

The Painful (and Taxing) Realities of Doing Business in Brazil

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Introduction

Countering the trend trumpeting Brazil's current economic appeal, this article seeks to demonstrate that doing business in Brazil is still very complicated, costly and can be surprisingly painful as well. Due to the natural limitations of the format, the article covers only the basic aspects of a foreigner doing business in Brazil. Certain topics—such as, but not limited to, tax compliance, trade and customs, and transfer pricing—are not included; each of those topics alone is worth study.

While there seems to be little doubt that Brazil's economy will keep growing, making the country attractive to foreign capital, prospective investors should give special consideration to their tax planning: the recent thirty-point increase in the country's industrial-product tax on imported cars is just the latest measure that contributes to legal and economic uncertainty.

Brazil's Form of Democracy

Brazil has always been protectionist to varying degrees, and its formal democracy includes tools that give the federal government powers not found in many other democratic countries. Economic protectionism has been a part of the political landscape since Brazil gained its independence from Portugal in 1822. This can be found in the economic policy of import substitution—replacing imports with domestic production based on the premise that a country should attempt to reduce its foreign dependency through the local production of industrialized products—that the country practiced for most of the twentieth century.¹ Such policies can be instituted through a far stronger executive branch than exists, for example, under the U.S. Constitution. For instance, except on certain matters, in Brazil the President of the Republic has the constitutional power to legislate by what is called Provisory Measure (*Medida Provisória*) “in case of

relevancy and urgency.”² Every Brazilian President has used (and some have argued, abused) the *Medidas Provisórias* (“MPs”), because almost anything can be “relevant” and “urgent” to the government, and this of course avoids messy congressional debate.

As of 19 September 2001, a new numbering system was assigned to the MPs, starting with “No. 1.”³ Since that time, the President of the Republic has issued 546 MPs, an average of 55 per year or 4.5 per month, to create legislation. While it is true that Congress must approve the MPs and the current Constitution allows Congress to amend the original text submitted by the President,⁴ their existence in the Federal Constitution certainly makes for a weaker Congress. Thus, the Brazilian executive branch has primary power, with a weaker legislative branch, and the Federal Justice becomes the ultimate check and balance. As a consequence, the federal justice system has faced an onslaught of hundreds of thousands of lawsuits filed by private citizens against the federal government.⁵ In 2004, 2.6 million new lawsuits were brought before the Federal Justice in Brazil,⁶ and in 2010 the number increased to 2.98 million, which makes 1,933 new federal actions per 100,000 inhabitants.⁷ And this is only the Federal Justice, disregarding the entire Federal Labor Law Courts and all of the state judiciaries, whose numbers are much higher. For the sake of comparison, in 2010:

[P]laintiffs [in the U.S.] filed 272,000 new civil suits in federal District Courts, including 34,000 contract claims, 4,000 real property claims, and 77,000 tort claims (15,000 of them relating to asbestos). The rest of the claims were statutory: 53,000 prisoner petitions, 32,000 civil rights cases, 19,000 labor law cases, 13,000 social security claims, and 11,000 intellectual property disputes.⁸

Brazil's Blended Civil Law System

Brazil has a civil law system, mean-

ing that the law is based on written codes, consolidations, and “statutes.” (In Brazil, “statutes” refers to regulations of a certain class of people (e.g., Statute of the Indian, Statute of the Foreigner) or of a certain activity or profession (e.g., Statute of the Lawyers, Statute of the Land, etc.). A “code” is a methodical set of rules of a specific field of law intended to be a body of permanent law. When certain legislations have not been codified, however, but have been assembled together (as, for instance, the several laws on labor), it is called “consolidation of laws.” Not as systematic as a code, a consolidation of laws merely assembles legislations in the same field of law in an organized single volume. In Brazil only the federal Union can legislate on civil law, commercial law, penal law, electoral law, agrarian law, maritime law, aerospace law, labor law, and criminal and civil procedure.⁹ As a consequence, for each of those areas, there is either a single national code (e.g., the Civil Code, the Commercial Code, the Tax Code, etc.), or a consolidation (for instance, the Labor Laws Consolidation), or a single statute (e.g., the Statute of Child and the Minor).

In Brazil, as in most civil law systems, court decisions usually do not serve as a source of precedent, and they bind only the litigating parties. Decisions of a Brazilian tribunal made by the absolute majority of its members are, however, the object of a *Súmula*, or a “summary” that constitutes a precedent for the purpose of making the jurisprudence uniform.¹⁰ In 2004, Congress amended the Federal Constitution to establish that the final decisions issued by a two-thirds majority of the members of the Federal Supreme Court (“STF”) would have binding legal effect on the entire judiciary.¹¹ The so-called *Súmulas Vinculantes*, (binding summaries, or binding precedent) are regulated by Law No. 11,417 of 19 December 2006 and enable the judiciary to decide in a definitive and final way thousands of cases dealing with

the same issue.¹² Additionally, the STF can declare the constitutionality (“ADC”) or the unconstitutionality (“ADIN”) of a certain law in the abstract,¹³ erga omnes, although only a certain few people or entities have standing to file those specific lawsuits.¹⁴ The decision of STF in an ADC or an ADIN has the same effect as a *Súmula Vinculante*, but it requires only a simple majority of the members of the STF (six justices).¹⁵ If the decisions of the STF on the ADCs and ADINs were made within a reasonable period of time, the legal uncertainty would decrease, especially when it comes to tax matters. It can take years, however, for the STF to decide an ADC or ADIN. For instance, it has been almost ten years since the Brazilian Confederation of the Industry (“CNI”) filed the ADIN No. 2578 on an important tax issue, but there is still no final decision.¹⁶ Thus, Brazil does not have a pure civil law system, although it is not a common law system either.

