difference between the underlying equity value and the carrying value of the investment must be reported as an equity gain or loss for the year, which is not considered for tax purposes, provided the following conditions prevail:

- It is attributable to profits and losses of the investee.
- It is attributable to real and proved gains or losses.
- It falls within the criteria laid down by the Securities Commission (for listed companies and banks only).

Cash dividends derived from investments accounted for on the equity basis must be deducted from the investment account if they are declared out of prior years' earnings.

- **Property, plant and equipment**

Reductions in the carrying value of property, plant and equipment, including buildings, must be registered periodically, using the following accounts.

Depreciation: Provisions, generally on the straight-line basis, should represent the distribution of the cost incurred, plus any appraisal increment over the useful life of the related assets.

Additional provision should be made to account for the effects of nature, obsolescence or impairment. In practice most companies adopt the depreciation rates established for tax purposes (see Appendix II).

Amortization: Expenditure incurred in acquiring patents, trademarks, etc., and other rights having a limited life or duration period, such as leased property and improvements thereto, must be amortized over the life of the related asset.

Depletion: In order to record the reduction in value of rights or tangible assets resulting from the exploitation of mineral or forest reserves, depletion allowances are calculated on the basis of the proportion that annual production bears to estimated total reserves or the duration of the concession.

- **Deferred charges**

Deferred charges must be amortized over a period of up to ten years from the commencement of operations or from the year in which benefits from the expenditure begin. Deferred charges must be written off when the related business or activity is abandoned or when it is established that the activity will not be able to generate sufficient income to absorb the amortization.

- **Investment incentives**

Investment incentives must be recorded at the lower of cost or market.

## Purchase of another business

When a new investment is made and it qualified for the equity method, the investor must allocate and record the purchase price as follows:

- Underlying book net worth at date of acquisition.
- Goodwill, or negative goodwill, which should be analyzed and attributed to one or more of the following factors:
  - Difference between book and market value of assets acquired;
  - Estimated present value of future income streams;
  - Other factors.

Goodwill must be amortized to the extent that the underlying assets are depreciated or amortized in the books of the acquired company or as the events to which it relates occur.

## Consolidation

A listed company with investments in subsidiaries that exceed 30 percent of its net worth must present consolidated financial statements in addition to its own individual financial statements. Groups of companies, as defined in the legislation, are also required to present consolidated financial statements, as well as the financial statements of each company within the group. A controlling company's interest in net worth and net income of the period must be disclosed in the consolidated balance sheet and statement of income, respectively.

The excess of the cost of shares in a subsidiary or associated company over their proportionate underlying book equity value must be classified as a permanent asset. Such excess represents goodwill that must be explained in a note to the financial statements. Should the underlying equity value of an acquired investment exceed its cost, the difference may be classified separately as part of deferred income until the gain is realized.

Financial statements included in consolidation should be prepared using uniform accounting principles and as of similar dates. When there is more than a 60-day differential between the balance sheet dates, a special closing must be made for consolidation purposes.

Closely-held companies and limitadas are not required to prepare consolidated financial statements.

## Provisions and reserves

There is a basic requirement that provisions be made for all known liabilities and losses, if the amount thereof can be reasonably estimated. In general, expenses should be provided for on the basis of economic necessity and not on the basis of incentives or facilities contained in income tax legislation. Income tax must be provided currently and interperiod allocation of income tax should be made. The law also provides for the recording of contingency provisions, current or long term, but these are not deductible for income tax purposes.

Proposed profit distributions should be recorded for subsequent approval by the shareholders in the annual general meeting. Dividends proposed after the balance sheet date but before the financial statements are approved for publication are accounted for as an adjusting event and thus considered in the balance sheet as an obligation.

Corporate law makes a distinction between capital, revaluation and revenue reserves as follows.

- **Capital reserves**

Capital reserves can be used only to do the following:

- Absorb losses in excess of the total of retained earnings and revenue reserves.
- Redeem or purchase a company's own shares.
- Redeem profit participation rights.
- Increase capital.
- Pay cumulative dividends on preferred shares in years in which profits are insufficient, if this is provided for in the bylaws.

- **Revaluation reserve**

The revaluation reserve comprises increments arising from revaluations of property, plant and equipment based on independent appraisals approved by shareholders. The reserve is reversed to retained earnings as the corresponding assets are realized through depreciation or on sale or disposal.

- **Revenue reserves**

Revenue reserves comprise the following:

- **Legal reserve**

Formed by the annual appropriation of 5 percent of net income until the reserve reaches 20 percent of share capital. Appropriation need not be made if the sum of the legal reserve plus capital reserves exceeds 30 percent of share capital. The legal reserve may be used only to absorb losses or to increase capital. It is not required in the case of limitadas.

- **Statutory reserves:**

All other reserves prescribed in the bylaws.

- **Reserve for contingencies:**

For qualified probable losses expected to be incurred in a future year for which amounts can be reasonably estimated.

- **Reserve for investment projects:**

Must be made by appropriation from retained earnings and supported by a capital expenditure budget previously approved by a general shareholders' meeting. Such budget should cover all sources of funds and their application in both fixed and current assets. These budgets can be for a period of up to five years, or longer for large investment projects.

- **Reserve for unrealized profits:**

The following amounts included in current net income may be appropriated to a reserve for unrealized profits:

- Equity adjustment of investments in subsidiary and associate companies.
- Profits from long-term sales, to the extent that the related installments are classifiable as long-term receivables.

For S.A. companies only, the total of all revenue reserves, excluding reserves for contingencies and unrealized profits, may not exceed the capital stock. Should this occur, the shareholders in a general meeting must decide on capitalization or distribution of the excess.

- **Lease expenses**

Installments payable under lease agreements are expensed, even when of a capital nature.

- **Research and development costs**

Research and development costs may be carried as a deferred charge or taken to income, but deferral is the more common practice.

- **Disclosure requirements**

### Accounts (footnote) disclosure

Corporate law and Brazilian GAAP require financial statements to be accompanied by such explanatory notes and analytical exhibits as are necessary to clarify the financial position and results of operations. The actual information contained in the notes will vary depending on the nature of operations, but would normally include the following:

- Summary of significant accounting principles, such as the basis of consolidation, method of revenue recognition, and the bases used to value inventories, provide for depreciation, amortization and depletion and make adjustments to cover expected losses on disposal of assets.
- Details of significant investments in other companies and related-party transactions.
- Increases in the carrying value of property, plant and equipment as a result of revaluations.
- Details of inventories, property, plant and equipment and long-term receivables and borrowings.
- Deferred income tax and details of tax loss carry forwards.
- Pledges on assets, guarantees given to third parties, other contingent liabilities and significant commitments.
- Interest rates, maturity dates and guarantees given for long-term loans.
- The number, type and classes of shares.
- Stock options granted and exercised during the year.
- Prior-year adjustments.
- Significant events subsequent to the balance sheet date.

A general description of the company, including the nature of operations and the principal subsidiaries, is generally given in the first note.

Currently, there is no requirement to disclose segment information.

## Recording of income

The normal accounting period is one year. The corporate accounting year must be established in the bylaws and may or may not correspond to the calendar year. However, for income tax purposes, financial statements must be prepared as of December 31 of each year and consequently most companies close as of this date.

Listed companies with annual sales greater than R\$ 100 million and financial institutions are generally required to prepare and file quarterly information with the Securities Commission or the Central Bank.

The accrual basis of accounting is followed in the preparation of financial statements. Revenue is recognized when the earning activity is complete and the amount and collectibility are reasonably assured. Costs are accrued in the same period as the related revenue, provided their relationship can be reasonably established.

## Book and tax differences

Tax legislation recognizes the existence of differences between book and tax amounts. There is a basic requirement in tax legislation that accounting profit be drawn up in accordance with corporate law. The differences between the book and tax treatment of income and expenses are recorded in a special official book (LALUR).

## Trend towards convergence with IFRS

Recent Brazilian accounting standards have been prepared based on similar standards in IFRS but only to the extent that these standards do not conflict with the 1976 Corporation Law. A more comprehensive convergence between Brazilian GAAP and IFRS will be possible only through the passage of new legislation by the Brazilian Congress.

# Chapter 13 Tax system

## Investor considerations

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

## Principal taxes

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

Federal:

- Income tax (IR);
- Corporate social contribution net income (CSLL);

- Excise tax (IPI);
- Import tax (II);
- Export tax (IE)
- Financial operations tax (IOF);
- Tax on financial transactions (CPMF)
- Corporate social contribution on billings (COFINS);
- Corporate contribution to the Social Integration Program (PIS/PASEP);
- Contribution to the Economic Intervention Domain (CIDE);
- Rural property tax (ITR).

State:

- Value-added tax on sales and services (ICMS);
- Bequeath and gift transfer tax (ITCMD);
- Automobile tax (IPVA).

Municipal:

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

Details of the principal indirect taxes are given in Chapter 22.

## Tax guarantees

Under the Brazilian tax system, tax guarantees do not exist.

## Legislative framework

### Statute law

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

The interpretative duties of the Ministry of Finance and SRF range from the general to the specific. Regulations are written in broad, general terms to explain and illustrate the provisions of the CTN. On the other hand, revenue rulings interpret the CTN only with respect to specific facts. Revenue procedures are issued to announce administrative practices that the SRF follows. The SRF uses normative rulings ("pareceres normativos") to disseminate important technical information on specific issues.

### Case law

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

Records of discussions in the legislative, as well as leading professional and academic opinions, are important sources of interpretation. Opinions issued by persons of high professional reputation give useful help toward developing arguments in support of specific cases, mainly in contentious areas.

### Antiavoidance

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

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

## Form versus substance

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

## Clearance procedures

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

## Income tax

### Concepts of income taxation

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

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

For individual taxpayers the progressive rates of income tax are 0, 15, and 27,5 percent (see Appendix VI for details).

## Social Contribution on Net Profits

The Social Contribution on Net Profits (CSL) was created with the purpose of financing Social Security System. This contribution is levied at the tax rate of 9% on the net profits of the fiscal year, before some legal adjustments (additions and exclusions).

## Classes of taxpayer

The main groups of taxpayers are.

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

## Taxable income

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

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

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

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

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

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

## Tax year

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

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

## Tax-free zones

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

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

## Tax holidays

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

## Capital taxation

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

### Companies

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

### Individuals

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

## International aspects

### Foreign operations

Brazilian resident companies are taxed on worldwide income. Foreign branch profits are taxed as earned and foreign subsidiary profits are taxed when distributed or made available. Double taxation is avoided by means of foreign tax credits.

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

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

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

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

### International financial center operations

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

# Chapter 14 Tax administration

## Investor considerations

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

## Administration of the tax system

The income tax laws were consolidated by Decree 3.000/99 (Regulamento do Imposto de Renda). The federal government department responsible for income tax administration is the Secretaria da Receita Federal (SRF - Federal Revenue Service) under the Ministry of Finance, with branches in all states and major cities. The SRF is also responsible for the enforcement of the law, including collection of taxes, performance of audits and advocacy in tax disputes leading to litigation. Supplementary regulations are frequently issued by the tax authorities through ordinances, instructions and normative rulings.

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

## Corporate taxpayers

### Tax returns

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

In the case of late filing, a penalty limited to 20% of the tax due may be charged. If the tax is not paid on time, there is also a penalty limited to 20% of the tax, and interest based on a rate established by the Brazilian Central Bank (known as the SELIC), provided the authorities have not already issued their own assessment, in which case the penalty would be increased to 75 percent.

A company's tax returns must be signed by a professionally qualified accountant, who need not be independent. Many companies submit their tax returns for the review of professional consultants before filing them with the authorities.

It is not required to attach financial statements or other data, either audited or unaudited.

Supporting documentation must be retained for at least five years.

### Assessments

Corporate income tax is self-assessed and returns must be filed at the place of domicile of the taxpayer. At the time of filing, all tax returns are subject to a summary check of the tax calculation and of the deductions taken. Later on they may be subject to audit. Tax is deemed assessed at the moment the return is filed. Provisional assessments are not made.

The authorities may assess taxes when the following events occur.

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

### Appeals

Upon receiving any additional assessment notification, a taxpayer has 30 days in which to file an appeal with the local branch of the SRF. This first appeal is submitted to the same authority who issued the additional assessment. In the event of an unfavorable decision, a second appeal may be made to the Taxpayers' Council (Conselho de Contribuintes), a federal administrative tax court in Brasília, whose decision normally terminates the administrative process. Thereafter, a taxpayer may enter into judicial proceedings to contest the assessment, or in some cases, file an appeal with the Superior or Supreme Courts.

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

## Payment and collection

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

Self-assessments are based on the monthly or quarterly tax returns as filed. Tax due at the end of each month must be paid by the last day of the following month. Alternatively, tax due at the end of each quarter is paid at the end of the subsequent month.

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

Any tax due based on the annual tax return would be payable at the end of January.

## Withholding taxes

Withholding tax rates are set out in Appendix IV. Withholding taxes, including those on employees' wages and salaries, are normally payable within three days after the date the income is considered to be at the disposal of the recipient or on the same day. Such withholding tax is the responsibility of the employer or the payer.

## Tax audits

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

No corporate entity, whether a taxpayer or not, is excused from furnishing information or explanations required by the tax authorities. Furthermore, in given circumstances, government agencies and other entities are obliged to disclose information to them. This applies in the case of banks and other financial institutions, notaries, stock exchanges, unions, insurance companies and companies paying copyright fees.

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

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

## Penalties

Where irregularities are discovered as a result of audits by the tax authorities, a fine ranging from 75% to 225% of the tax due is imposed.

