

International Tax and Business Guide

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Brazil

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Professionals of the member firms of Deloitte Touche Tohmatsu have created the Deloitte International Tax and Business Guides, an online series that provides information on investment conditions, tax regimes and regulatory requirements, along with information for executives working abroad. The Guides are supplemented by the Highlights series, an at-a-glance summary of basic information, including tax rates, for over 120 jurisdictions.

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1.0 The investment climate

Political background

Brazil is a federal republic. The president executes policy approved by the Chamber of Deputies and the Senate. Constitutional review is conducted by an independent judiciary.

1.1 Economic structure

With its ample natural resources, Brazil has comparative advantages in many areas, including agricultural, livestock, wood, mineral and metal products.

1.2 Banking and financing

Brazil has a strong and diversified financial sector, with commercial banks playing a leading role. The growth of the sector has led to the formation of financial conglomerates, usually with a commercial bank serving as the mainstay of the group and selling the products of the other group members, among them investment banks, insurers, and leasing and finance companies.

The *Banco Central do Brasil* (central bank) has been receptive to the entry of foreign banks and foreign participation.

São Paulo is Brazil's principal financial and commercial centre; Brasília, the capital, is the seat of most government bodies. Some state agencies, banks and associations continue to have their headquarters in Rio de Janeiro, previously the national capital.

1.3 Foreign trade

The U.S. is Brazil's leading trade partner, followed by Argentina, the Netherlands and Mexico. The U.S. is also the main source of imports, followed by Argentina, Germany, China and Niger.

Brazil is a member of the Southern Cone Common Market (Mercosur) trade agreement, along with Argentina, Paraguay and Uruguay. The Mercosur Customs Union, which took effect in 1995, includes:

- A "rules of origin" agreement whereby Mercosur member countries may exchange products tariff-free provided 60% of the content is local;
- Exclusion lists that grant Mercosur countries the right to specify import product categories they sought to exclude from the common external tariff; and
- A bilateral accord permitting products manufactured in Brazil's Manaus free trade zone or Argentina's Tierra del Fuego to be traded with full tariff exemptions within Mercosur.

The 2004 Mercosur–Andean Community Free-Trade Area, under which Mercosur partners agreed to link their trade area to that of the Andean Community (comprising Bolivia, Colombia, Ecuador, Peru and Venezuela), states that import duties should be eliminated among the signatories within 15 years. To respect previous bilateral agreements within Mercosur and within the Latin American Integration Association, the bloc has 67 schedules for the reduction and eventual elimination of import duties among the nine members. Brazil is also a member of the World Trade Organisation (WTO) and the Latin American Integration Association.

Mercosur signed an agreement in 2004 to adopt special tariffs in its trade with the countries of the Southern African Customs Union, comprising Botswana, Lesotho, Namibia, South Africa and Swaziland. The agreement aims to gradually reduce and eventually eliminate tariffs. A similar agreement was signed with India in 2005.

2.0 Business regulations

2.1 Registration and licensing

Brazil has overhauled its legislation on intellectual property and the country has started to attract more licensing, including the use of trademarks, technology transfer and franchising.

The National Institute of Industrial Property (INPI) regulates matters relating to industrial property, i.e. patents, trademarks, manufacturing processes, technology and know-how. INPI's headquarters is located in Rio de Janeiro, and the organisation maintains nine full service branches and numerous representative offices across the country. All forms of licensed property and technology transfer must be registered with the INPI to remit royalties and fees abroad. Deductibility of the relevant expenses also depends on certain registration requirements.

The INPI will not approve licensing arrangements that restrict or control a licensee's exports or stipulate the source of imported materials or components, since such provisions violate Brazil's antitrust laws.

An application must be filed with INPI to register a technical assistance or technology transfer contract. Such contracts are normally registered for five years, but may be extended up to an additional five years. The authorities may grant an extension when additional time is needed to complete the transfer of technology. The INPI rarely authorises full five-year extensions, although it frequently allows extensions of less than five years. Its authority to alter the duration of technology transfer agreements has been upheld by the courts.

Royalty remittances require certification from the INPI and registration with the central bank. Remittances of royalties and fees to a parent company or unrelated foreign licensors are generally limited to 1%-5% of gross sales, depending on the products.

2.2 Price controls

Some public goods and services supplied by state-owned enterprises or by local governments remain under government control. Although many public services and infrastructure investments such as railways, telecommunications and electricity have been privatised or transferred to private management through public concessions, the federal government still oversees tariffs and prices through regulatory agencies for these sectors.