Foreign Investment in Brazil

The World Bank currently ranks Brazil number 127 out of 183 with regard to ease of doing business.¹⁷ In 2010 Brazil was ranked 124, meaning that it is falling in the rankings. With regard to protecting investors, the country is ranked number 74. On enforcing contracts, Brazil is ranked only 98. All of this contributes to the reputation of the “*Custo Brazil*,” broadly meaning the extra cost of doing business in Brazil due to everything from bureaucracy to infrastructure.¹⁸ In March 2010, ABIMAQ (the Brazilian Association of the Manufacturers of Machinery and Equipment), published a detailed comparison of the costs of doing business in Brazil, the United States, and Germany. Among other things, the research pointed out that the cost to manufacture comparable goods in Brazil is 36.27% higher than in those countries.¹⁹ Although the negative consequences of the *Custo Brazil* has been a subject of discussion since the early 1990s²⁰—the government even created a deregulation task force comprised of all government ministers to discuss it—progress has been slow.²¹

The Law of Remittance of Profits

Foreign investments in Brazil are governed by Law No. 4.131 of 4 September 1962 and its amendments.²² The original law is called Law of Remittance of Profits (“LRP”), and it defines foreign capital as:

any goods, machinery and equipment entered into Brazil without the initial expenditure of foreign currency, intended for the production of goods or services, as well as any funds brought into the country for use in economic activities, provided that [the goods and the funds] belong to individuals or business organizations domiciled or headquartered abroad.²³

The term “goods” also includes intellectual property in general, such as trademarks, patents, and technology transfers registered before the National Institute of Industrial Property (“INPI”). Moreover, in order to obtain exclusive use protection in Brazil for intellectual property rights, the foreign investor must register trademarks, industrial designs, utility models and patents already registered abroad with the INPI.

According to the LRP, Article 3(a), in order to be repatriated or to remit profits abroad, all foreign investments that enter Brazil must be registered with the Central Bank (“BACEN”). The registering process is simple and can be done electronically over the Internet. Upon registering, the foreign investor receives a permanent number, and this number will be necessary for any financial transaction concerning the registered capital. Foreign investments in Brazil are classified as direct or indirect. Direct investments are made either by investing in a new business or by acquiring an equity participation in an existing Brazilian company. On the other hand, investments in the financial and securities market, where there is no requirement to create or acquire participation in a Brazilian company, are considered indirect foreign investments.

Equity participation includes cash investments, investments by conversion of foreign credit, and investments by importing goods that have not been paid for yet. Investments in equity by the conversion of foreign credit (such as inter-company loans or other credits previously registered

with BACEN) are not subject to BACEN’s authorization and can be easily made by combining symbolic exchange agreements. Goods imported without payment may also be converted into foreign investment, but if the goods are used or were imported under certain tax incentives, they cannot be similar to goods produced in Brazil, and the conversion must be recorded with BACEN within ninety days after their customs clearance.

Foreign investments in the Brazilian financial and capital markets are regulated by BACEN’s Resolution No. 2,689 of 26 January 2000. Prior to investing in those markets, the foreign investor must, among other things, appoint one or more representatives in Brazil and obtain a register with the Brazilian Securities and Exchange Commission (“CVM”).²⁴ The CVM is the Brazilian counterpart of the SEC and was created by Law No. 6,385 of 7 December 1976.²⁵

Restrictions and Rules

Usually, investments in equity are not subject to governmental approvals or authorizations, and there are no requirements regarding minimum investment or local participation in capital. Foreign investors, however, are prohibited from engaging in business related to nuclear energy, hydraulic power generation, health services, and mail and telegraph services. Moreover, foreign investors may not hold more than a minority participation in media, airlines, financial institutions and insurance companies, except that they may acquire control of a bank pursuant to a reciprocal agreement or with prior authorization from the federal government.

As to airlines and airports—which in Brazil are all under the control and management of the federal Union—the large increase in the number of both domestic and international passengers has shown that modernization of Brazil’s airport infrastructure requires hundreds of billions of *reais* that the government does not have. As a consequence of hosting the 2014 FIFA World Cup, Brazil has entered into certain agreements with FIFA to modernize or

build stadiums and airports, and certain deadlines must be met to receive and accommodate the millions of expected visitors. Thus, on 18 March 2011 the President of the Republic sent to Congress MP No. 527 which, among several other things, significantly changes the business of airports and airlines in Brazil. Congress has proposed amending the MP to increase to 49% (from 20%) the percentage that foreign investors may hold in Brazilian airlines. MP No. 527 became Law No. 12,462 of 5 August 2011, but the proposed amendment has not yet been approved.

There are also restrictions on foreign participation in activities concerning national security, as well as on foreign ownership of rural areas and businesses in border zones.²⁶ While the restrictions were loosened on the airport business, restrictions in other areas are becoming tighter. For instance:

Farmland is being treated as a strategic asset on a par with oil. Last year, spooked by the idea of foreign sovereign-wealth funds and state-owned firms buying up vast tracts, the government resurrected a 1971 law limiting the amount of rural land foreigners can buy. It was revived even though in the 1990s it was deemed incompatible with the new democratic constitution and open economy. The details are under review: foreigners may be allowed to buy a bit more without restriction, and still more if the government thinks it is in the national interest. But there is no timetable for passing a new law. The Brazilian Rural Society estimates that \$15 billion of planned foreign agriculture investments are being dropped.²⁷

The same can be said regarding foreign investment in oil. In 2007 the government started the so-called Acceleration Growth Program (“PAC”), which was scheduled to receive up to R\$503.9 billion in projects related to energy, infrastructure, social and urban buildings, transportation, energy, sanitation, housing and water resources. The PAC sets forth three areas for investment: (1) logistics infrastructure, involving the construction and expansion of highways, railways, ports, airports and

waterways; (2) energy infrastructure, representing generation and transmission of oil, natural gas and renewable fuels; and (3) social and urban infrastructure, covering sanitation, housing, subways, commuter trains, water resources, as well as the universalization of the program “Light for All.”