These fines are computed on the amount of the tax liability but may be reduced by one-half if the taxpayer does not contest the claim and pays within the required period, which is normally 30 days. Some irregularities are considered to be of a criminal nature. Prison sentences may be given.

Interest on the amount of tax in arrears is payable based on a the SELIC rate, which is presently around 1 percent, together with a fine of 0,33% per day with a limit of 20%.

When overdue taxes have been negotiated with the tax authorities to be paid in installments and an installment is not paid before the next one matures, the balance of the tax payable, including installments not yet due, will be considered as payable immediately.

## Statute of limitations

The tax authorities may generally audit taxpayers up to five years after the close of the tax year. Assessments may be made only as a result of tax audits initiated, but not necessarily terminated, within five years from the date on which the return was filed. With respect to claims for refund, a taxpayer normally must file for a refund within five years from the time the return was filed.

## Individual taxpayers

Personal income tax is also self-assessed and tax returns are filed in April by individuals domiciled or resident in Brazil. Filings are normally made at authorized banks, at the post, via telephone or via Internet. Since individual income tax is due and payable monthly the annual return generally accounts for only minor tax adjustments, but it also serves to list personal assets and liabilities.

Most income items and capital gains of an individual are taxed at source monthly. However individuals receiving income or gains not subject to Brazilian withholding tax (e.g. alimony, pensions, rental income from individuals, non-Brazilian-source income, capital gains on the sale of personal properties) must also make special monthly filings (the *carnê-leão*) and any income tax due must be paid by the last working day of the subsequent month. The tax is calculated using the normal tax table.

In addition to basic information on taxable income, the taxpayer is required to declare details of personal assets and liabilities at the beginning and end of the tax year and provide explanations as to changes in certain assets and liabilities. This declaration should include assets held both in Brazil and abroad and cover such items as real estate, securities, accounts receivable, vehicles, bank balances, jewelry, precious stones and metals, loans and mortgages, i.e., all property of intrinsic value, excluding household effects and personal

clothing. Unexplained increases in an individual's net worth may result in the issue of arbitrary tax assessments on the unexplained increase.

Employers are required to furnish employees with a certificate of remuneration earned and taxes withheld in the year.

Penalties for noncompliance and the procedures for tax audits and appeals are the same as for corporate taxpayers. It should be noted that, in the case of disguised profit distributions (see "Nondeductible items" in Chapter 15), the responsibility for both taxes and fines due by the corporate taxpayer rests with the individual beneficiary of such distributions.

## Community property/Spouse

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

However, a jointly tax return is also permitted. In it the individual includes all income and therefore, the income is taxed jointly, as a single person. The head of the household may, accordingly, treat the other spouse as dependent. Moreover, even if a dependent receives taxable income but is not obliged to fill in a tax return, it can still be treated as a dependent for tax purposes.

## Foreign personnel

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

## Exit permits

A foreigner who leaves the country permanently is required to obtain tax clearance. This permits official repatriation of funds and the sending back of other assets. At such time, the authorities require the foreigner's identity card to be returned. This in effect removes the right to remain and work in the country and terminates the foreigner's Brazilian income tax obligations. A Brazilian leaving the country on a permanent basis must also obtain tax clearance.

## Trusts, partnerships and joint ventures

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

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

# Chapter 15 Taxation of corporations

## Investor considerations

- Corporate income tax is calculated and paid monthly or quarterly on the basis of worldwide taxable income.
- There is a surcharge on taxable income over a certain level.
- There is no distinction in terms of tax burden between local and foreign-owned companies.
- Dividends distributed to resident or non-resident beneficiaries (individuals and/or corporate entities) are generally not subject to withholding income tax.
- Dividend payments are not tax deductible by the distributor.
- Dividends received are excluded from taxable income.
- Interest may be paid to shareholders based on a company's net equity and is deductible for income tax purposes.
- Interest paid on loans from foreign shareholders is fully deductible for tax purposes on the accrual basis provided that the loan contract is registered with the Brazilian Central Bank, and in case the loan contract is not registered with the Brazilian Central Bank, the interest paid will be deductible limited to the amounts not exceeding the values calculated through the application of the 6 months Libor plus 3 percent spread, proportionally to the periods to be paid/calculated.
- Exchange losses on foreign loans may be deducted on the accrual basis. Although the taxpayer may elect to recognize the exchange gain/loss when realized.
- Intercompany transactions are subject to transfer pricing rules
- There are no specified debt/equity ratios except for financial institutions.
- Consolidated tax returns are not permitted.
- Books must be kept on the accrual basis.

## Corporate tax system

### Corporations and shareholders

Corporate net income is taxed at the corporate level. Dividends paid out of profits generated as from January 1, 1996 are not subject to Brazilian withholding income tax.

## Taxable entities

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

## Territoriality

A corporation is considered resident in Brazil if it has been incorporated in Brazil and its tax domicile is where its head office is located.

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

## Gross income

### Accounting period

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

## Accounting methods

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

## Business profits

Business profits for tax purposes are computed on the basis of net income as reported in the statement of income (profit and loss account), adjusted for nontaxable income and nondeductible expenses.

## Intercompany transactions

### Transfer Pricing Rules

According to Law 9.430/96 and subsequent regulation, transfer pricing is the price admitted by the tax authorities as deductible or admissible in the operations between related parties resident and domiciled, one in Brazil and the other abroad.

Therefore, any operation, involving goods, rights, services and interests on financial transactions, to or from referred related parties are subject to one of the methods indicated in the mentioned legislation as per the information summarized below (the company may chose the most convenient method):

- **Methods used on import transactions:**

- I **Comparable Independent Price Method (PIC):**

This Brazilian equivalent of the Comparable Uncontrolled Price (CUP) Method is defined as the average price for the year of identical or similar property, services or intangible rights obtained either in Brazil or abroad in buy-sell transactions using similar payment terms. For this purpose, only buy-sell transactions conducted by unrelated persons may be used.

- II **Resale Price Less profit Method (PRL):**

This Brazilian equivalent of the Resale Price Method is defined as the average price for the year of the resale of property, services or intangible rights minus unconditional discounts, taxes and contributions on sales, commissions and a gross profit margin of 20%. If value is added before resale, the margin profit is increased to 60%, calculated based on the resale price (less unconditional discounts). In applying the PRL, a Brazilian taxpayer may use its own prices (wholesale or retail) established with unrelated persons.

- III **Production Cost Plus Profit Method (CPL):**

This Brazilian equivalent of the Cost Plus Method is defined as the average direct cost incurred for the year to produce identical or similar property, services or rights in the country where they were originally produced, increased for taxes and duties imposed by that country on exportation plus a gross profit margin of 20%, calculated based on the obtained cost.

The amounts paid by the company, which exceeds the amount calculated on the methods above, will be considerable as a non-deductible expense for income tax and corporate social contribution.

- **Methods used in export transactions**

Primarily, the revenue accrued by companies in exportation to related parties are subject to transfer pricing methods if their average price is less than 90% of the transactions effected with the same goods or services in the Brazilian market

- I **Export Sales Price Method (PVEx):**

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

- II **Resale Price Method**

The Brazilian version of the Resale Price Method for export transactions are defined as the average price of identical or similar property, services or intangible rights in the country of destination under similar payment terms reduced by the taxes included in the price imposed by that country and a profit margin of either:

- 15%, calculated by reference to the wholesale price in the country of destination (Wholesale Price in Country of Destination less Profit Method, or "PVA"); or
- 30%, calculated by reference to the retail price in the country of destination (Retail Price in Country of Destination less Profit Method, or "PVV").

### III- Acquisition or Production Cost Plus Taxes and Profit Method (CAP):

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

In the event that the value of the exports, determined using any of the methods above, are less than the sales price contained in the export documents, the amount of the revenues recognized by the exporting company will be based on the price stated in such documents.

On the other hand, if the value determined by any these methods is greater than that reported by the company, the excess must be recognized by the export company as income.

Accordingly, the company may evidence the transfer price practiced for the exports during the same period exclusively with the documents relating to the sales (safe harbor) in the following conditions:

- a) if net income derived from export sales to related foreign persons, excluding companies in low tax jurisdictions, is at least 5% of the revenue from such sales (please note that as per recent legislation, the taxpayer has to demonstrate an average net income of 5% for export sales to related parties (before income tax and social contribution), taking into account the current year and the two preceding years; or
- b) if net revenue from exports does not exceed in any calendar year 5% of total net revenue in the same period.

#### Divergence Margin

For inter-company import and export transactions, even if actual transfer price is above or below of the accordingly determined transfer pricing, no adjustment should be required as long as actual transfer

price does not differ from the determined Brazilian transfer price by more or less than 5 percent.

- **Interest on loans**

In relation to interest on loans, the transfer pricing legislation applies if there is no registration of the loan contract between related companies (one domiciled in Brazil another abroad) with the Brazilian Central Bank (BACEN).

Under this scenario, interest paid or credited will only be deductible, for income tax and social contribution on profits purposes, up to the amount not exceeding the amount calculated based on the LIBOR rate for U.S. dollar six-month deposits plus a 3% annual spread. In turn, the company domiciled in Brazil must recognize at the minimum as financial income the amount based on the referred limit.

### Inventory valuation

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

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

There must be conformity between book and tax reporting.

## Capital gains/losses

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

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

## Financial income

Financial income will be taxed according to the following rates:

	Prepayment of income tax	Year End Calculation (income tax and social contribution tax)
Net capital gains on equity trades in the stock exchange market	15%	Income: 34%  Losses: carried forward to be compensated in future years with gains of the same nature.
Net capital gains on futures, options or forwards, traded in the Futures Stock and Commodities Exchange, similar markets; or capital gains on flexible options, out of the exchanges	22,5% = application period <180 days 20% = 181 < application period <360 days 17,5% = 361 < application period <720 days 15% = application period >721 days	Income: 34%  Losses: carried forward to be compensated in future years with gains of the same nature.
Investment in Variable Investment Funds	15%	Income: 34%  Losses: tax deductible

Swap Transactions	22,5% = application period <180 days 20% = 181 < application period < 360 days 17,5% = 361 < application period < 720 days 15% = application period > 721 days  (for contracts signed before 12/31/2004 = 20%)	Income: 34%  Losses: tax deductible under certain conditions
Capital gains and interest in fixed income investments including fixed income investment funds, which funds portfolio medium term is inferior to 360 days	22,5% = application period <180 days 20% = 181 < application period < 360 days	Income: 34%  Losses: tax deductible
Day Trade	20%	Income: 34%  Losses: tax deductible
Capital gains and interest in fixed income investments including fixed income investment funds, which medium term is superior to 360 days	22,5% = application period <180 days 20% = 181 < application period < 360 days 17,5% = 361 < application period < 720 days 15% = application period > 721 days	Income: 34%  Losses: tax deductible

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

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

Please note that financial income shall not be taxed by PIS/PASEP and COFINS in case the legal entity has adopted the non-cumulative form of application of said contributions. Nevertheless, income from

hedge operations and from interest on net equity, shall be taxed by PIS/PASEP and COFINS at the rates of 1.65% and 7.6%, respectively.

On the other hand, legal entities taxed by the cumulative form of the PIS/PASEP and the COFINS shall subject all financial income to taxation at the rates of 0.65% and 3%.

Please note that in case of financial institutions, taxation may differ.

## Interest

Interest income is taxable on the accrual basis.

## Dividends/Intercompany dividends

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

## Stock dividends

Stock dividend distributions are not subject to withholding tax or to corporate income tax in the hands of the receiver.

## Dividends-in-kind

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

## Royalties and service fees

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

## Exchange gains and losses

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

## Nontaxable income

The following types of income are nontaxable for corporations ("Sociedades Anônimas"), however, except for the first one, it must be taken to a capital reserve.

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

## Deductions

### Business expenses

In general, all ordinary and necessary expenses paid or incurred in conducting the business are deductible. Minor expenditures on capital assets or any expenditure on capital assets with a useful life of less than one year are also deductible. Territorial limits are not in themselves a factor in determining the deductibility of expenses. There are no prohibitions against payments to affiliates if they reflect an arm's-length charge but an exception could be made for those that might be imposed by exchange control regulations. Such payments may be subject to Transfer Pricing rules (see "Nondeductible items" below).

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

## Depreciation and amortization

Except for land, which is not depreciable, depreciation of property, plant and equipment is an allowable deduction. The regulations do not establish depreciation methods, but the annual straight-line rates listed in Appendix II can be considered as normally acceptable. However, in special cases, when the rates listed do not reflect the real depreciation period it is possible to obtain different rates provided that evidences of incompatibility of rates are presented, such as reports prepared by specialized technical entities. Allowable depreciation for tax purposes must be booked, except in certain tax- incentive circumstances. However if assets are not utilized in the production or sale of products or services, depreciation or amortization thereof would not be deductible for tax purposes.

Amortization of goodwill that arises as a result of accounting for investments in subsidiary and associated companies by the equity method is deferred for taxation purposes until such time as the related investment is realized.

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

In certain situations goodwill paid upon the acquisition of the shares of a company may be amortized.

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

These expenses may be deferred and amortized on the straight-line basis over a period of not less than five years, beginning with the month in which the business starts operating.

## Leasing agreements

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

## Depletion

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

## Interest and financial charges

All interest and financial charges paid or accrued during the taxable year are generally deductible, including those paid or accrued to an affiliated company, local or foreign. On foreign loans, interest credited to the beneficiary is generally subject to payment of 15 percent withholding tax at source. Interest on financing of property, plant and equipment incurred in the pre-operational stages of a business venture may be deferred for future amortization, and, for income tax purposes, normally should be so deferred. There are no "thin capitalization" rules under which debt is treated as equity and thus interest as dividends.