2.3 Monopolies and restraint of trade

Law 8884 of 1994 prohibits certain monopolistic activities: collusion with competitors on price or sales conditions; apportionment of markets or supply sources; restraint of market access by new participants; barring access to inputs, equipment or distribution channels; collusion in public-procurement auctions; and production-limiting agreements.

The governments of Brazil and Argentina agreed in 2003 to allow their respective antitrust organisations to exchange information on anti-competitive behaviour. The accord also stipulates conditions under which analysis made by the two countries can be shared with Uruguay and Paraguay when the issue is relevant to Mercosur.

2.4 Intellectual property

As mentioned above, Brazil has overhauled its intellectual property legislation with a view to providing better protection for copyrights, patents, trademarks and industrial designs.

2.5 Mergers and acquisitions

Mergers are prohibited only when they could create monopolistic conditions and abuse a dominant position, i.e. when such a merger might result in a firm being able to eliminate its competition in the local market.

Approval of the Administrative Council for Economic Defence (CADE) is required where an acquisition or a joint venture agreement would result in control of at least 20% of a particular market. CADE also must review mergers between companies with combined revenue of BRL 400 million or more.

Mergers and acquisitions (M&A) in the petroleum, energy and telecommunications sectors must be examined and approved by the relevant regulatory agency. In addition, the General Telecommunications Law prohibits a partner of a company from having more than 5% of the assets in another group of the same category.

The central bank examines M&As in the financial services sector and the National Monetary Council approves them. Foreign institutions entering Brazil must be issued a presidential decree. Foreign financial institutions may not enter the Brazilian market via subsidiaries; instead, a foreign bank must acquire a local institution or make a capital contribution to an existing institution.

3.0 Foreign investment

3.1 Foreign investment incentives and restrictions

Foreign capital may freely enter Brazil and is usually treated like local capital. Although no rules expressly prohibit foreign takeovers, these may not be made via share purchases on the stock market without proper registration.

Legally registered companies—foreign or domestic—enjoy the same rights and privileges, and they compete on an equal footing when bidding on contracts or seeking government financing. Foreign-owned firms may also engage in mineral exploration and extraction.

Foreign investors may participate in private Brazilian financial institutions but must first present a proposal to the central bank, which submits it to the National Monetary Council for approval. The president must then sign a decree officially authorising participation.

Incentive programmes in Brazil were increased due to the financial crisis in 2008, but gradually will be reduced during 2010. Research and development (R&D) projects and information technology qualify for some direct assistance and tax relief. Subsidised financing is available to purchase capital goods, invest in infrastructure projects and build ships. Export sectors qualify for duty drawback on imports and for special financing through an export-promotion programme. There are some tax incentives that allow an extra deduction of corporate income tax for employee meal programs, donations and investments in northern and north eastern Brazil; R&D tax incentives for expenditures in Brazil that allow an extra deduction from 60% to 100% of expenditure; a reduction of federal value-added or excise tax on manufactured goods (IPI) on the acquisition of assets connected with R&D; and withholding tax credits of 10% on royalty payments for transfer of technology agreements of until 2013.

Under a tax relief programme for exporters, firms that earn at least 70% of their revenue from exports are exempt from two federal taxes—the social integration programme contribution (PIS/PASEP), and the social security contribution (COFINS)—on investments in industrial goods and technology.

Municipalities continue to offer companies advantages, such as the donation of sites in industrial districts, exemption from municipal taxes and subsidies of rent expenses.

A foreign company requires no special government authorisation to organise a local business, unless it is formed as a branch or is in a restricted industry such as financial services. Inbound investment must be registered with the central bank within 30 days, and registration is necessary to obtain the right to repatriate capital and dividends on a tax-free basis and to remit other fees. Remittances abroad are subject to special controls. Payments for foreign technology, especially to a foreign parent, are also controlled and require registration with the authorities.

Central bank approval is required for foreign investments made through conversion of foreign credits or by the import of goods with exchange cover. In the former, the credits must be incorporated into the company's capital and registration applied for within 30 days of the inflow of funds. In the latter, trade payables arising from the ordinary importation of goods with foreign exchange coverage may be contributed as foreign direct investment and registered as foreign capital with full convertibility and repatriation rights. Goods imported without exchange cover, such as under a drawback or temporary admission regime that are not registered as assets owned by the local importer, cannot be contributed and registered as foreign direct investment.