In April 2010 the government launched the PAC 2, proposing to invest an additional R\$958,900 billion until 2014 (which includes preparation and investments related to the 2014 FIFA World Cup). Foreign companies can participate in the bidding process and development of PAC 2 projects. There are certain opportunities to participate in the exploitation and production of oil and to participate as suppliers of equipment and services, as well as natural gas transportation. Foreign firms can only pump oil in the recently discovered *pré-salt* oil fields as junior partners of state-controlled Petrobras, however, where previously they could bid for all concessions on equal terms.²⁸ In other words, the rules have been changing dramatically since the PAC 2 was launched last year.

Limits on Foreign Loans

As of 6 November 2010, there are new regulations on the loans that foreign parent companies make to their Brazilian subsidiaries. These regulations seek to prevent Brazilian companies from being undercapitalized and heavily indebted to their foreign parents. Basically, the goal is to make the parent companies increase their equity in the Brazilian subsidiaries.²⁹ As a result, interests paid or credited by a Brazilian company to a foreign-related party that is not incorporated in a country listed as a tax haven by the Brazilian tax authority, will be deducted for income tax purposes only when deemed to be necessary expenses for the Brazilian company’s activity and provided that, on the date of payment or credit of the respective interests, the following thresholds are cumulatively met:

- (1) each related party debt-to-equity ratio cannot exceed twice the value of the direct equity investment made by such related party in the Brazilian recipient company; and

- (2) the overall indebtedness, considering all forms and terms of financing, whether the loan agreement is registered or not before BACEN, cannot exceed the same proportion in relation to the aggregate amount of the direct equity investments made by all related parties in the Brazilian recipient company.

Any excess of the limits imposed by the law will be deemed an unnecessary expense for the Brazilian company’s activity, and non-deductible for income tax purposes.

Establishing a Company in Brazil

Business organizations in Brazil are regulated by the Civil Code³⁰ and by the law of *Sociedades Anonimas* (literally, “anonymous societies,” but the better translation is “corporations”).³¹ The Code and the law embrace the universal principle that a legal entity is different from its partners, meaning that the entity’s assets do not belong to its partners, and such assets may be used only to cover responsibilities attributable to the entity.³² The Civil Code uses the word “*sociedade*” for all of types of business organizations that have more than one partner. The word “*companhia*” (“company”), however, applies exclusively to the *sociedades anonimas*. In the Code’s context, probably the most appropriate translation for “*sociedade*” is partnership. Recently, the Civil Code was amended to include an individual company called “*Empresa Individual*” (loosely translated as “individual enterprise” or “individual business”).³³ In any case, from the perspective of a foreign investor, only the “*sociedade limitada*” (limited partnership) and the “*sociedade anonima*” (corporation) have relevance.

A partnership in Brazil is deemed to exist from the date its articles of organization are recorded with the *Junta Commercial* (Commercial Board). Each Brazilian state has a Commercial Board, but the statute that regulates them is the same: Law No. 8,934 of 18 November 1994. While the regulations of business entities are set forth either by the Civil Code or the Law of the

Corporations, recording the articles of organization of a partnership is regulated by another law and a series of regulations of the Commercial Boards themselves. That explains why it takes at least thirty days to record articles of organization before a Commercial Board in Brazil.

Among other requirements, foreign partners must appoint a legal representative resident in Brazil with the power to receive service of process and represent the company before the government authorities. The legal representative is the person who signs, on behalf of the foreign partner, the articles of organization of the Brazilian company and all of its amendments, as well as any other documents pertaining to the entity's business. The appointment is made by a notarized power of attorney ("POA"). If the POA is issued in a foreign country, it must be "legalized" at the respective Brazilian Consulate, translated by a translator accredited by the Commercial Board, and recorded at the Notary Public for the Registration of Titles and Documents. In addition, there is also a requirement that the foreign investor resident abroad prove its/his/her capability of doing business by providing certain personal documents (in the case of individuals) or corporate documents (in the case of business entities).

The articles of organization of a to-be-formed Brazilian partnership must be signed by the partners and two witnesses and, among other things, must set forth the partners' qualifications and positions, the subscribed corporate capital, the corporate bodies, the elected managers, as well as other matters related to the entity's business. Amendments to the articles must observe the same requirements.

The name by which the business organization will be identified must be researched at the Commercial Board and must comply with the principle of novelty; it cannot use a previously registered name, and the name must be sufficiently distinctive such that it cannot generate any confusion with existing names. The entity's name is an asset of the entity, and its exclusivity is protected by Brazilian law. As mentioned, trademarks, industrial designs, utility models and patents already registered abroad or

already being used by the foreign investor, and which will be used in Brazil, must be registered with the INPI in order to ensure exclusivity. Moreover, in order to receive royalties from the Brazilian entity, the foreign investor must enter into a license agreement with it and record the agreement with the INPI as well. Remittances of royalties are taxed, a topic covered in the next section.

Contrary to most states in the U.S., where a business organization can be formed without any specific business purpose ("any and all lawful business" being the general purpose), in Brazil the entity's business purpose (for some reason called the "social object") must be spelled out in articles of organization, and the entity will not be allowed to do business out of its stated purpose. A business organization can apply for a license with any of the regulatory Brazilian agencies only if its articles of incorporation list as its social object the one regulated by the specific agency. For instance, and this certainly comes under the meaning of *Custo Brazil*, if an entity does not list among its business purposes the act "importing goods," even though the entity is a distributor of the same goods, it will not be able to obtain a license to import, unless it amends its articles of organization to include "importing that certain specific type of goods" as one of its business purposes. Amending an entity's articles of organization in Brazil is as complicated as the initial filing.