## Interest on net equity

As from January 1996, companies can pay interest to share/quotaholders based on the amount of the company's net equity. Such interest, which may not exceed 50% of the annual profits or retained earnings, is deductible for income tax purposes and for corporate social contribution purposes and is generally subject to 15% withholding tax. It is calculated on the pro rata tempore basis and up to a given rate known as the long-term interest rate. For the first quarter of 2005 this rate is 9,75% percent per annum. Whenever the beneficiary is a corporate entity subject to normal income tax in Brazil, the tax withheld at source may be taken as a tax credit against the normal corporate income tax due or that due at source on distributions of interest. If the beneficiary is a Brazilian resident individual, such interest is not subject to further tax.

## Royalties and service fees

For tax deduction purposes, royalties, license fees, technical assistance and similar charges, together with amortization of patent costs, may not in total exceed certain percentages of net sales of the related products. The highest total charge is 5 percent, allowed to some industries. The maximum payment for the use of trademarks and trade names is 1 percent of the corresponding net sales. Formal agreements must be registered with the National Institution of Industrial Property (Instituto Nacional de Propriedade Industrial - INPI) in support of all such charges.

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

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

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

There is no withholding tax on royalties and service fees, etc., paid to resident parties, however, payments of royalties and technical assistance service fees to foreign companies, are subject to 15 percent withholding tax, or lower treaty rate. However, the Brazilian payer will be subject to the payment of the Contribution for the Intervention on the Economic Domain, at the rate of 10% on the amounts remitted. It should be noted that the said contribution is not creditable to the foreign party and is not subject to tax relieves. Please refer to transfer pricing rules relating to services paid to associated foreign companies.

## Employee remuneration

Employees' wages and salaries and related social security contributions are fully deductible and no restrictions or limitations apply specifically to foreign personnel. Monthly contributions to the Employees Severance Indemnity Fund (FGTS) are deductible, as well as expenses of group medical care and health insurance programs for employees, contributions to private supplementary pension schemes and meals supplied to all employees indistinctly. Schooling expenses of employees' children are deductible if this benefit is given to all employees or considered as a bonus.

Directors' and Officers' remuneration is also deductible, however payments made at the discretion of the employer will not be considered as remuneration, therefore non-deductible.

## Insurance premiums

There are no limits for income tax purposes. However, insurance cannot be placed with overseas companies unless specifically authorized by the government's agency which deals with the insurance industry. Self-insurance reserves are not deductible.

## Intercompany charges

In general, intercompany charges are deductible when they correspond to actual services rendered and to the extent they are deemed necessary. These must be established at arm's length. In the case of foreign associates, amounts paid are subject to exchange control regulations and transfer pricing rules.

It should be noted that charges by foreign associates for management, general and administrative expenses are subject to careful scrutiny by the Tax and Exchange Control authorities, and remittance permission may be refused.

## Travel and entertainment

Travel and entertainment expenses in general are deductible, provided they are documented and substantiated. However, meals of share/quotaholders and/or high level management are generally not deductible (see below under non-deductible items).

## Doubtful accounts receivable

Deductions relating to doubtful accounts receivable must follow specific procedures connected to value of credits, outstanding periods, whether there is a guarantee or not, the solvency situation of the debtor and the existence of judicial procedures. In general terms there is no problem relating to its deductibility, provided that full documentation is available.

## Taxes and contributions

All taxes (except corporate income tax and the social contribution on net income), compulsory contributions and related costs, such as arrears interest, are deductible for tax purposes on the accrual basis.

This rule does not apply to taxes/contributions being or to be challenged by the taxpayer at any level of litigation, which are deductible for tax purposes only on the cash basis. Also, taxes, rates and other charges on assets not-utilized in the production or sale of goods, products or services would not be deductible.

Withholding tax on income paid to nonresidents, which is assumed by the payer, is deductible if the underlying payment itself is deductible. Most tax/contribution penalties are not deductible.

## Charitable donations

Donations are deductible up to certain limits if recipients are registered as charitable institutions.

## Deferred compensation

Contributions to qualified deferred employee compensation plans are deductible, within limits, in the year of contribution.

## Repairs

Expenditure on repairs that result in an increase of more than one year in the estimated useful life of related assets is not deductible and should normally be capitalized in order to support future depreciation.

## Professional fees

Professional fees are deductible, subject to proof of effective supply of services.

## Advertising

Advertising is deductible on the accrual basis. The cost of free samples is not deductible.

## Research and development

At the option of the company, research and development expenditure may be deducted when incurred or deferred until termination of the project and then amortized over a period of not less than five years.

## Nondeductible items

As a general rule, except for the specific items listed immediately below, amounts paid or credited for the furtherance of business activities are deductible.

- Meals (food) expenses incurred or paid in favor of partners, share/quotaholders and high level management
- Non compulsory contributions and donations (with very few exceptions).
- Gifts in general.

Where the beneficiary or nature of a transaction is unidentified the related payments are also subject to a 35 percent withholding tax at source, which is in effect a penalty tax.

Disguised profit distributions are nondeductible expenses and are taxable income of the recipient. In general, disguised profit distributions arise as a result of the non-application of the arm's-length basis in transactions with shareholders (whether corporate entities or individuals), directors, officers and their relatives.

Provisions in general are not deductible except those for vacation pay and 13th month salary. The technical provisions of insurance and capitalization companies, however, are deductible under certain special conditions.

## Equity investments

Provisions for probable losses on realization of equity investments are not deductible

## Losses

Tax losses may be carried forward without any time limitation. However, tax loss offset is restricted to 30 percent of taxable income in each subsequent year. Loss for this purpose is defined as the accounting loss adjusted for tax purposes. Tax losses may not be carried back. Tax losses may be extinguished in certain instances such as a result of mergers and split-offs and may not be used by the survivor and/or successor.

Additionally, tax losses may be extinguished when a company undergoes simultaneously a change in control and its business activity.

Non operating losses may only be offset against profits of the same kind, up to the limit of 30 percent of such annual profits.

## Tax computation

### Net income

Taxable income is computed by adjusting net book income for nontaxable income and nondeductible expenses. A sample corporate tax computation is given in Appendix III.

### Tax rates

The single corporate federal income tax rate is 15 percent on taxable income, but there is a surcharge of 10 percent on annual taxable income above R\$ 240,000 ( approx. US\$ 100,000) (see Appendix I).

### Presumed profits

Corporate taxpayers with gross annual revenues not exceeding R\$ 48 million (approx US\$ 20 million) may opt to pay tax based on presumed profits. The normal tax rate of 15 percent is calculated on a percentage of monthly gross revenue after minor adjustments, and a surcharge of 10 percent on annual taxable income above R\$ 240,000 (approx. US\$ 100,000) is also applicable. For further details, see Appendix III.

The annual adjusting tax return for presumed profits must be filed at the same date the regular income tax return is due; normally at the end of June.

### Arbitrary profits

The Tax authorities may access tax based on arbitrary profits (profits discretionally assumed to exist) if a taxpayer fails to comply with the rules and regulations for keeping records and/or computing taxable

income. The taxable income basis would be arbitrated based on the company's activity presumed percentage of profits. Profits presumed percentages vary depending on the company's activity and range from 1.92 % to 38.4 % of gross monthly revenue. Tax so determined would then be increased by 20 percent (45 percent for financial institution). When the gross revenue is unknown, federal tax authority will utilize several other methods to determine taxable basis (e.g. based on last adjusted financial statements, adjusted capital amount and others).

### Tax credits

Foreign tax credits are available with certain limitations. There are no other specific tax credits.

### Consolidation - Group relief

Consolidated income tax returns are not permitted.

## Other taxes

### Social Contribution on Net Income

Monthly corporate net income before income tax after some deductions is subject to the social contribution on net income at the rate of 9 percent tax.

## Social Integration Program - PIS/PASEP

This contribution is levied at the rate of 1.65 percent on gross income, thus considered the sum of the total company's revenue, less taxes not grossed up on the sales invoice, such as Excise Tax - IPI, unconditional discounts canceled sales, goods and service exports revenue and other deductions legally established. However, companies can offset credits arising from the application of the same rate on the value paid on the acquisition of certain inputs. Companies subject to the Presumed Profit regime are subject to the rate of 0.65 percent, but can not offset credits. Special rates apply on specific sectors such as automotive industry, pharmaceuticals, beverage and petroleum products. The contribution is also levied on import transactions.

## Social Contribution on Billings - COFINS

This contribution is currently levied at the rate of 7.6% and it has the same taxable basis and credit regime as the PIS, mentioned above. Companies under Presumed Profit regime are subject to COFINS at a 3.0 percent rate. The contribution is also levied on import transactions.

- For further details see Chapter 22.

For a detailed description of all significant indirect taxes see Chapter 22.

## Branch versus subsidiary

The advantages and disadvantages of operating in Brazil as a subsidiary versus a branch are discussed in Chapter 16. Very few branches of foreign entities are operating in Brazil.

## Special industries

There are a number of categories of corporate taxpayers for which special provision is made in the income tax regulations, the more important of which are as follows.

### Insurance

Insurance companies are allowed a special deduction for the technical reserves required by law.

### Real estate

In the case of installment sales, taxable income may be determined on the cash basis.

### Leasing

Leasing companies are regulated by the Central Bank, and optional accounting and tax methods exist.

### Agricultural enterprises

These enterprises may take a deduction from taxable income for certain specified investments in land improvements and plant and equipment.

## Mutual and investment funds

Generally, investors may pool their funds in order to obtain diversity of investment and proportional investment advice from the funds' administrators. Tax is payable only at source at varying rates, for individuals.

## Holding companies

There are no special rules for holding companies, and they are taxed in the same manner as other corporate taxpayers. They are required to account for their relevant investments by the equity method. Dividend income received from other corporate entities is nontaxable. Any income received from foreign associates is taxable.

## Corporate tax planning strategies

### Type of entity

Corporate taxation is basically the same for all types of corporate entities.

### Subsidiary versus branch

Foreign investors are advised to incorporate operations in Brazil instead of setting up branches as specific presidential decree is required to set up as a branch.

## Joint venture

There are no tax advantages or disadvantages.

## Holding company

There is no legislation that favors foreign shareholders or holding companies.

## Special industry companies/Special-use companies

Companies participating in certain sectors, such as banking, insurance, leasing, etc., are subject to special tax rules.

## Locality/Industry

Tax holidays are offered by governments for certain industries installed in specific areas (see Chapter 4).

## Reorganizations, mergers and acquisitions

Companies can be reorganized tax free under certain conditions.

The tax basis of assets can be stepped up through acquisitions under certain conditions.

Allocation of cost in asset purchase or deemed asset purchase must be made by both buyer and seller.

## Liquidations

In general, liquidations may result in taxation at both corporate and shareholder levels.

## Tax treaties

Relief from double taxation is applicable. See Appendices IV and V for details.

See Appendices XIV, XV and XVI for other points to consider in setting up, structuring or acquiring an investment in Brazil.

# Chapter 16 Taxation of foreign corporations

## Investor considerations

- Subsidiaries of foreign corporations receive the same tax treatment as local companies.
- Dividends payable by subsidiaries of foreign corporations to foreign shareholders are not subject to withholding income tax.
- Foreign corporations are not normally subject to tax on income arising from their export sales to Brazil.
- Local salesmen/agents with authority to make binding contracts may increase the tax exposure of exporters to Brazil.
- Administrative and similar service charges from foreign head offices or affiliates to Brazilian subsidiaries should be necessary, actually incurred and properly documented for tax purposes and remittance permission is under Brazilian Central Bank control.

## Tax concepts

The basic taxation principle for foreign corporations is that only income from Brazilian sources is taxable in Brazil. Thus, a foreign corporation is only subject to Brazilian tax when it directly derives income from Brazilian sources. A foreign corporation exporting goods to Brazil would not be liable to income tax on the export income, although resale of the merchandise inside Brazil would be a taxable transaction under the conditions described below under "Imports".

There is no difference between income tax payable on net income earned by Brazilian companies, whether held locally or by foreigners. There is no withholding tax on distributions of profits to shareholders, both local and foreign.

No foreign corporation may carry out permanent activities in Brazil other than through a registered subsidiary, branch or permanent establishment.

## Imports

No income tax liability will normally arise on the sale of products shipped to Brazil by a foreign corporation and billed directly to the customer, provided title passes directly to the customer and provided any local agent involved in the sale (corporate or individual, related or unrelated) does not have power to bind the overseas principal contractually. If the local agent has such power, income tax will be calculated on a deemed profit, based on gross income plus an additional surcharge of 20 percent (see "Sales agent or subsidiary" in Chapter 8). Any tax assessed would be charged to, and collected from, the local agent.

### Imports without agent

There are no tax implications.

### Unrelated agent

Agents are normally entitled to a commission and, as such, subject to Brazilian income tax and service tax. However, there are no tax implications for the foreign exporter.

### Sole or exclusive agent

The implications are the same as for unrelated agents. However, the sole or exclusive agent may not hold binding powers.

### Employee/salesman

There are no tax implications, provided he/she does not hold binding powers.

## Sales subsidiary

Sales subsidiaries are subject to the same Brazilian taxes as any local company.

## Branch operations

Profits of a branch of a foreign corporation are taxable in the same way as those of a local company, regardless of the branch's business objectives. They are not subject to an annual branch withholding tax.