Projects seeking fiscal incentives need approval from the relevant agencies. Most such incentives are available from the federal government only to exporters, investors in less-developed northern and north eastern Brazil, and companies planning automation or other projects under special sectoral development programmes. Foreign investors are free to expand their operations, but incentives granted for the original investment are not automatically extended to the enlarged operation. The investor must apply to the proper authorities.

3.2 Exchange controls

The National Monetary Council sets Brazil's exchange controls. The central bank, which is responsible for implementing this policy, has a number of departments that deal specifically with foreign investment and exchange.

Companies generally do not need prior authorisation for foreign exchange transactions, although a record of the transaction must be filed (online) with the central bank.

The central bank requires registration of all foreign investments (equity or debt) in Brazil. Investors must register to secure their right to acquire foreign currency directly from institutions authorised by the central bank. This purchase is necessary each time the investor decides, for example, to remit dividends, pay interest or repatriate capital. Bank accounts must be held in local currency. Foreign currency accounts are prohibited in Brazil, with the exception

of a few accounts defined by the central bank (such as bank accounts for investments in oil, gas and energy).

To deter tax evasion, both inbound and outbound travellers must declare to the customs authorities if they are carrying on their person or have in their possession foreign exchange (including travellers' cheques) exceeding USD 10,000. The customs authorities then report these declarations to the Secretariat of Federal Revenue.

Brazil maintains an official commercial rate and a floating "tourist dollar" rate.

The requirements of the commercial exchange rate apply to import and export transactions, foreign equity investment in Brazil and loans, among others. The tourism rate is used to exchange funds either by persons who are travelling outside of Brazil and want to convert Reais to a foreign currency or by foreigners who are travelling within Brazil and seek to convert their foreign currency to Reais.

4.0 Choice of business entity

4.1 Principal forms of doing business

Foreign companies may engage in business in Brazil by acquiring an existing company or by forming a local subsidiary. Many foreign firms elect the latter as they prefer to establish a limited liability company (*sociedade por quotas de responsabilidade limitada*) or *limitada*. This form has fewer formalities and less public disclosure than the alternative, one of several types of *sociedade anônima* (SA). Other types of organisation are less suited to foreign investment.

Requirements of an SA and a limitada

Capital. SA: No minimum or maximum. Capital must be totally subscribed and at least 10% deposited in a bank. It may be paid in cash or in kind (the latter must be appraised by shareholders after appraisal by three experts or by a specialised firm appointed by the shareholders). At least 5% of annual net income must be set aside in a legal reserve until it reaches 20% of capital. *Limitada*: No minimum or maximum; capital may be changed by simply revising the founding deed. No legal reserve requirement.

Founders, shareholders. SA: Except in the case of a wholly-owned subsidiary, a minimum of two founders (who need not have a direct interest in the venture) is required. No nationality or residence requirements apply, but foreign shareholders must have legal representatives in Brazil. *Limitada*: Minimum of two; it is not necessary to be a Brazilian resident to qualify as managing shareholder. Foreign quota holders must have legal representatives in Brazil.

Directors. SA: Minimum of two, who must be residents. *Limitada*: Minimum of one, appointed as a general manager in the articles of incorporation.

Management. SA: An administrative council is mandatory for listed companies. The board must have at least three members who are resident in Brazil. Executive directorate must have at least two individuals, resident in Brazil. Members are elected for up to three years by the shareholders. Council elects and can dismiss board members and fixes members' duties. Up to one-third of members may also be directors. *Limitada*: None.

Labour. SA and *Limitada*: Labour need not be represented in management unless the bylaws so provide.

Disclosure. SA and *Limitada*: Publicly and non-publicly traded companies with assets exceeding BRL 240 million or gross revenue exceeding BRL 300 million must have outside auditors. Only publicly traded companies must publish annual account reports in Brazilian GAAP. IFRS will be required as from calendar year 2010. Annual reports, balance sheets, income statements and minutes of annual meetings must be published in the *Diário Oficial* and another well-known newspaper. A closed corporation must also publish its financial statements if shareholder equity is equal to or greater than BRL 1 million.

Taxes and fees on incorporation. SA: Expenses include dues for registration (with the Commercial Registry and the INPI) and legal and notary fees that vary depending on the complexity and capital involved. *Limitada*: Costs of trademark registration, if the company decides to protect its brand, and legal and notary fees.