The Limited Partnership

The name and certain similarities notwithstanding, the Brazilian limited partnership is different from a limited liability company in the U.S. To begin, the capital of a limited partnership is divided in quotas, there are no membership certificates and the articles of organization set forth the capital contribution of each partner (not "member," as in the U.S.). Each partner's liability is restricted to the value of his/her/its quotas. There is no stipulated minimum capital, and the increase or reduction of the partnership's capital must be reflected in the articles of association. If the capital

is increased, in order to avoid the dilution of the partners' quotas, the Civil Code provides for the first right of refusal of the existing partners, which is proportional to the percentage of their quotas. The partnership's capital can be reduced when there are irreparable losses, or the existing capital is excessive.

The Civil Code does not provide for different classes of partners, and the capital contribution cannot be provided through services,³⁴ although it does not necessarily need to be made through cash. The partners can deliberate as they wish regarding the distributions of profits and losses.³⁵ Deliberations on certain matters enumerated by the Civil Code require the approval of three-quarters of the quotas representing the partnership's capital (for instance, amending the articles of association, merger, dissolution, etc.). Other matters require approval by half of the quotas, while certain others can be decided by the majority of the partners attending a meeting.³⁶ The qualified quorums cannot be diminished by the partners, although they can be increased. Resolutions can be taken during meetings (*reuniões*) or assemblies (*assembléias*), as provided by the articles of association.

A meeting may be attended by any number of partners, and an assembly can be installed only on first call with a minimum number and on a second call with any number of the partners. When there are more than ten partners, resolutions must necessarily be taken during an assembly. Written notice of the meeting or assembly must be provided unless all the partners attend or state, in writing, that they are aware of the place, date, time and agenda. Limited partnerships must hold at least one yearly assembly, on or before 30 April, to deliberate on the partnership's accounts and to resolve matters about the balance sheets and the financial results.³⁷

As a rule, limited partnerships do not need to audit and publish their financial records, except if they are large-sized companies; i.e., those that, in the preceding fiscal year of the preparation of the balance sheets, reported total sheets above R\$240 million or an annual gross income higher

than R\$300 million.

Limited partnerships may be managed by one or more senior managers, partners or non-partner managers. The senior managers are appointed by the partners and may be designated in the articles of association or in another corporate document. There is no minimum or maximum mandate period for the position of senior manager, and the partners may, at any time, remove him/her from office.

Vis-à-vis a corporation, the limited partnership is simpler and less formal with a more flexible structure and reduced costs, which makes it appropriate for foreign partners with one common controller. If, however, the partnership is controlled by different groups of partners or if it has plans to issue debentures, subscription warrants, commercial papers and other securities and stock, then adopting the corporate format makes more sense. Moreover, a limited partnership cannot engage in certain business, such as banking and other financial activities.

Business companies have the obligation to maintain bookkeeping records of the business they take part in, presupposing the organization of an accounting department with duly certified professionals. Bookkeeping has several purposes: management assessment; support for third parties' information interests; and surveillance of compliance with mainly fiscal legal obligations.

Corporations

Corporations are entities whose capital is divided into shares and whose partners' liability is limited to the issuing price of their respective shares.³⁸ Corporations can be publicly or closely held, and the public ones are regulated by the CVM. As a general rule, no minimum capital is required. As a prerequisite to forming a corporation, a minimum of two shareholders must subscribe and contribute at least 10% of the capital. The law does not use the expression "articles of organization" for a corporation; only the word "bylaws" (*estatutos*) is used. The rules differ for public and private corporations but, in any case, the bylaws must be filed with the state's Commercial

Board.³⁹ Usually, a capital increase is done by amendment of the bylaws, and existing shareholders have right of first refusal. The corporation's capital can be reduced, as can the limited partnership's, due to certain losses or excess of capital.

Brazilian corporations can issue common, preferred or fruition shares, with or without nominal value. If the shares have nominal value, the issuing price of new shares cannot be lower than the nominal value of the existing shares. Common shares guarantee to holders the right to vote, while preferred shares have determined preferences or advantages, such

as priority in receiving dividends or in receiving capital repayment. The number of non-voting preferred shares, or those subject to restriction to vote, cannot be more than 50% of the total of the shares issued.⁴⁰ The fruition shares are those that result from the amortization of either the preferred or common shares. According to Law of the Corporations, Article 44, § 2°, amortization is an early distribution to the shareholders, without reduction in the corporation's capital, of certain amounts that could be distributed to them in case of the corporation's liquidation.

As a mandatory minimum dividend, the



law provides the percentage of the net profits set forth in the bylaws or, if the bylaws are silent, at least 50% of the net profits minus certain adjustments.⁴¹

As a general rule, the resolutions of a corporation are taken by the absolute majority of votes (50% + one vote of the valid votes of the shareholders who are present, excluding the annulled votes), with certain exceptions listed in Article 136 of Law of the Corporations, such as the amendment of the corporation's bylaws and the reduction of the mandatory minimum dividend, which require at least 50% of the corporate shares that have the right to vote. The shareholders may conclude agreements among themselves regarding the purchase and sale of their shares, right of first refusal to purchase from one another, the exercise of their right to vote or their power of control. The corporation must observe the agreements when they are filed in the corporation's headquarters⁴² and, in case of breach, these agreements are enforced by the Brazilian courts.