## Income from subsidiaries

### Dividends

Dividends paid by subsidiaries of foreign corporations to foreign shareholders are not subject to withholding tax.

### Interest

Withholding tax at 15 percent, or lower treaty rate (see Appendix IV), is payable on interest that a foreign corporation might receive from its Brazilian subsidiary. Exemption of withholding tax may be obtained in case of certain type of export financing.

## Royalties, capital gains, service/management fees, rentals, etc.

Withholding tax on royalties and on service fees of 15, or lower treaty rate, is also payable on these items of income that a foreign corporation might receive from its Brazilian subsidiary. It should be noted that transfer pricing rules are also applicable for import and export of services to or from related companies and not applicable on royalty's agreements. Furthermore, the Brazilian entity is subject to the Contribution for the Intervention on the Public Domain at 10 percent (see chapter 15 - "Taxation of Corporations" under "Royalties and service fees").

## Foreign portfolio investments

The direct investment of foreign capital in the Brazilian capital market must be made through a special foreign investment account under Brazilian Security Exchange Commission rules. The main features of these funds are as follows:

- IOF - Tax on Financial Operations - taxation on the inflow of resources (currently 0%);
- CPMF - Provisional Contribution on Financial Activities - is not levied on the inflow and outflow of investment resources provided certain requirements are met.
- Income of the investment fund is not subject to Brazilian corporate income tax.
- Capital gains in transactions within the Brazilian exchanges and similar markets are tax exempt (equity and derivative funds)
- Capital gains in variable income transactions out of the exchanges or in variable income funds are subject to withholding income tax.

- Capital gains and interest on fixed transactions or investment funds are subject to withholding income tax.
- Foreign investor residents in tax havens are subject to an increased taxation as applicable to Brazilian residents.

The rules for the formation and administration of foreign investment accounts are contained in National Monetary Council Resolutions and they must be previously approved by the Securities Exchange Commission and administered by authorized Brazilian financial institutions. The incoming foreign resources must be registered at the Brazilian Central Bank.

The investment accounts are taxed on the portfolio provided that there is no further taxation upon outflow of resources.

## International financial center

There are no concessions available to foreign corporations to use Brazil as an international financial center.

# Chapter 17 Taxation of shareholders

## Investor considerations

- Dividends distributed to local or foreign shareholders are not subject to withholding tax.
- Interest may be payable to shareholders based on the value of a company's net equity and is subject to withholding tax.
- Foreign-source dividend or equity income is subject to Brazilian income tax.
- Capital gains realized by a foreign shareholder on sale of shares to both a local or foreigner shareholder are subject to withholding tax.

## Local shareholders

### Dividends

No withholding tax is payable on cash dividends distributed to local shareholders, both corporate and individual. Brazilian resident recipients of such dividends are not subject to further income tax.

Stock dividends are not subject to taxation in the hands of local shareholders.

Foreign-source dividend income is subject to Brazilian income tax.

### Capital gains

Gains on the sale or transfer of shareholdings are taxed at normal rates.

## Foreign shareholders

### Dividends

Dividends paid, remitted or credited to foreign shareholders, both corporate and individual, are not subject to withholding tax.

Stock dividends are not subject to taxation in the hands of foreign shareholders.

### Capital gains

Any gains on sale or transfer of shareholdings by foreign shareholders are normally subject to withholding tax of 15 percent whenever the buyer or the transferee is a resident of Brazil, or the asset is located in Brazil.

## Interest on net equity

Companies can pay interest to shareholders based on their net equity participation. Such interest is subject to 15 percent withholding tax. For details of the calculation basis and restrictions see Chapter 15.

## Reorganizations

### Incorporation

There are no tax consequences from the conversion of a non-incorporated business into an incorporated entity or from changing the corporate form, such as from a "limitada" (private limited liability company) into a corporation.

### Merger or amalgamation

In the case of a merger, the surviving or new company succeeds to the rights and obligations of the extinct company with regard to taxation and labor matters except that it does not have the right to use tax-loss carry forwards of the extinct company. For tax purposes, mergers may be accounted for on the basis of book or market values. If accounted for at market value, the taxable gain or tax-deductible loss is computed as follows.

**Taxable gain** - A taxable gain is the excess of the value at which the net assets received are accounted for over the book value of the investment that they have replaced. To the extent that such gain arises from permanent assets, it may be deferred for tax purposes until it is realized, i.e., upon sale, depreciation or depletion of the related asset.

If assets and liabilities are revalued as part of the transaction, the resulting surplus will not be taxable provided it is maintained in a revaluation reserve account in the books of the surviving company. Such surplus will be subject to tax only when the reserve is capitalized or realized by disposal, depreciation, amortization, or depletion of the underlying assets.

Tax losses, provided the merger is conducted at market value, the negative difference between the net assets received and the book value of the investment will be treated as deductible capital loss.

## Reorganization

Legislation permits spin-offs, split-offs or split-ups whereby a company transfers all or part of its net assets to one or more companies set up for that purpose, or already existing. The tax considerations described above for mergers or amalgamations also apply in the case of reorganizations.

## Liquidation

There are no special tax rules relating to companies in liquidation. Any net income accruing to corporate shareholders will be taxed normally as part of taxable income. With regard to individual shareholders, any gain arising from the redemption of shares will be taxed as a normal capital gain. If the shareholder is resident overseas, any gain is taxed at source at the rate of 15 percent, or lower treaty rate.

## Acquisitions

### Asset acquisition

Acquisitions of assets by a foreign company should preferably be carried out via a local incorporated company. The assets must be recorded at cost and may be depreciated normally. Interest and other charges on loans obtained for the acquisition of assets are deductible expenses.

## Share acquisition

In general an acquisition of shares made by a Brazilian resident company would allow the premium/goodwill paid in the acquisition to become under certain circumstances, deductible upon the merger of the acquiring and the acquired company, either upstream or downstream.

See Appendix XVI for other points that should be considered by investors, their legal counsel and their accountants before acquiring a business enterprise in Brazil.

# Chapter 18 Taxation of foreign operations

## Investor considerations

- Foreign source profits and earnings are subject to tax in Brazil (world-wide taxation).
- Foreign tax credits are available with certain limitations.
- Foreign source losses cannot be offset against Brazilian source profits.

## Taxation of foreign income

The territorial concept for corporate income tax purposes was abolished as from January 1996 and corporate taxpayers are now taxed on a world-wide income basis. Foreign source income/gains of any nature, net of foreign source losses, are subject to Brazilian income tax, when distributed or made available. Foreign tax credits are available, with certain limitations.

Profits of overseas associated companies, when distributed or made available, are included in the determination of taxable income of the Brazilian company proportionately to its participation based on the financial statements prepared in the country where the associated company is domiciled. As per newly enacted legislation, the profits of overseas associated companies are considered "available" to the Brazilian controlling company at the time the overseas associated company closes its financial statements at the end of its fiscal year.

Special rules for certain activities exercised partly in Brazil and partly abroad are referred to in the section on "Geographical source of income" in Chapter 13.

## Double tax relief

A Brazilian corporate entity may offset income tax incurred abroad on profits, revenues and capital gains and include it in taxable income up to the limit of the income tax incurred in Brazil on such profits, revenues or capital gains. The income tax to be offset is converted into reais based on the bank selling rate on the date the tax was paid.

Brazil has double taxation agreements with various countries. See Appendix V for a complete listing.

# Chapter 19      Consortiums and joint ventures

## Investor considerations

Among the various forms of association provided for in Brazilian legislation, the consortium has recently gained a bigger dimension.

On introducing the consortium figure, the Brazilian commercial law intended to facilitate the common activity of companies to leverage a certain purpose without constitution of a new legal entity in fact.

A consortium will not constitute corporate entity and the consortium members only bind themselves to observe the conditions stipulated in the respective contracts, being each member liable for its own obligations, there being no joint liability implied in case of inexistence of any contractual covenant in this respect.

## Consortiums

See Chapter 9 for the different types of partnerships and their common uses.

## Entity or conduit

A consortium cannot be a creditor nor can it assume obligations alone since it is not a legal entity, only consortium members can be creditors or assume obligations. A consortium operates through its member companies, usually through only one of these, denominated as the "Leader Company".

Creditors of a consortium cannot claim full performance of obligations assumed by the consortium by only one of the consortium members, observation, which must be made public by being expressly included in the contract constituting the consortium, duly registered with a Trade Registry.

As mentioned above, a consortium must be constituted through a contract in writing duly registered with a Trade Registry, containing the minimum requirements established by Law.

## Taxable income

There is no specific disposition in Brazilian legislation on consortium taxation. Since a consortium is not a legal entity, its results of operations will only be taxed through the consortium members.

In this respect, each of the legal entities participating in the consortium must appropriate individually its revenues and expenses, and file its own separate income tax return.

However, Federal Tax Authorities establishes compulsory registration with the General Taxpayers' Register - CNPJ of consortium, paying earnings subject to withholding income tax or receiving earnings arising from their activities, being the latter subject to the same tax regime applicable to legal entities.

Also, accounting records must be centralized in a specific book for consortia to be later transferred to each of the consortium members.

A consortium cannot be a legal entity nor assume obligations, not being liable for paying the Social Contribution on Gross Revenue - PIS or the Social Contribution on Billings - COFINS. These charges will be levied on the consortium members. Since the results arising from the enterprise will be appropriated by each of the consortium members.

## Joint ventures

### Entity or conduit

The concept of a non-incorporated joint venture as a separate corporate entity does not exist in Brazil.

Accordingly, the parties to a non-incorporated joint venture or consortium ("sociedade em conta de participação") are taxed individually.

### Taxable income

As stated above, parties to a non-incorporated joint venture or consortium are taxed individually. Their tax liability is based on their tax status and their share of the joint venture or consortium taxable income. Incorporated joint ventures are taxed in the same way as corporate entities.

### Taxation of foreign ventures

Foreign ventures are subject to withholding tax at the rate applicable to foreign shareholders (see Chapter 17).

## Chapter 20 Taxation of individuals

### Tax planning for expatriates

#### Resident/non-resident status

Special visas and work permits are required for any foreigner intending to live and/or work in Brazil, whether for short or long periods. Two types of visa may be granted in connection with work permits, and each one has a different tax consequence.

Foreigners with permanent visas are considered residents as from the date of arrival in Brazil and subject to income tax on their worldwide income.

Foreigners with temporary residence visas which are valid for two years, but may be renewed for another consecutive two-year period, are considered resident if physical presence in Brazil exceeds 183 days within any given period of 12 months, as long as they do not hold any local employment agreement. If a temporary visa holder has an employment agreement with a local company, the foreign individual will be considered resident as from the date of arrival in Brazil.

Non-residents are taxed only at source on their Brazilian-source income.

There are no special tax concessions for foreigners working permanently or temporarily in Brazil.

#### Pre and post-assignment periods

Any amounts payable by a non-Brazilian source to an expatriate who has not yet acquired the status of a Brazilian resident, or who has relinquished this status, are not subject to Brazilian income tax.

#### Job-related activities partially outside Brazil

Resident status must be considered. Worldwide income would generally be subject to Brazilian income tax for a Brazilian resident.

#### Bonuses and fringe benefits

Bonuses and most employer-provided fringe benefits are taxable. Tax-exempt fringe benefits include employers' contributions to private social security plans and labor indemnities.

#### Special foreign assignment allowances

Any special foreign assignment allowance paid in Brazil is subject to income tax. If paid in the employee's base country, it will have to be included in his worldwide income if he has resident status.

## Social security contributions

Social security contributions are payable by all persons working in Brazil.

## Special tax concessions

There are no special tax concessions for foreigners working in Brazil.

## Timing of arrival/departure

Since tax is due monthly, it generally makes no difference whether a foreigner arrives or departs early or late in the year. Tax clearance certificates are needed before final departure from Brazil.

## Territoriality and residence

The basic principle of taxation of individuals is that residents are taxed on their worldwide income and non-residents only at source on just their Brazilian-source income. The source of income is determined by the place where the income payer is located, irrespective of where the work is performed.

Foreigners arriving in Brazil with permanent visas or with a temporary visa and with a local employment agreement are considered residents and taxed on worldwide income from the date of their arrival.

On departure of foreigners holding permanent visas, they should surrender their visas so as not to be considered resident and liable to Brazilian income tax on worldwide income during the next 12 months.

As well, assuming that the transfer is on a permanent basis, the foreigner (whether a holder of temporary or permanent visa) should prepare an Individual Income Tax Return relating to the period from January 1 up to the date of departure. The income tax return for the previous tax year will also need to be filed if this has not yet been done. At the same time, a Federal Tax Clearance Certificate should also be requested.

After filing for the Certificate, the foreigner is no longer considered a resident and all income earned in Brazil will be taxed at source at the rate of 25 percent, except for income or gains on financial investments, which are taxed at the same rates applicable to residents.

There are special rules for Brazilians working abroad.

## Special provisions

There are no special favorable provisions applicable to foreigners working in Brazil.

## Gross income

Gross income is the sum of earnings from capital, labor or a combination of both, including allowances, alimony and pensions received in cash, gains of any other nature, and also of any increase in personal wealth not supported by declared income. Income from overseas sources is also included in gross income. Capital gains arising from the disposal of assets or rights of any nature and investment income are generally considered as part of gross income. However in some circumstances certain transactions are tax free or are taxed exclusively at source at lower rates.

The annual income tax return is subdivided into various sections, which serve to classify income according to source as follows.

- Taxable income received from companies.
- Taxable income received from individuals and overseas sources.
- Exempt and non-taxable income.
- Income subject to exclusive taxation.

In addition to these income-related sections, all taxpayers with income and/or assets above certain levels must prepare a list of personal assets and rights, and of liabilities at the beginning and end of each calendar year, including those overseas.

Types of income exempt from individual income tax include the following.

- Board, transportation and special work uniforms or clothing provided free of charge by the employer, or the difference between the amount charged and their market values.
- Per diem allowances to cover room and board when working outside the county in which the company or office is based or in which the work is normally performed.
- Labor indemnities, limited to the legal amounts, including indemnities for labor accidents.
- Contributions made by the employer to private social security programs in favor of employees.
- Reimbursement of relocation costs when moving to a different area at the request of the employer.

## Employee services

The definition of taxable income arising from service as an employee is very broad and includes everything that is directly or indirectly connected with the work and/or assignment remuneration package including salaries, premiums, directors' fees, bonuses, tips and other gratuities, allowances of any kind, 13th month salary, tax reimbursements, club dues and use of company-owned cars.

Stock option schemes are not covered in the individual tax legislation, but do trigger tax implications in Brazil.

Foreign-source income is taxable but relief is normally given for foreign taxes paid to foreign jurisdictions if a tax treaty exists or reciprocity treatment is available.

## Employees' profit sharing

Workers have the right to participate in to company's profits, irrespective of any remuneration received. Any amounts received are not considered employee services and are taxed exclusively at source.

## Capital gains

In general, capital gains of resident individuals are taxed at the rate of 15 percent. However, gains on sales of assets or rights where the sales price is less than certain thresholds may be tax-free. This is a monthly exemption. In addition a capital gain on the sale of an individual's principal residence is tax-free up to a certain amount.

## Other income

Royalties, professional fees, pensions, annuities and alimony are taxable upon receipt and should be included in gross income. Credit will be given for tax deducted at source.

Rents from property abroad, including a personal home, and dividends and interest from investments abroad, should also be included in gross income.

Amounts paid by employers for group life insurance, medical care, meals, uniforms, transportation and per diem expense allowances are not generally taxable to the individual. Employers' contributions to private pension plans and savings and investment plans are also exempt from individual income tax.

Income from short-term investments is taxed only at source at varying rates.

## Closely held companies

There are no special tax rules for shareholders/quotaholders of closely held corporation/ limitadas (private limited liability companies). Care must be taken to ensure that shareholders'/quotaholders' transactions are perceived to be on an arm's-length basis and therefore not deemed to be disguised profit distributions, which would be subject to income tax (see "Nondeductible items" in Chapter 15).

## Non-residents

Brazilian-source income and capital gains of non-resident individuals are subject to withholding tax of 15 or 25 percent, except if financial income held with bank accounts maintained in Brazil, which may be subject to lower rates. The source of income is determined by the place where the income payer is located, irrespective of where the work is performed.

## Deductions

Deductions should be listed in the corresponding sections of the annual income tax return. As a general rule, deductions will be allowed only when disbursements have been made. Deductions may be summarized as follows.

- Social security contributions.
- Medical, dental and hospital expenses.
- Amounts paid to private medical schemes.
- Private pension fund contributions.
- Alimony payments.
- Schooling expenses of dependents.
- Expenses of lawsuits related to income earned.

For limitations on amounts deductible, see Appendix VII.

Business expenses are not deductible.

## Personal allowances

Personal allowances are deductible for each dependent. A special allowance applies to elderly taxpayers. For deductible amounts, see Appendix VII.

## Non-residents

Non-residents do not need to prepare income tax returns. As mentioned above, their Brazilian-source income is taxed only at source.

## Double tax relief

Relief from double taxation is available if a tax treaty exists between Brazil and the country from which foreign-source income is generated or if reciprocal treatment is applicable. See Chapter 23 and Appendix V for details of tax treaties.

## Tax computation

### Taxable income

A sample calculation of individual taxable income is shown in Appendix VIII.

Specific filing categories exist for married people filing jointly or separately, and for single taxpayers.

### Tax rates

The progressive tax rates are shown in Appendix VI. The current maximum individual tax rate is 27.5 percent.

## Tax credits

Tax credits are available (within certain limits) in respect of income tax paid to countries with which Brazil has a ratified tax treaty, or to countries that would render reciprocal treatment in relation to income taxes paid to the Brazilian government.

## Other taxes

### Local taxes on income

No state or municipal income taxes are levied on individuals.

Social security taxes are payable monthly at the rate of 8 to 11 percent of the Brazilian-source salary. However, the maximum contribution basis may not exceed a certain threshold set by legislation (see Appendix XII).

Minor amounts are payable annually to the various unions.

### Wealth and inheritance taxes

There are presently no wealth or inheritance taxes.

### Bequeath, gift and transfer tax

ITCMD - transfer tax is imposed at state level at different rates.

## Chapter 21      Taxation of trusts and estates

### Trusts

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

### Estates

There is at present no inheritance tax in Brazil. The 1988 Constitution introduced the concept of a wealth tax, although to date no legislation and/or regulations have been issued.

As regards the estate of a deceased person, the executors are required to file income tax returns covering the net income of the estate up to the date of distribution of the available resources. The net income of the estate is taxable in exactly the same way as an individual's net income (see Chapter 20).

The only other tax relating to the dissolution of a deceased's estate is the property transfer tax ("imposto de transmissão causa mortis"), which is payable by the estate (see Chapter 22).

## Chapter 22 Indirect taxes

### Investor considerations

- A federal value-added excise tax is payable at varying rates on nearly all sales and transfers of industrialized products. It is also payable on most imported merchandise.
- Import tax is levied at varying rates on most imports.
- Many payroll taxes are levied in addition to social security contributions.
- Financial transactions are subject to a financial operations tax at varying rates.
- Companies must contribute to various federal social and welfare funds.
- A state value-added sales and services tax is levied on most sales and imports.
- Service tax is levied by municipalities at varying rates.

### General

All taxes that are complementary to income tax (taxes on occasional gains, dividends and remittances) have been discussed in previous chapters. This chapter refers to the more important indirect taxes that affect businesses and individuals in Brazil. Indirect taxes are also summarized in Appendix XIII.

### Federal indirect taxes

#### Temporary Contribution on Financial Activities (CPMF)

CPMF (Temporary Contribution on Financial Activities) is charged on every debit (e.g.: withdrawal, transfer, etc.) made to a bank account at the rate of 0.38%. CPMF is not levied on debits made to investment accounts.

## Value-added excise tax

Excise Tax - IPI ("Imposto sobre Produtos Industrializados") is levied at various rates on industrialized products when sold or transferred by the industrializing establishment even though industrialization may be incomplete, partial or intermediate. There are a few exceptions, including exports and most food products. It is also levied on imports at the same rates as on Brazilian-made products. All related laws and regulations were consolidated in Decree 4544/02.

The tax is payable at the point of production or importation. When items are transformed or processed, additional excise tax is payable on the finished product, but credit is allowed for tax paid on the purchase of raw materials or component parts used for production. Tax must also be paid on the price differential of items imported and later sold at a higher price by the importer, and on those repackaged or reoffered for sale at a higher price.

IPI is calculated ad valorem on selling prices at rates that vary according to the degree of necessity. For example, food products in general are free of tax while cigarettes and certain other tobacco products are taxed at over 300 percent. Normally the rate is around 10 to 15 percent. Product specifications are to be found in the Table of Excise Tax Levy (TIPI).

Excise tax is passed on to the purchaser as an addition to the sales price of each item shown in the fiscal note ("nota fiscal") and related invoice ("fatura").

Fiscal notes must accompany all items in transit whether they have been sold or are merely being transferred to another location since, as in the case of the state value-added tax on sales and services - ICMS (see below), each plant or location of an entity is considered a separate taxpaying unit. Fiscal notes must always indicate the amount of excise tax and the calculation basis.

## Customs duties

Import duty - II ("Imposto de Importação") is generally levied on an ad valorem basis. For details see Chapter 8.

## Payroll taxes

Payroll Taxes in the form of social security and other contributions are discussed in Chapter 10. They are also summarized in Appendix XII.

## Export tax

Export Tax - IE ("Imposto de Exportação") is levied on a very limited number of products (e.g. animal fur and cigarettes). This tax is applied more as a foreign trade regulator than as a revenue instrument.

## Financial operations tax (IOF)

The financial operations tax - IOF ("Imposto sobre Operações Financeiras") is levied at varying rates on loans and credit operations, securities transactions, certain foreign exchange transactions and insurance policies. It is added to the cost of each transaction. This tax is also levied at varying rates on income earned from certain short-term financial investments, the tax being withheld by the financial institution from the investor. Both companies and individuals are subject to this tax. For further details see Appendix XIII.

## Rural property tax

The rural property tax - ITR ("Imposto Territorial Rural") is normally based on the value of land and buildings assessed for this purpose and the land area and utilization rates. The tax rate normally ranges from 0.03 percent to 20 percent per annum, depending on the stage of use. Small rural properties are exempt, if the owner or the owner's family cultivates them.

## Corporate social contribution

All companies, except non-profit entities, legally qualified as a social assistance entity, must make monthly/quarterly contribution ("Contribuição social") at the rate of 9 percent on each month or quarter's profit (depending on the taxation regime) before income tax, after some adjustments. Whenever the contribution basis is negative, it may be carried forward for compensation purposes without any time limitation. However, negative basis compensation may not reduce more than 30% of the contribution basis. Contributions are not deductible for income tax purposes. The federal government applies resources obtained in the Social Welfare System.

## Social contribution on billings

All companies, except non-profit-entities and those not subject to "real income" (lucro real) corporate taxation, must make monthly contributions to this federal social financing scheme ("Contribuição Social para Financiamento de Seguridade Social" - COFINS) at the rate of 7.6 percent on gross monthly revenue after certain deductions and exclusions. However, it is possible to offset certain credits on inputs and some other expenses, according to the applicable legislation. Companies subject to a regime other than the "real income" are subject to a lower rate of 3 percent, but can not make deduction of credits. Resources are used to finance social security expenses in the areas of health, social welfare and social assistance.

COFINS is also levied at 7.6 percent on the import of goods and services from abroad. Credits calculated on the "COFINS Import" paid, and on expenses related to the import of goods and services, according to the applicable legislation, may be offset against the COFINS due on monthly gross revenue.

Additionally, different tax rates apply for certain products which levy occurs only once in the supply chain. Tax rates shall vary as follows:

- sale of fuels in general by the manufacturer or importer: from 19.42% to 47.4%;
- import and domestic resale of medicines: from zero to 9.9%;
- domestic sale of perfumery and personal health care products: 10.3%; and
- domestic acquisition of inputs by the manufacturer of vehicles and machinery, parts of vehicles and tires: from 9.5% to 10.8%.

The above mentioned rates vary based on the type of the transaction and on the Tariff Code (NCM) of the products.

Finally, the amount of COFINS due by producers of soft drinks, beer and water shall be determined in accordance with the quantity of the input or product sold or acquired.

## Social integration program

All companies, except those not subject to "real income" (lucro real) corporate taxation, must make monthly contributions to this federal program ("Programa de Integração Social" - PIS) at the rate of 1.65 percent of gross monthly revenue after certain deductions and exclusions. However, it is possible to offset certain credits on inputs and some other expenses, according to the applicable legislation.

Companies subject to a regime other than the "real income" are subject to a lower rate of 0.65 percent, but can not make deduction of credits on inputs. Contributions are used to create a fund for employees that can be used on the occasion of marriage, retirement, incapacity, or home purchase, to an extent dependent on the employee's salary level and length of service. Income from the fund attributable to each employee may be withdrawn annually, provided that the beneficiary is registered as an employee for more than five years.

PIS is also levied at 1.65 percent on the import of goods and services from abroad. Credits calculated on the "PIS Import" paid, and on expenses related to the import of goods and services, according to the applicable legislation, may be offset against the PIS due on monthly gross revenue.

Additionally, different tax rates apply for certain products which levy occurs only once in the supply chain. Tax rates shall vary as follows:

- sale of fuels in general by the manufacturer or importer: from 4.21% to 10.2%;
- import and domestic resale of medicines: from zero to 2.1%;
- domestic sale of perfumery and personal health care products: 2.2%; and
- domestic acquisition of inputs by the manufacturer of vehicles and machinery, parts of vehicles and tires: from 2% to 2.3%.

The above mentioned rates vary based on the type of the transaction and on the Tariff Code (NCM) of the products.

Finally, the amount of PIS due by producers of soft drinks, beer and water shall be determined in accordance with the quantity of the input or product sold or acquired.

## Contribution for the Intervention on the Economic Domain

Companies that pay royalties fees to foreign parties are subject to the Contribution for the Intervention on the Economic Domain calculated at the rate of 10% based on the amounts paid, credited, delivered, used or remitted to the nonresident beneficiary. This contribution is also applicable on the remuneration for administrative services and services that incorporate transfer of technology.

## State indirect taxes

### Valued-added tax on sales and services

Sales and services tax - ICMS ("Imposto sobre Circulação de Mercadorias e Serviços") is levied on sales or physical movement of goods, on freight, transportation and communications services, and on electric energy, normally at the rate of 18 or 19 percent for intrastate transactions and 7 to 12 percent for interstate transactions. In some states certain products are exempt, including food products. This tax is also payable on almost all imports at 18 to 25 percent but most exports are exempt. Each location of a business operation is considered as a separate taxpaying unit. The total tax assessed must be shown separately on the fiscal note ("nota fiscal"), but it is considered as an integral part of the sale or transfer amount of each item listed in the fiscal note. Tax is calculated on monthly operations and payment is due according to the company's activities code. Payments are generally made during the following month.