A corporation is managed by a Board of Directors and by Executive Officers, or only by the latter if there is no Board of Directors. The Board of Directors is elected by the Shareholders' General Assembly, and the Executive Officers are elected by the Board of Directors. If there is no Board of Directors, the Executive Officers must be elected by the Shareholders' General Assembly. A Board of Directors with at least three directors is mandatory in public corporations and optional in private ones. The members of the Board of Directors must be shareholders of the corporation and do not need to live in Brazil.⁴³

The Executive Officers are responsible for representing the company and managing its business. There must be at least two executive officers, shareholders or not, who reside in Brazil. The executive officers have a mandate up to a maximum of three years.

Corporations shall also have an Audit Committee, with a minimum of three and maximum of five members, and with equal numbers of replacements, shareholders or not. There is certain confusion regarding the Audit Committee because it can be per-

manent if there is a provision in the corporation's bylaws; if not, it can be convened by request of the shareholders.⁴⁴ Regardless of the existence of the Audit Committee, the financial statements of corporations must be audited by independent auditors. Last but not least, corporations—public and private—must publish, both in an official gazette and in a newspaper of wide circulation in the place where they have their main offices, the minutes of their meetings and any other resolutions that may affect third parties.

Taxation in Brazil: the Basics

Brazil has a multitude of taxes, generally levied one on top of the other in a cascade effect (*efeito cascata*), effectively making the government a risk-and-investment-free majority partner in most businesses. For instance, 54% of the final price of a car manufactured in Brazil consists of taxes of all sorts. On imported products in general, taxes make up an average of two-thirds of the final prices. To illustrate, on an imported product the initial tax basis is usually its CIF value. Applied on top of that is the import tax, then the IPI, then the customs expenses, then the ICMS, then PIS, and COFINS due on the import. Upon customs clearance, the cost of the good may be more than double the original CIF value.

As a consequence, many business entities must employ accountants and CPAs and have tax, labor law and corporate attorneys on retainer—obviously adding to operating costs.

The Brazilian federal tax system is handled by the *Secretaria da Receita Federal do Brasil* ("RFB"), whose latest incarnation was created by Law No. 11,457 of 16 March 2007. The RFB is the Brazilian equivalent of the IRS, and on paper it is under the authority of the Ministry of the Economy (*Ministério da Fazenda*). Similarly, states and municipalities have their own agencies. The main taxes can be divided into the four following groups:

I. Federal Corporate Income Taxes.

For tax purposes, there is no distinction

between domestic and foreign investors. A company is considered to be domestic if it has been incorporated under Brazilian law and is domiciled in the Brazilian territory. As noted, Brazilian law requires the company's effective management to be present physically in Brazil. Brazilian companies are taxed on a universal basis, and the profits generated by a foreign subsidiary or branch must be included in the December 31 financial statements of the Brazilian entity in the year in which the profits are earned, regardless of an effective dividend or profit distribution.⁴⁵

In certain other circumstances, such as the liquidation of a Brazilian company, foreign profits may be subject to Brazilian tax before December 31. Brazilian tax law provides that a subsidiary's financial statements must be prepared according to its local commercial legislation and translated into Brazilian currency. Consolidation of profits and losses of foreign companies, in principle, is not authorized for Brazilian tax purposes (except for branches of the same entity located within the same jurisdiction if certain conditions are met). Losses incurred by the Brazilian entities through a foreign company may not be used to offset Brazilian profits. But if the foreign profits are subject to income tax in the country in which the foreign company is located, the Brazilian parent company is entitled to a tax credit in Brazil, subject to certain limitations.

Brazil has two federal corporate income taxes: the corporate income tax ("IRPJ"), and the social contribution on the net income ("CSLL"). There are no state income taxes. Part of income tax collected, however, is transferred from the federal government to the states and municipalities.

The IRPJ is levied on business net income at a rate of 15%, plus a surtax of 10% on annual income that exceeds R\$240,000.00 per year or R\$20,000.00 per month. According to Law No. 9,430 of 30 December 1996, taxpayers may opt to calculate the IRPJ quarterly or annually. If the IRPJ is calculated quarterly, it is also payable quarterly. A 15% rate is applied over the quarter's net income, plus 10% surtax on net income exceeding R\$60,000

per quarter.⁴⁶

The CSLL's purpose is to fund social and welfare programs, and it is paid in addition to the IRPJ at a rate of 9% of income; for financial institutions, private insurance and capitalization companies, the rate is 15%. The overall income tax rate, considering the maximum rate for the income tax (15% + 10%) plus CSLL, is currently 34%.

There are basically three methods of calculating the IRPJ and the CSLL: (1) actual profit; (2) presumed profit; and (3) arbitrated profit. Note that a business whose annual gross income is under R\$2.4 million may elect to be taxed under the "simple system."⁴⁷

(1) Actual Profit System: The net taxable income is equal to the entity's net book profit, which is determined by applying Brazilian GAAP. Businesses are required to maintain appropriate accounting records, an income tax book and the supporting documentation along with the respective calculations. Dividends received from other Brazilian entities and revenue from investments in other companies are generally excluded from taxable income. Losses can be carried forward indefinitely (but cannot be carried back), subject to a maximum 30% off-set of the annual taxable income. Non-operational losses may be carried forward, but they can be used to off-set only non-operational profits, such as capital gains.

(2) Presumed Profit System: A business may elect to be taxed under the presumed profit system when all of the following conditions are met: (a) its total revenues in the preceding year were lower than R\$48 million; (b) the business is not obligated to file its taxes under the actual profit system (for examples, factories and financial institutions);⁴⁸ (c) it did not earn any foreign profits, income or gains, either directly or through foreign subsidiaries;⁴⁹ and (d) it does not qualify for an exemption or reduction of the corporate income tax.⁵⁰ The business must make the election at the beginning of each year, and the choice can be renewed every year. The election is valid for both corporate income tax and social contribution tax on

profits.⁵¹ Under the presumed tax regime, the taxes must be calculated and paid on a quarterly basis.