The regulations contain many requirements for documenting and recording the movement of goods for the purpose of controlling this tax. Heavy penalties are payable for failure to comply with the regulations.

## Property tax

A property transfer tax - ITCMD ("Imposto de Transmissão Causa Mortis e Doações") is normally payable at a rate of up to 4 percent on inheritances and donations of real state properties and its rights (\*see Chapter 21).

## Tax on Automotive Vehicles

The state tax on ownership of automotive vehicles - IPVA - is payable on a yearly basis and it is levied in relation to all kinds of automotive vehicles, including motor boats and airplanes. Amounts payable are based on the market value of the vehicle by the beginning of each year, when this tax is due.

## Municipal indirect taxes

### Service tax

A service tax - ISS ("Imposto sobre Serviços") is normally levied on services rendered, except for those related to freight, certain transportation services and communications and electric energy, which are subject to the ICMS tax as commented above. Rates vary from 2 percent up to the maximum rate of 5 percent, (which is more frequently applied), depending on the municipality. It is payable on a monthly basis. It is not a VAT tax. For certain professional firms or individuals, these rates are substituted by an annual contribution based on the number of practicing professionals.

ISS is also levied on payments for remuneration of services rendered from abroad (import of services).

## Property taxes

A property tax - IPTU ("Imposto Predial e Territorial Urbano") is levied annually based on the fair market value of property in urban areas at rates that generally vary between 0.2 to 5 percent according to the municipality and location of the property. Payments can be made in up to 10 monthly installments. In few cases it is possible to obtain exemption of this tax.

Another property tax - ITBI ("Imposto de Transmissão de Bens Imóveis Inter Vivos") is levied at rates of up to 6 percent on sales or transfers of properties. It is payable by the acquirer. A reduced rate of 0.5 percent applies to transactions under housing programs financed by federal government schemes.

Transfers of properties to a corporate entity as a capital subscription are tax free except where the business activity is real estate.

## Chapter 23 Tax treaties

### Tax treaty policy

Brazil has ratified a number of tax treaties to accomplish the following objectives.

- Income derived from Brazil should be subject to Brazilian income tax only and thus an exemption or foreign tax credit should be granted by the other country.
- The effects of reductions of Brazilian taxes should not be compensated by increasing taxes in the other country.
- The establishment of maximum levels of taxation for income deriving from Brazilian sources.
- The reduction of foreign taxes on profits earned abroad by Brazilian enterprises.

In general, the treaties cover only corporate and individual income tax and remittance taxes and do not affect the payment of capital gains tax.

Fiscal residence is usually determined in accordance with the tax law prevailing in the country in which an establishment is located. Normally, treaties contain special provisions for the determination of the residence of individuals who would otherwise have dual residence. This determination is generally based on the personal and economic interests of the individual.

A wide network of tax treaties is not being actively pursued. Treaties currently in force and those under negotiation are listed in Appendix V. Most treaties follow the OECD model.

### Withholding taxes

The withholding tax on dividends was reduced from 15 percent to zero as of January 1996. Treaty rates in excess are automatically reduced to zero. The rate for remittances of interest and royalties was reduced from 25 percent to 15 percent also as of January 1996. Treaty rates in excess of 15 percent are automatically reduced.

### Permanent establishment

A branch is considered to be a permanent establishment, as is an agent who has powers to bind an overseas principal contractually (see Chapter 8).

Each treaty should be consulted for further definition of a permanent establishment.

## Personal services

The tax treaties in force do not cover personal services by nonresidents temporarily working in Brazil.

## Other articles

There are no special tax treaty benefits for industrial and commercial income.

Generally, earnings from properties are subject to the tax regulations of the country where they are located.

Shipping and aircraft transportation companies are normally taxed only in the country where their head offices are located.

## Elimination of double taxation

Each treaty should be consulted to determine the method of eliminating double taxation, tax credit or exemption.

## Exchange of information

Although treaties provide for an exchange of information on a confidential basis, this does not include disclosure of any trade, business, commercial, industrial, or professional secrets.

## Competent authority/Mutual agreement

Any case arising in relation to a treaty may be submitted to the competent authorities of the country of which the taxpayer is resident. If no satisfactory solution is reached, the competent authorities of both countries will try to settle the case by agreement in order to maintain the spirit of the treaty.

## Appendix I

## Corporate income tax & Social contribution rates

Rates applicable to taxable income (2004/2005).

	<u>%</u>
Income tax rate	15
Surcharge on taxable income in excess of R\$ 240,000	10
Social contribution (see note 2)	9

Notes:

1. Income tax and social contribution payments can be made on a monthly or quarterly basis. Up to the last business day of June of the following year, the annual tax return for the previous calendar year is prepared and filed with the authorities and any further tax due or refundable is settled. However, monthly payments may also be final.
2. In addition to corporate income tax, all legal entities are subject to a social contribution to the federal government at the rate of 9%, which is not deductible for income tax purposes. The tax basis is the profit before income tax, after some adjustments.
3. Accordingly, the current maximum consolidated effective tax rate on taxable income is 34%.
4. The official exchange rate at June 30, 2005 was US\$ 1= R\$ 2.35.

## Appendix II Tax depreciation rates

Type of asset	Rate per annum %
Buildings - industrial, office and warehouses	4
Building improvements	4
Machinery and installations, air-conditioning, elevators and equipment	10
Tools and molds	20
Computer hardware	20
Office installations	10
Office furniture and fittings	10
Automobiles and trucks	20
Aircraft, including engines	10

### Notes:

1. Rates are applied on the straight-line basis.
2. Rates for machinery and installations, air-conditioning, elevators and equipment are for an 8-hour working shift per day. For double-shift working the rates can be increased by 50 percent and for triple-shift working by 100 percent.
3. Rates may be decreased or increased if the taxpayer can prove that the asset concerned has a correspondingly longer or shorter life.
4. Leasehold improvements are normally depreciated over the period of the lease.

## Appendix III Corporate tax calculation

### Year ending December 31, 2004

	<u>R\$</u>
Net income before income tax, before social contribution	11,800,000
Less: Dividends received (Note 2)	<u>1,000,000</u>
Net taxable income	<u><u>10,800,000</u></u>
Tax thereon:	
Basic income tax at 15%	1,620,000
Surcharge: 10% from 240,000 to 10,800,000	<u>1,056,000</u>
Total federal income tax	<u><u>2,676,000</u></u>

The social contribution calculation is as follows.

	<u>R\$</u>
Net taxable income	10,800,000
Social contribution at 9%	<u><u>972,000</u></u>

### Notes:

1. Dividends received from other Brazilian companies, including affiliated companies are not subject to withholding tax and excluded from tax calculation.
2. The income tax/social contribution may be computed in three different ways, as follows:
  - a. On a "presumed taxable income" basis:

Only corporate taxpayers with gross annual revenues of not over R\$48 million in the preceding year may opt for this income tax computation method. The tax rate of 25% is imposed on a percentage of monthly gross revenues (from the sale of goods / products / services) plus capital gains and money-market income, less some minor adjustments such as unconditional discounts and canceled sales. The taxable basis for other diversified activities is determined according to the proportionate amount of gross revenue.

Taxable basis as a percentage of monthly gross revenue

Type of activity	%
In general	8.0
Oil, gas, lubricants etc (retail)	1.6
Transportation (except cargo)	16.0
Services in general	32.0

The social contribution liability, at the rate of 9%, presumes a taxable basis equal to 12% of the sum of gross monthly revenues, capital gains and money market income and equal to 32% of services rendered.

b. On an "arbitrary" basis

Established solely at the discretion of the tax authorities, should the taxpayer fail to comply with the regulations for keeping records and/or computing taxable income.

c. On an "actual taxable income" basis

This basis is computed in accordance with the corporate records and adjusted for tax purposes in line with the applicable regulations. Legal entities with the following characteristics/activities must utilize this method:

- i. Annual gross revenues in the preceding calendar year of more than R\$48 million;
- ii. Financial institutions in general, leasing companies, insurance companies, and non-private pension funds;
- iii. Legal entities that have profits, income or capital gains from abroad;

- iv. Legal entities benefiting from income tax incentives (reduction or exemption);
- v. Legal entities that have made the monthly payments on an estimated basis during the tax year;
- vi. Legal entities that render services related to credit and market assistance, credit management, risks and selection, management of receivables and payables assistance or factoring.

These corporate taxpayers estimate their monthly tax payments (income tax and social contribution) by using the computation rules applicable for the presumed taxable income basis. Payments are due on the last working day of the subsequent month. A final balance sheet and statement of income must be drawn up at year-end and the annual tax liability (including income tax surcharge) computed. At this time, nominal gains from money market as well as from transactions in the stock/commodities exchange and/or futures market must be considered, and taxes withheld at source are treated as tax credits. Any difference between the final tax liability computed at year-end and the amounts estimated and paid in advance or withheld at source will either be paid up to the last working day of the month of March (subject to interest) or claimed as a tax credit. The taxpayer may at any time suspend or reduce the monthly advance payments upon proof that amounts already paid or withheld at source exceed what is due on actual taxable income for the same period.

Alternatively, the above-listed corporate taxpayers may draw up quarterly financial statements, calculate the appropriate taxable income and pay the income tax (including surcharges) and the social contribution thereon up to the last working day of the subsequent month. Taxes paid under this alternative are considered final, and the annual financial statements are not required for tax purposes.

The official exchange rate at June 30, 2005 was US\$ 1 = R\$ 2.35.

## Appendix IV Withholding taxes

Payments of dividends, interest and royalties are subject to withholding tax at the following rates.

Recipient	Dividends %	Interest %	Royalties %
Resident:			
Companies	Nil	20	Nil
Individuals	Nil	Progressive Rate	Progressive Rate
Nonresident companies and individuals:			
Nontreaty (non tax haven)	Nil	15	15
Tax Haven	0	25	25
Treaty (Note 1):			
Argentina	0	15	15
Austria	15	15	25, 15, 10
Belgium	15	15, 10,	25, 15, 10
Canada	15	15, 10	25, 15
Chile	10,15	15	15
China, P.R.	15	15	25, 15
Czech Republic	15	15, 10	25, 15
Denmark	25	15	25, 15
Ecuador	15	15	25, 15
Finland	10	15	25, 15, 10
France	15	15, 10	25, 15, 10
Germany (note 2)	15	15, 10	25, 15

Recipient	Dividends %	Interest %	Royalties %
Hungary	15	15, 10	25, 15
India	15	15	25, 15
Italy	15	15	25, 15
Japan	12.5	12.5	25, 15, 12.5
Korea, Republic	15	15, 10	25, 15
Luxembourg	25, 15	15, 10	25, 15
Netherlands	15	15, 10	25, 15
Norway	15	15	25, 15
Philippines	25, 15	15, 10	25, 15
Portugal	10, 15	15	15
Slovakia	15	15, 10	25, 15
Spain	15	15, 10	25, 15, 10
Sweden	25, 15	25, 15	25, 15

In addition, tax is withheld from other payments as follows.

	%
Repatriated capital in excess of registered amount (note 3)	15
Gains on sale or transfer of shareholdings by foreign shareholders or the asset is located in Brazil (note 3)	15

Notes:

1. Treaty rates in excess of those for nontreaty countries are automatically reduced. As can be seen, dividends paid are not subject to any withholding tax.
2. Tax treaty to be revoked as of January 1 2006.
3. In case of residents in tax havens the capital gain tax rate is increased to 25%.

## Appendix V Tax treaties

### Treaties in effect

<u>Country</u>	<u>Date of treaty</u>	<u>Applicable since</u>
Argentina	May 1980	December 1982
Austria	May 1975	July 1976
Belgium	June 1972	July 1973
Canada	June 1985	December 1985
Chile	April 2001	July 2003
China P.R.	August 1991	January 1993
Czech Republic	August 1986	November 1990
Denmark	August 1974	December 1974
Ecuador	May 1983	January 1988
Finland	February 1972	December 1973
France	September 1971	May 1972
Germany (*)	June 1975	December 1975
Hungary	June 1986	July 1990
India	April 1988	March 1992
Italy	October 1978	April 1981
Japan	January 1967	December 1967
Korea, Republic of	March 1989	November 1991
Luxembourg	November 1978	July 1980
Netherlands	March 1990	November 1991
Norway	October 1967	December 1969
Philippines	September 1983	October 1991
Portugal	May 2000	October 2001
Slovakia	August 1986	November 1990
Spain	November 1974	December 1975
Sweden	April 1975	December 1975

The Tax Treaties with Israel, South Africa, Paraguay, Ukraine and Mexico, although already signed, are not yet in force.

(\*) The treaty with Germany is revoked as from January 1, 2006.

## Treaties limited to airlines

Brazil is a signatory to the 1944 International Civil Airline Convention.

## Treaties under negotiation

Treaties are under negotiation with the following countries.

United Kingdom  
Romania  
Switzerland  
Trinidad Tobago

United States

## Social security totalization agreements

Agreements have been signed with the following countries.

Argentina  
Cape Verde  
Chile  
Italy  
Greece

Paraguay  
Portugal  
Spain  
Uruguay  
Luxembourg

## Appendix VI Individual tax rates

The following tax table is applicable to income tax payable in 2005.

### Net taxable income (1)

<b>Over</b>	<b>Not over</b>	<b>Tax rate (2)%</b>	<b>Amount to be deducted from (1) times (2)</b>
R\$0	R\$ 13,968.00	0%	-
R\$ 13,968.01	R\$ 27,912.00	15%	R\$ 2,095.20
R\$ 27,912.01	-	27.5%	R\$ 5,584.20

### Notes:

1. These rates apply to all types of tax returns, i.e., married individuals filing jointly or separately and single taxpayers.
2. An individual who receives income in any month from a source other than an employer must prepare a compulsory monthly tax computation (carnê lêão) and pay any tax due by the last working day of the following month.
3. At June 30, 2005 the official exchange rate was US\$ 1 = R\$ 2.35.

## Appendix VII Personal allowances and deductions

### Allowances

A taxpayer may deduct a flat allowance of R\$ 1,404 per annum per dependent in 2005.

A further allowance of up to R\$ 13,968 may also be taken relating to annual income from retirement or military pensions as from the year in which the taxpayer reaches 65 years of age.

### Deductions

The following may be deducted from taxable income.

- Social security contributions.
- Medical, dental and hospital expenses that are not covered by an insurance policy or subject to refund by any entity.

- Amounts paid to recognized Brazilian health insurance/medical cost-coverage plans.
- Contributions to recognized Brazilian private pension funds.
- Alimony payments based on a court order or other legal agreement.
- Schooling expenses up to an annual limit of R\$ 2,198 per student.

Business expenses are not deductible.

All individuals can elect to file a simplified tax return and take the benefit of the standard deduction, equal to 20% of the gross income, but limited to R\$ 10,340, which substitutes all other deductions.

## Appendix VIII Individual tax calculation

2005

### Assumptions

Resident, married with two children, wife takes classes, pays alimony to first spouse.

Income, gains and deductible expenses in 2005 was as follows.

	<u>R\$</u>
Brazilian-source salary income	110,000
Brazilian payroll withholding tax	24,665
Social security contributions	3,311
Foreign-source income	80,000
Income tax paid to a foreign tax jurisdiction on foreign-source income	16,415
Short-term money market income - Brazilian source	5,000
Withholding tax on short-term money market income	750
Capital gain - Profit on sale of property	5,000
Income tax on capital gain	750
Medical expenses	1,500
Alimony payments	10,000
Schooling expenses	7,000

## Tax computation

Brazilian-source salary income		110,000
Foreign-source income		80,000
Short-term money market income - Brazilian source		5,000
Capital gain - Profit on sale of property		5,000
Gross income		200,000
Less - Income taxed only at source:		
Short-term money market income	5,000	
Capital gain subject to special taxation (Note 1)	<u>5,000</u>	<u>10,000</u>
Net taxable income before allowances and deductions		190,000
Less - Allowances and deductions:		
Social security contributions	3,311	
Dependents (three)	4,212	
Medical expenses	1,500	
Alimony payments	10,000	
Schooling expenses (for three)	<u>6,594</u>	<u>25,617</u>
Net taxable income		<u>164,383</u>
Income tax at 27.5%		45,205
Less - Amount deductible relating to lower tax brackets		<u>5,584</u>
		39,621
Less - Tax paid at source:		
On Brazilian-source salary income	24,665	
On foreign-source income	<u>16,415</u>	<u>41,080</u>
Refund (Note 2)	<u>1,459</u>	

## Notes:

1. Capital gains are taxed only at source at the rate of 15%, payable by the taxpayer up to the last working day of the subsequent month.
2. In case there is tax due, it is payable in full at the time of filing or, at the option of the taxpayer, in up to six installments as from April 30. Each installment may not be less than R\$ 50 and if the due amount is less than R\$ 100 it should be paid in one installment.
3. At June 30, 2005 the official exchange rate was US\$ 1 = R\$ 2.35.

## Appendix IX Tax on foreigners working in Brazil

Individuals entering the country with a Temporary work visa under an employment contract with a company incorporated in Brazil are considered "tax resident" as of the date of arrival. Therefore, foreign and Brazilian earnings are taxed, as of that date, in accordance with the progressive tax rates.

Individuals entering the country with other temporary visas are considered "tax resident" of Brazil after completing 183 days of physical presence in the country within any given period of 12 months. As of the 184th day, the individuals are considered resident and taxed on their worldwide income. Therefore, foreign and Brazilian earnings will be taxed in accordance with the progressive tax rates. During the non-residency period, only Brazilian source income is subject to taxation at a flat tax rate of 25%.

It should be noted that the 183 days do not need to be consecutive. The 12-month period can commence as of the date of any entry into the country. The residency taxation rules will be applied as of the 184th day of presence. There is no income tax filing obligation for the period of non-residency.

## Appendix X **Wealth tax**

Wealth tax is not yet applicable in Brazil. The 1988 Federal Constitution refers to a wealth tax to be imposed, but regulations have not yet been issued.

## Appendix XI Estate, inheritance and gift tax rates

The income arising from the estate of a deceased person and up to the final distribution of the estate is subject to income tax at the same rates as for individuals (see Appendix VI).

For inheritance and gift taxes, please refer to Chapters 21 and 22.

## Appendix XII Social security contributions and benefits

### Monthly contributions

Employer

20% of gross payroll.

Employers must also make various other monthly contributions as follows.

	<b>Percentage of gross payroll</b>
FGTS - Employee Indemnity Guarantee Fund	8.0
Additional to FGTS	0.5
Education fund	2.5
Work accident insurance - maximum (1)	3.0
SESI/SESC Social programs	1.5
SENAI/SENAC Training programs (2)	1.0
SEBRAE Program for small companies	0.6
INCRA Supplementary rural pension	0.2
	<hr/> 17.3 <hr/>

Notes

1. Accident insurance contributions vary from 1% to 3% of the gross payroll depending on the degree of risk in the workplace.
2. Applicable to industrial and commercial companies only.
3. All contributions are deductible for corporate income tax purposes.

### **Employee Salary base for monthly contribution**

<b>From - R\$</b>	<b>To - R\$</b>	<b>Contribution - %</b>
0	800.45	7.65
800.46	900.00	8.65
900.01	1,334.07	9.00
1,334.08	2,668.15	11

## Notes:

1. Contributions are deducted from employees' monthly remuneration.
2. Contributions are deductible for individual income tax purposes.
3. The salary base for contributions is adjusted annually according to minimum wage restatements

## Social security benefits

## Pensions

<u>Type</u>	<u>Minimum Contribution Period</u>
Old age:	
Male - 65 years and over	180 months
Female - 60 years and over	180 months
Retirement	35 years (30 years for women)
Invalid	12 months

The monthly pension varies according to contributions made. The maximum amount is R\$ 2,668.15.

## Sickness benefit and accident insurance benefit

The maximum amounts payable for each of these benefits is also R\$ 2,668.15 per month.

## Unemployment benefit

The unemployment benefit of up to a maximum of R\$ 561.30 per month is payable by the government after certain conditions have been met and for a period of from three to five months.

## Notes:

1. All benefits are adjusted annually.
2. At June 30, 2005 the official exchange rate was US\$ 1 = R\$ 2.35.
3. The employment benefit is strictly connected to the minimum wage variation. Therefore any change in its values will reflect on the benefit value.

## Appendix XIII Indirect taxes

### Federal

#### Excise tax (IPI)

This federal value-added tax is levied at varying rates on nearly all sales and transfers of products industrialized in or imported into Brazil, depending on the degree of necessity. Industrialization may be incomplete, partial or intermediate. Examples of average rates for various products and groups of products are as follows.

	<u>%</u>
Food in general	0
Soft drinks	40
Alcoholic drinks	8/60
Plastic and rubber	0/20
Textile materials	0/10
Machinery and equipment	2/30
Precision instruments	0/15
Cigarettes	30/330

Exports are exempt. Imports are normally taxed at the same rate as Brazilian-made products. Rates are changed frequently and vary depending on the product.

#### Customs duties (II)

Customs duties are levied on foreign goods upon their entry into Brazilian territory. Rates vary in accordance with product specifications listed in the Common External Tariff (TEC). Exemptions or reductions may be granted temporarily. For further details see Chapter 8.

#### Payroll taxes

These taxes are summarized in Appendix XII above.

## Financial operations tax (IOF)

This tax is levied at various rates, which may be summarized as follows.

	%
Loans and credit operations	0.0041/day
Insurance policies	0 to 4
Other financial transactions	0 to 25
Incoming loans repayable in foreign currency in less than 90 days	5
Incoming resources for application in fixed-income funds	0 to 1
Incoming loans for periods longer than 90 days	0

Rates may be changed at any time

## Rural property tax (ITR)

Taxation at the minimum rate of 0.03% per annum on assessed property values but can be increased to up to 20%, depending on the stage of utilization and exploration and the total area of the property.

## Social contribution on billings (COFINS)

This monthly contribution, in its non cumulative regime, is levied at the rate of 7.6% of corporate gross revenues after certain deductions and exclusions. However, it is possible to offset credits calculated on certain inputs against tax due. As from August 2004, financial income is not subject to this contribution. Companies not subject to the non cumulative regime are levied at the rate of 3% and may not discount credits.

Special regimes are provided for certain business, such as pharmaceutical, automobile and tires industry, petroleum and its derivatives and beverages, which are subject to different rates.

See below, under PIS, an example of COFINS calculation.

## Social Integration Program (PIS)

This monthly contribution, in its non cumulative regime, is levied at the rate of 1.65% on corporate gross revenues, including financial income, and after certain deductions and exclusions. However, it is possible to offset credits calculated on certain inputs to reduce tax due. As from August 2004, financial income is not subject to this contribution. Companies not subject to the non cumulative regime are levied at the rate of 0.65% and may not discount credits.

Special regimes are provided for certain business, such as pharmaceutical, automobile and tires industry, petroleum and its derivatives and beverages, which are subject to different rates.



## Transfer tax - Inheritance and Gift Tax (ITCMD)

A property transfer tax is normally payable at a rate of up to 4% on inheritances and donations of properties and rights.

## Municipal

### Service tax (ISS)

Rates vary from 2% to 5%. The rates listed are more common for services rendered in the larger cities.

	%
Hospitals, schools, colleges	2
Civil construction,	5
Leasing	2
Tourism sector	5
Specified entertainment activities	5
Other services	5

## Property tax (IPTU)

This annual tax amounts to between 0.2% and 5% of assessed fair market property values.

## Tax on sale or transfer of properties (ITBI)

A property transfer tax of up to 6% is payable by the acquirer on sales or transfers of real estate.

## Appendix XIV Setting up in Brazil - A Checklist

This checklist illustrates points that investors and their advisers should consider when contemplating setting up a business enterprise in Brazil.

### I - Investor's considerations

#### • Market - Existing and potential

- Existing and potential market for products or services.
- Competition.
- Market surveys.
- Patent, trademark and design protection.
- License to trade (some sectors only).
- Franchising.
- Industrial standards.

#### • Preparation of a business plan

- Determination of overall strategy.
- Financial projections, including cash flow.
- Assistance from professional advisers.

#### • Form of entity to utilize

- Corporation ("sociedade por ações").
- Private limited liability company ("limitada").
- Partnership.

- Branch.
- Joint venture.

(See Appendix XV for details.)

#### • Capital structure

- Nature of business and minimum capitalization requirements.
- Importation of capital.
- Foreign equity limitation.
- Possibility of raising capital from local sources.
- Availability of financing - Local/foreign source.
- Repatriation of interest and principal of foreign-source loans.
- Bank borrowings.
- Equity issues.
- Injection of cash from parent or holding company.
- Government assistance.
- Other forms of finance (debentures/share issues).
- Lease or purchase of assets.
- Debt/equity ratio.
- Tax implications.
- Obtain advice from bankers, attorneys and accountants.

- **Location**
  - Logistical aspects.
  - Market and labor factors.
  - Transportation facilities.
  - Availability of tax/nontax incentive development areas/enterprise zones.
  - Tax implications - Federal, state and municipal.
- **Premises**
  - Type needed.
  - Own or lease.
  - Current requirements.
  - Expansion possible.
  - Storage/warehousing.
  - Insurance.
  - Health and safety regulations.
  - Planning restrictions.
  - Restrictions on ownership of buildings, land.
  - Approvals required.
  - Tax implications.
- **Management - Availability and compensation**
  - Skills required.
  - Compensation levels.
  - Availability locally; recruitment.
  - Possibility of bringing own staff from outside.
  - Limitations on expatriate staff - Number and compensation.
  - Executive recruitment services.
  - Pension and other retirement arrangements.
  - Visa requirements.
  - International schools for children of expatriate staff.
- **Labor - Availability and compensation**
  - Numbers and types needed.
  - Compensation levels.
  - Terms of employment.
  - Work permits.
  - Recruitment.
  - Employee benefits/pensions.
  - Payroll taxes and social security costs.
  - Training programs.
  - Unions.
  - Government assistance, grants.
- **Production capabilities**
  - Capacity - Current and projected.
  - Capital commitments - Initial and projected.
  - Raw materials - Sources, availability, customs duties.
  - Technology available.
  - Import restrictions.
  - Projected costs - Overall and unit.
- **Selling the product**
  - Projected costs.
  - Promotion methods.
  - Selection of advertising and/or public relations firms.
  - Market campaigns.
  - Sales force.
  - Sponsorship.
  - Exhibitions and trade shows.
  - Pricing policies.
  - Exporting process.
  - Sales tax, excise tax and indirect taxes requirements.
  - Existence of sales price controls.
  - Tax implications.