The presumed profit is calculated by applying a predetermined percentage, which varies according to the activity of the taxpayer, to the gross sales. The total amount of capital gains, financial revenue and other revenue are then added to this presumed profit base. Finally, the corresponding tax rates are applied to the presumed profit.⁵² For instance, the rate of tax on income from revenues derived from the sale of products is 8%, while the rate of tax on revenues derived from services is 32%. For CSLL, the percentages are 12% and 32%, respectively.⁵³

(3) Arbitrated system: Under certain circumstances, where the taxpayer does not comply with certain accessory obligations, either under the actual profit or the presumed profit systems, the RFB may arbitrate profits. If the gross income is known, the taxpayer may pay the arbitrated tax under the rules of the presumed profit but usually at higher rates, and eventually the RFB adds penalties. The income tax paid on the arbitrated profit is final and cannot be set off against future payments.⁵⁴

II. Gross Revenue Taxes: PIS and COFINS

PIS ("Program for Social Integration") and COFINS ("Contribution for the Financing of Social Security") are federal taxes levied on gross revenues on a monthly basis, and they can be cumulative or non-cumulative. Since their creation, PIS and COFINS were levied, respectively, at the rates of 0.65% and 3% for most of the business activities, and generated a cascading effect because there was no credit mechanism. Law No. 10,637 of 30 December 2002 changed the PIS, and Law No. 10,833 of 29 December 2003, and established new rules for the COFINS. As a consequence, the PIS rates were increased to 1.65% from 0.65, the COFINS to 7.6% from 3%, and a credit mechanism was created. Therefore, the PIS and COFINS levies on a business entity's gross revenues are non-cumulative, with a combined rate

of 9.25 percent.

III. Indirect Taxes: IPI, ICMS, and ISS

The IPI (manufactured products tax) is a federal tax levied on the importing and the manufacturing of goods.⁵⁵ The IPI must be paid either by importers, manufacturers, or entities legally treated as manufacturers.⁵⁶ The applicable rate varies with the product and its classification in the IPI tax rates table ("TIPI").⁵⁷ Contrary to most other taxes, whose rates cannot be increased in the same year that a decision to increase them is made, the IPI's rates (as well as the IOF's) can be increased at any time by government decree (something that has been done frequently).

The ICMS (tax on the circulation of goods and on certain services) is a tax levied by the states and the Federal District on the circulation (and not necessarily the sale) of goods and on the rendering of services of interstate and inter-municipal transport, as well as communication services, "even though the operations and the rendering of the services start abroad."⁵⁸ By express provision of the Constitution, the ICMS is also levied on imported goods.⁵⁹ While technically the ICMS is not a sales tax, every manufacturer, distributor, and retailer of almost every type of goods, as well as providers of those certain services, must pay the ICMS⁶⁰ and pass the cost along to the consumer. Most Brazilian consumers have no idea how much the ICMS costs them, because invoices and receipts usually indicate only the total price of the good, not the amount of the ICMS.

Certain goods and services are ICMS exempted, such as books, newspapers, magazines, goods bound for export, leased goods, etc.⁶¹ The rates vary from 7% to 25%, according to the product or whether the transaction is interstate or intrastate. On interstate transactions, the rate is 7% for certain regions and 12% for other ones. Transactions within the same state range from 17% to 19%, depending on the state, but sales of cars, communication services and electricity are subject to 25% ICMS.

Each state has its own ICMS Regulations, and as an incentive to attract invest-

ments, certain Brazilian states offer ICMS tax reduction or exemption on certain products, which may vary according to the type of merchandise, type of taxpayer, type of operation or type of service rendered. In order to avoid what is called a “fiscal war” among the states, there are certain restrictions regarding benefits and incentives that the states may offer. In fact, incentives can be offered only by consensus among all of the Brazilian states through an entity called CONFAZ. Many states (especially the less industrialized), however, are known for ignoring the CONFAZ and offering benefits considered unconstitutional by other states (the more industrialized). In these cases, lawsuits seeking the declaration of the unconstitutionality of those benefits are brought by the latter states against the former and recently, in a single day, the STF voided twenty-three regulations created by certain states to attract investments to the detriment of other states.⁶²

The ISS (services tax) is a tax levied by the municipalities and the Federal District on the services enumerated in the list attached to Complementary Law No. 116 of 31 July 2003. The tax is levied on the price of the service, and its rate varies from 2% to 5%, depending on where the service is provided, where the service provider is located, and the type of service. As with almost all Brazilian taxes, the ISS also applies on the import of services,⁶³ although the export of certain services is exempted.⁶⁴

IV. Other Federal Taxes: Import Tax, IOF, CIDE and Withholding

There are several other taxes; some are addressed briefly below.

The import tax is a federal tax levied on imported goods. The applicable rates can be found in the TEC (the Mercosur Common External Tariff)⁶⁵ and vary according to the product and its country of origin.