- Formation procedures

- Appointment of professional advisers - Attorneys, accountants, tax advisers and bankers.
- Registration.
- Ordering stationery/design of logo.
- Company secretarial and administrative services.

## II - Legal counsel's considerations

- Approval of foreign investment by government authorities.
- Documentation and registration requirements for type of entity selected.
- Permits and licenses required.
- Clearance of company name.
- Statutory operating and audit requirements.
- Conduct of the entity.
- Business contracts and agreements.
- Employment contracts.
- Property evaluation and documentation.
- Business, banking and industrial regulations.

## III - Accountant's considerations

- Evaluation of industry/feasibility study.
- Tax planning.
- Requirements for tax purposes.
- Profit planning for initial years.
- Accelerated depreciation.
- Management control systems (i.e., financial management systems, employee records, inventory control).
- Financing requirements.
- Bookkeeping requirements.
- Use of computers.
- Financial statement preparation.
- Management consulting.
- Help from auditors.
- Projections.

## Appendix XV Structuring an investment in Brazil - A Checklist

This checklist illustrates the points that investors and their advisers should consider in deciding the form of business entity by which to operate.

### I - Corporation (sociedade por ações)

- Investor's considerations
  - Rules and limitations for foreign ownership/shareholders.
  - Number of founder shareholders required, including local shareholders, and voting limitations.
  - Advantages/disadvantages of incorporating.
  - Availability of local funding, including equity issues.
  - Degree to which capital must be imported.
  - Extent of powers to be given to the board of directors.
  - Requirements as to local and/or labor representation on board of directors.
  - Repatriation of capital and profits.
- Legal counsel's considerations
  - Formation requirements.
  - Registration requirements.
  - Documentation.

- Accountant's considerations
  - Tax advantages of incorporating.
  - Tax planning opportunities to minimize tax.

### II - Private limited liability company (limitada) and partnerships

- Investor's considerations
  - Rules and limitations on foreign quotaholders/partners.
  - Requirement for residence (or legal representation) of quotaholders/partners.
  - Advantages/disadvantages of operating as a "limitada"/partnership.
  - Repatriation of capital and profits.
- Legal counsel's considerations
  - Formation requirements.
  - Registration requirements.
  - Documentation.
  - Residence and representation of quotaholders/partners.

- Accountant's considerations

- Taxed as conduit or entity.
- Tax planning opportunities to minimize tax.

### III - Branch

- Investor's considerations

- Limitations on foreign participation.
- Advantages/disadvantages of operating as a branch.
- Capital requirements.
- Repatriation of capital and profits.

- Legal counsel's considerations

- Formation requirements.
- Capital to be assigned to the branch for legal purposes.
- Registration requirements.

- Accountant's considerations

- Taxation of a branch.
- Taxation of profits, whether or not repatriated.
- Taxation of reinvested profits.
- Tax planning opportunities to minimize tax.

### IV - Joint venture

- Investor's considerations

- Government and local authorities' view of joint ventures.
- Emphasis on foreign participation in joint ventures.
- Advantages/disadvantages of participating in a joint venture.

- Legal counsel's considerations

- Formation requirements.
- Registration requirements.
- Documentation.

- Accountant's considerations

- Taxed as conduit or entity.
- Tax planning opportunities to minimize tax.

# Appendix XVI Acquiring a business enterprise in Brazil - A Checklist

This checklist illustrates the points that investors and their advisers should consider when contemplating acquiring a business in Brazil.

## I - Investor's considerations

An investor should investigate the following aspects, among others, of the seller.

History and current status of the business

- When, where and by whom established?
- What is for sale - entire business, or only controlling interest (with possible minority problems)?
- Corporation, "limitada", partnership?
- Why is business for sale?
- Evaluation of sector in which the company operates, including growth potential and stability.
- Status of target business within its sector: reputation, competitive position and recent changes of significance.
- Target business.
- History of development, including new products;
- General nature of current operations and principal products;
- Assessment of company's overall strategy and extent to which it sets strategic objectives and monitors its performance against them;
- Strategies and the extent to which these are integrated into company's overall strategy;

- Is business dependent on a high level of research and development activity or on large imports of raw materials?

## Capital structure

- Business owned by few or many shareholders.
- Major shareholders.
- Analysis of differing classes of equity.
- Should business be restructured? Form to use.
- Retain present business name because of established name and history, employee morale, stock listing, etc.?
- Special trade arrangements.

## Markets and competitors

- Markets served.
- Potential new markets.
- Involvement in mature, declining markets.
- Seasonality of the business.
- Proposed new products.
- Proposed research and development.
- Principal competitors.
- Effects on company's markets of any relevant legislation, current or pending.

## Capital required

- Purchase costs.
- Assets replacements.
- Projected operating costs.
- Relations with local bankers.
- Limitations on foreign ownership.

## Location and premises

- Where located?
- Accessibility to road, air, river, or sea transport facilities.
- Whether premises are in a development or enterprise zone.
- Availability of customs bonded warehouse.
- Any planning restrictions or approvals required for developing present site?
- Main premises, owned or leased?
- Space available for expansion?
- Adequacy of security in the premises.
- Details of any professional valuation of premises.
- Government approval for acquisition of properties.
- Any restrictions in connection with environmental protection.

## Management evaluation

- Management organizational chart.
- Key employees - Name, age, years of service, health and qualifications.
- Present salaries and other forms of remuneration.
- Sector experience.
- Continued employment.
- Details of any service agreements and pension schemes.
- Any unfunded liabilities for pensions or severance payments?

## Production evaluation

- Standards for sector.
- Estimated production capacity.
- Scope for utilizing spare capacity or for increasing capacity.
- Quality of plant and equipment, including buildings.
- Nature and amount of work subcontracted.
- Relationship between fixed and variable costs.
- Details of patents, tools and dies.
- Possibility of obtaining government grants toward modernization/extension of production facilities.
- Raw materials used and principal suppliers.
- Terms of purchases.
- Any significant forward purchase commitments?
- Impact of purchases in foreign currencies.
- Supply position of raw materials - Any difficulties in the past in obtaining, either from regular suppliers or from alternative sources?
- Any control of prices/supply of materials by government or under trade association agreements?

## Workforce evaluation

- Safety record.
- Number of employees and staff at each main factory and office, broken down by full-time/part-time and male/female.
- Labor relations with management and unions.
- Approximate present salaries/rates of pay.
- Holiday pay arrangements.
- Existence of collective bargaining agreements.
- Fringe benefits provided and costs thereof.
- Projected future requirements.
- Pension scheme arrangements.
- Profit sharing arrangements

## Sales and marketing - Analysis of current and potential

- Share of market.
- Sales promotion methods.
- Export methods and situation.
- Nature of relationship between company and its selling agents.
- Sales by product, by major customers and by geographical market.
- Particulars of any major contracts unfulfilled.
- Extent to which company is involved in fixed prices and long-term contracts.
- Any controls on selling prices by government, trade associations, etc.?
- New product potential.

## Contractual obligations, other than with management or labor

- Loan agreements.
- Government and/or long-term contracts.
- Purchase or sale agreements.
- Leases.
- Licenses.
- Warranties.
- Franchises.
- Mortgages.
- Insurance policies.
- Guarantees.
- Assignability of contractual obligations (except in share/quota transfers).
- Royalties and technical assistance agreements.

## II - Legal counsel's considerations

The investor's legal counsel should investigate and review the following aspects, among others, of the seller.

### Corporate, statutory and regulatory documents

- Corporate documents:
  - Articles of incorporation;
  - Bylaws;
  - Possibility of special restrictions on sale;
  - Share certificate book and stubs;
  - Minute book;
  - Shareholders' agreement.
- Regulatory documents:
  - Annual reports to shareholders;
  - Reports to the Securities Commission.
  - Shareholders' approval requirements.
  - Dissenters' rights.

### Management/labor obligations

- History.
- Present contract obligations.
- Prospects.
- Changes in labor picture and union relations that acquisition might bring about.
- Pension, profit-sharing, share-option, and/or other employee benefit plans:
  - If none, might acquisition make adoption necessary (particularly if buyer has such plans in force)?
  - If seller has such plans in force, what might be effects of termination on retained employees and retention on buyer?
- Accrued leaving indemnities, including labor suits.

## Property titles and liens

- Outstanding or potential litigation.
- Real property:
  - List and description;
  - Evaluation;
  - Title documents;
  - Surveys;
  - Insurance policies.
- Tangible property:
  - List by category;
  - Valuation;
- Intangible property - List by category (patents, trademarks, etc.) and expiry dates.
- Existing liens.
- Pending legislation.

## Other

- "Doing business" requirements/qualifications.
- Regulatory consents - Such consents required for acquisition of certain types of businesses.
- Employee agreements:
  - Can and should any existing agreements be canceled?
  - Should any new ones be entered into with "key" employees?
- Noncompete agreements - Should any be entered into with seller's shareholders?
- Public disclosure requirements.

## III - Accountant's considerations

- The investor's accountant should analyze the following aspects, among others, of the seller.

### Past trading results

- Accounting policies.
- Compliance with accounting standards and the law.
- Consistency of application.

### Financial statements

### Balance sheet

#### Assets:

- Accounts receivable;
- Is the bad debt allowance adequate, excessive?
- Average period outstanding.
- Inventory:
  - Inventory turnover;
  - Basis of valuation;
  - Methods adopted for providing for slow-moving and obsolete inventory;
  - Adequacy and consistency of these provisions.
- Tangible assets:
  - Relation of cost to appraisal value and market value.
- Buildings and equipment:
  - Relation of cost to appraisal value and market value;
  - Depreciation rates;
  - Replacement policy.
- Intangible assets:
  - Patents, trademarks, designs, copyrights.
- Particulars;

- Policy;
- Basis for writing off the capital costs.
- Goodwill:
- How acquired?
- Arising on consolidation?
- Cost.
- Amounts written off.
- Current value.
- Research and development cost policies.
- Investments:
- In securities;
- Nature of business relationship with investors;
- Details of material transactions with investors;
- Details of any guarantee to, or other arrangements with, investors;
- Details of any restrictions on realization of overseas interests.

### Liabilities:

- Details of security given - Both at balance sheet date and at present.
- Short and medium-term financing:
- Amounts;
- Dates of repayment;
- Currencies;
- Interest rates;
- Security;
- Details of any conversion options.
- Long-term financing:
- Amounts;
- Dates of repayment;
- Currencies;
- Interest rates;
- Security;
- Details of any conversion options.
- Availability of further financing:

- Short-term at favorable rate of interest?
- Long-term - Favorable or unfavorable rate of interest?
- Possibility of refinancing?
- Leasing agreements;
- Guarantees;
- Contingent liabilities.
- Discounted bills.
- Litigation pending.
- Other considerations:
- Capital and material purchase commitments at balance sheet date and details of any significant individual orders since placed;
- Insured values;
- Basis for capitalizing own labor and materials;
- Arrangements for company cars and their private use;
- Review of any liabilities for repayment for grants on change in ownership of the business;
- Deferred pension plan costs - What are past service costs, if any?
- Pension agreements - extent of liability.
- Agreements, written or unwritten, regarding expenses;
- Severance pay liability.

### Statement of income

- Gross profit ratio.
- Comparison with other companies.
- Operating profit ratio.
- Data by division, if applicable.
- Do expense accounts include personal items of owners/shareholders?
- Nonrecurring income and expenses.
- Analysis of executive salaries and bonuses.
- Explanation of fluctuations in income or expense items.
- Change in over or under-absorbed overhead.
- Statement of income items:
- Income:

- Sales - Trends, order book, long-term contracts;
- Other income;
- Royalties;
- Management and technical fees;
- Service fees;
- Rents;
- Income from trade and other investments.
- Expenses - Cost of sales:
- Material, labor and production overhead costs;
- Accuracy of management accounts and costing procedures.
- Gross profits:
- By product division;
- By branch;
- Percentage margin on sales;
- Method of spreading profit on long-term contracts.
- Interest and costs of borrowings;
- General and administrative expenses;
- Income gearing.

### Statement of changes in financial position

- Profit and cash-flow forecasts and bases of assumptions;
- Source and application of funds;
- Adequacy of working capital;
- Relationship with bankers.

### Current tax status

- Reasons for high/low rates of charge.
- Analysis between current and deferred taxation.
- Adequacy of current provision for income taxes.
- Possible additional taxes for prior years.
- Particulars of important matters in dispute.
- Stages in negotiation with local Tax authorities.
- Comments on adequacy of overall provision estimated; deficiency or surplus.

- Details of losses available to carry forward.
- Extent to which tax planning schemes have been used in the past and assessment of any resulting potential exposure.

### Future prospects

- Profit and cash-flow forecasts and assumptions on which based.
- Accuracy of past forecasting.
- Long-term prospects.
- Adequacy of working capital, relationship with bankers.
- Effect of pending government regulations.

### Method of acquisition

- Tax implications of method of purchase - Shares versus assets.
- Shares:
- Change of control restricts carry forward of losses;
- Deductibility of interest;
- No step-up in capital cost of depreciable property.
- Assets:
- Price allocation issues;
- Withholding obligations if vendor is nonresident;
- Purchase price of fixed assets becomes depreciation base;
- Only specified liabilities assumed.
- Implications for future operations.

## Added Value\*

PricewaterhouseCoopers provides industry-focused advisory services in four areas:

- corporate sustainability
- risk management
- structuring, mergers and acquisitions
- performance and process improvement, including outsourcing of accounting and tax areas, among others

We use our network of professionals, experience, industry knowledge and business understanding to build trust and create value for clients.

This is what we call Connected Thinking.  
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