The IOF (“Tax on Financial Operations”) is a federal tax levied on credit, exchange, insurance and securities transactions made through financial institutions.⁶⁶ The tax also applies to transactions in gold and includes inter-company loans. Like the IPI,

IOF rates may be raised by decree of the federal government and become effective immediately. The tax basis varies according to the taxable event and the financial nature of the transaction.⁶⁷

The CIDE (“Contribution for Intervention in the Economic Domain”) is another protectionist tax that was created by Law No. 10.168 of 29 December 2000 ostensibly to stimulate the technological development of the Brazilian industry. The CIDE is levied at a rate of 10% on payments made by Brazilian entities to non-residents in the form of royalties, technical assistance, technical and administrative services, etc.⁶⁸

Income tax withholding applies to certain domestic and international transactions. Generally, in domestic transactions (e.g., certain payments to service providers, payment of salary in excess of a certain amount, incomes from financial investments) the withholding tax is a prepayment of the income tax on the individual or entity’s final tax return. On the other hand, payments made to nonresidents are subject to income tax withholding in Brazil and are usually final. The rates depend upon the nature of the payment, the residence of the beneficiary, and the existence of tax treaties between Brazil and the country where the beneficiary is located. Most common rates range from 15 to 25% and, as a general rule, income paid to residents of low tax jurisdictions⁶⁹ is subject to a 25% withholding tax.⁷⁰ Currently, subject to certain limitations, remittances to non-residents are exempt from withholding in several cases (e.g., dividends, interest and commission on export financing and on export notes; interest on certain government bonds; rental fees for aircrafts and ships; sea and air charter; demurrage, container and freight payments to foreign companies; and international hedging).

V. Tax Treaties

Although Brazil has signed tax treaties to avoid double taxation with various countries,⁷¹ the existing treaties offer only limited opportunity to reduce or eliminate withholding taxes on payments abroad. Most of the treaties currently in force have

tax-sparing clauses.⁷²

Notably, Brazil has not signed a tax treaty with the United States, notwithstanding the significant efforts of entrepreneurs from both countries since the 1960’s. In any case, there is an administrative regulatory measure that allows the deduction of the income tax according to the principle of reciprocity.

Conclusion

Brazil has come a long way since the extreme nationalism of the 1950’s and 60’s. Brazil has opened its market to foreign products, restructured the foundations of its economy and solidified the civil power. There is still work to be done, however, to improve the ease and cost of doing business there. Foreign investors have many opportunities in Brazil, but they should be aware of the inherent difficulties and prepare accordingly.



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Endnotes:

- 1 See, e.g., MARIA DA CONCEIÇÃO TAVARES, *DA SUBSTITUIÇÃO DE IMPORTAÇÕES AO CAPITALISMO FINANCEIRO: ENSAIOS SOBRE ECONOMIA BRASILEIRA* (Rio de Janeiro: Zahar Editores, 6th ed.) (1977).
- 2 CONST. OF 1988, art. 62.
- 3 Decree No. 3.930, of 19 Sept. 2001.
- 4 CONST. amend. no. 32, of 11 Sept. 2001.
- 5 Articles 108 and 109 of the Federal Constitution set forth the jurisdiction of the Federal Justice. The federal courts have exclusive jurisdiction over any lawsuit in which the federal government or any of its agencies or quasi-governmental bodies is a party,

as well as over cases involving foreign states or international agencies. Labor, military and electoral courts are within the federal system but have their own specialized courts. In Brazil, bankruptcy, and patent cases are litigated before state courts.

6 See http://www.stj.gov.br/portal_stj/publicacao/engine.wsp?tmp.estilo=2&tmp.area=398&tmp.texto=77804.

7 See http://www.cnj.jus.br/images/pesquisas-judiciarias/Publicacoes/relat_federal_jn2010.pdf.

8 J. Mark Ramseyer & Eric B. Rasmusen, *Are Americans More Litigious? Some Quantitative Evidence*, 6 (Jan. 8, 2010) (quoting from U.S. Dept. Commerce, *Statistical Abstract of the United States*, 2010 Tab. 323 (Wash., D.C.: Bureau of the Census, 2010), available at www.rasmusen.org/papers/litigation-ramseyer-rasmusen.doc).

9 CONST. OF 1988, art. 22(1).

10 C. C. P., art. 479.

11 Constitutional Amendment No. 45 of 31 December 2004 that became Federal Constitution, Article 103-A.

12 Pursuant to the Federal Constitution, Article 103-A, Law No. 11,417 of 19 December 2006, Article 2, § 3, requires a majority of two-thirds of the STF justices to issue, revise or cancel a “*Súmula Vinculante*.” The STF has 11 justices—the author believes a required majority may perhaps be 7 or 8.

13 Law No. 9,868 of 10 Nov., 1999.

14 *Id.* at art. 2.

15 *Id.* at art. 28, sole paragraph.

16 See *infra* note 46 and additional comments on the section regarding taxes in Brazil.

17 World Bank, *Doing Business: Measuring Business Regulations - Ease of Doing Business in Brazil 2011*, available at <http://www.doingbusiness.org/data/exploreconomies/brazil/>.

18 The original source is unknown.

19 *Impacto do “Custo Brasil” na competitividade da indústria brasileira de bens de capital* [The Impact of *Custo Brasil* on the Competitiveness of Brazilian Industry of Goods of Capital], ABIMAQ (São Paulo, March 2010), available at <http://www.abimaq.org.br/Arquivos/Html/DEEE/Custo%20Brasil%20de%20BK%20caderno%2031mar10.pdf>.

20 World Bank, *The Custo Brasil Since 1990-92*, World Bank Report No. 15663-BR (10 Dec. 1996), available at http://siteresources.worldbank.org/BRAZILINPOREXTN/Resources/3817166-1185895645304/4044168-1186403960425/20pub_br125.pdf.

21 On efforts to bring public awareness to the problem and try to resolve it, see especially José Augusto C. Fernandes, *Brazil Cost: How To Develop and Promote a Competitiveness Agenda*, undated, available at <http://www.cipe.org/pdf/publications/fs/BrazilCost.pdf>.

22 The original law has been amended at least 9 times since it became effective, the first time by Law No. 4,390 of 29 August 1964 and most recently by Law No. 11,371 of 28 November 2006.

23 L.R.P., art. 1.

24 BACEN, Res. No. 2,689 of 26 Jan. 2000, art. 3.

25 Since its enactment, Law No. 6,385/76 has been amended 10 times, most recently on 28 December 2007.

26 Law No. 6,634 of 2 May 1979 and Decree n° 85,064/80 limit activities carried out within Brazil’s frontier zone, including foreign ownership of land in those areas. The prospective foreign investor should consult the government agencies if interested in the acquisition of certain lands, and the General Office of the National Security Council will decide whether or not to authorize the acquisition.

27 *A Self-made Siege: First they went for the Currency. Now for the Land*, THE ECONOMIST, 24 Sept. 2011, at 48, available at <http://www.economist.com/node/21530144>.

28 *Id.*

29 See especially certain amendments introduced by Law No. 12,249 of 6 Nov. 2010 (sent by Congress to the President of Republic as M.P. No. 472/09).

30 The current Brazilian Civil Code entered into force on 11 January 2003 by virtue of Law No. 10,406 of 10 January 2002.

31 Law No. 6,404 of 15 Dec. 1976 and its amendments.

32 It should be noted that the separation of assets notwithstanding, Brazilian law provides for the disregarding of the corporate entity in certain cases. Generally speaking, however, the grounds are very different and broader than the ones for lifting the corporate veil in the U.S. Often, it suffices that the entity is not able to pay a certain debt. It is very common in labor lawsuits.

33 The “*Empresa Individual de Responsabilidade Limitada*” is a novelty in Brazilian law for it creates an individual limited liability company. Civil Code, art. 980-A, as amended by Law No. 12,441, of 7 July 2011.

34 C. C., art. 1055, § 2°.

35 C. C., art. 997, VII, which is also applicable to limited partnerships according to Civil Code art. 1054.

36 C. C., art. 1076.

37 C. C., arts. 1071-1080.

38 Law No. 6,404, of 15 Dec. 1976, art. 1.

39 *Id.*, art. 80.

40 *Id.*, arts. 15-20.

41 *Id.*, art. 202.

42 *Id.*, art. 118.

43 *Id.*, arts. 140-145.

44 Law No. 6,404 of 15 Dec. 1976, art. 161.

45 M.P. No. 2158/2001, art. 74. In December 2001 the National Confederation of Industry (“CNI”) filed an ADIN before the STF seeking the declaration of unconstitutionality of Article 74, arguing that only profits effectively transferred to the Brazilian parent company should be taxed. On 18 August 2011, after the vote of 9 of 10 justices (the STF has 11 justices, but one removed himself from the case), no majority was formed in the STF to decide the issue. Basically, four justices declared Article 74 constitutional, four declared it unconstitutional, and one voted without deciding the issue, making the vote of the remainder tenth justice irrelevant, because a majority of six justices is required to determine the unconstitutionality of a law (Law No. 9,868 of 10 November 1999, Article

23). The result, or its lack thereof, notwithstanding, the interested parties are entertaining the possibility of filing an Extraordinary Appeal (RE) before the STF itself seeking to revisit the issue on the grounds that four justices who voted in the case have retired, and the issue should be reviewed by the current STF justices. It could be another ten years until a final decision is made. On the votes, see <http://m.stf.jus.br/portal/processo/verProcessoAndamento.asp?incidente=1990416>.

46 Law No. 9,249 of 26 Dec. 1995, art. 3 and its paragraphs.

47 Comp. Law No. 123, of 14 Dec. 2006, art. 3.

48 Law No. 10,637 of 30 Dec. 2002, art. 46.

49 Law No. 9,718 of 27 Nov. 1998, art. 14; and Tax Income Regulations (“RIR”) 1999, art. 246.

50 *Id.*

51 R.I.R./1999, art. 516, §§ 1° and 4°.

52 R.I.R./1999, art. 518, and art. 519, §§ 1° to 6°.

53 Law No. 9,249, of 26 Dec. 1995, art. 20.

54 R.I.R./1999, art. 529 to 539.

55 See Decree 7,212 of 10 June 2010.

56 *Id.*, art. 9.

57 Available at <http://www.receita.fazenda.gov.br/Alíquotas/DownloadArqTIPI.htm>.

58 Comp. Law No. 87, of 13 Sept. 1996 (Kandir Law, art. 1).

59 CONST. OF 1988, art. 155, para. 2, IX (a).

60 *Id.*, art. 4.

61 *Id.*, art. 3.

62 *O STF e a Guerra Fiscal [The STF and the Fiscal War]*, Estadao.com.br, 7 June 2011, available at <http://www.estadao.com.br/noticias/impresso,o-stf-e-a-guerra-fiscal,728909,0.htm>.

63 Comp. Law No. 116 of July 31, 2003, art. 1, § 1.

64 *Id.*, art. 2, I.

65 Available at <http://www.desenvolvimento.ov.br/portalmidic/sitio/interna/interna.php?area=5&menu=1848>.

66 Law No. 5,143 of 20 Oct. 1966.

67 See <http://www.receita.fazenda.gov.br/aliquotas/ImpCreSegCamb.htm>.

68 Law No. 10,168 of 29 Dec. 2000, art. 2.

69 Available at <http://www.receita.fazenda.gov.br/legislacao/ins/2010/in10372010.htm>.

70 Law No. 9,779 of 19 Jan. 1999, art. 8.

71 Brazil has double taxation treaties with: Argentina, Austria, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Ecuador, Finland, France, Hungary, India, Israel, Italy, Japan, Luxembourg, Mexico, the Netherlands, Norway, the Philippines, Peru, Portugal, Slovakia, South Africa, South Korea, Spain, Sweden and Ukraine. The list is available at the RFB Website at <http://www.receita.fazenda.gov.br/Legislacao/AcordosInternacionais/AcordosDupla-Trib.htm>.

72 A tax sparing clause is a tax treaty provision whereby a contracting state agrees to grant relief from residence taxation with respect to source taxes that have not actually been paid.