Types of shares. SA: Shares need not have a par value, but if they do, they may not be issued at a discount. Corporations may issue common, preferred, convertible preferred and

founders' shares. Voting shares are called *ordinárias* and non-voting shares *preferenciais*. All common shares have equal voting power. There may be various classes of preferred shares. Non-voting shares may not represent more than two-thirds of total capital and generally acquire voting rights if dividends are missed for three consecutive years. For corporations incorporated on or after 1 November 2001 or for new issuers of preferred shares as from that date, non-voting preferred shares may not exceed one-half of total capital. Founders' shares may only be issued by closely held corporations and are given in return for services; intangible contributions have no par value and do not form part of capital. They may carry rights to up to 10% of profits. For SAs incorporated after 31 October 2001, the number of preferred shares may not exceed 50% of the total number of issued shares. The same limit should also be observed by an existing privately held SA that goes public after 31 October 2001. Public corporations that were established before 31 October 2001 may keep the existing ratio between preferred shares and voting shares. A public share offering must be made in a takeover bid and prior approval of the Securities Commission is required to acquire an open company's shares by a firm holding at least 10%, but not a controlling interest, in the concern. A shareholder whose shares represent at least 5% of an open company's capital can demand disclosure of information. *Limitada*: Capital is divided into quotas (the amount to which each partner limits his/her liability). If the articles of incorporation so provide, members may not sell quotas without the consent of all the other members.

Control. SA: Minority groups do not have representation on the board unless the charter so provides. When an administrative council is required, the shareholders who represent at least 0.1% of the voting corporate capital may adopt a multiple voting procedure to elect or dismiss a member. For open corporations incorporated on or after 1 November 2002, shareholders representing 15% of the voting shares or 10% of the non-voting preferred shares may elect or dismiss one member. Shareholders representing 10% of the capital have the right to elect one member of the fiscal council, if one exists. Shareholders with small stakes can control the company's management through a shareholders' agreement. *Limitada*: No special provisions except as contained in the company's founding deed.

4.2 Establishing a branch

A company may organise as a branch in Brazil. However, unless there is a substantial tax advantage in the investor's home country (such as deduction of exchange losses from the taxable income of the head office), the disadvantages of a branch probably outweigh the benefits. It is more difficult to establish a branch, which takes about six months, and the establishment costs are nearly the same as for other business forms. Remittances of profits, including those of a branch, are exempt from withholding tax.

Establishing a branch of a foreign company requires authorisation by presidential decree. The firm must operate in Brazil under the same name as in the country of origin (it may add the words *do Brasil* or *para o Brasil*), and it must retain a permanent, fully responsible representative (of no particular nationality), whose name must be registered.

To obtain the necessary government authorisation, a foreign company must submit documentary evidence of its legal existence, a copy of the articles of incorporation, a list of shareholders, its most recent balance sheet and a copy of the resolution to open a branch in Brazil. The firm must allocate a certain amount of capital to the branch and appoint a legal representative. All documents must be properly notarised, certified by a Brazilian consul and officially translated.

A branch may not function until it has been registered and its authorisation and documentary evidence are published in the *Diário Oficial* and a local newspaper. It must maintain accounts similar to those of an SA and, depending on the bylaws and/or laws of its country of origin, it must publish in Brazil corporate documents, other than its annual financial statements. No annual meeting is required.

4.3 Setting up a company

A company organised as an SA may be established as a closed or an open company. Open companies are those whose shares are traded publicly either on the stock market or over the counter.

A *limitada* is formed through a similar but simpler procedure and does not require an external audit. Very little disclosure is required; *limitadas* rarely reveal basic financial information, such as operating expenses or year-end profits. A *limitada* cannot be registered on a stock exchange or have its quotas publicly traded. No minimum amount of capital needs to be deposited in a

bank. Unless the articles of association provide otherwise, a member may not sell a stake in the company (called quotas) without the consent of all other members. *Limitadas* may not issue preferred shares or debentures. A *limitada* can be established in about two weeks. Additional government registrations necessary for a *limitada* to operate vary in accordance with the business activity and location of each corporation.

Companies seeking to list on the Brazilian New Market must agree to higher standards of corporate governance than those required under Brazilian law. For example, New Market companies may issue only voting shares, keep shares corresponding to at least 25% of their capital and publish annual reports according to generally accepted accounting principles.

Small companies with unlimited liability may be formed to render professional services such as accounting, engineering, economic planning, industrial design or marketing. If not qualified for the simple tax regime, or another alternative minimum tax regime, they are effectively taxed at the standard corporate rate. All corporate forms must be registered with the municipalities' board of trade.

5.0 Business taxation

5.1 Overview

Taxation in Brazil is mainly regulated by the 1988 Federal Constitution, the National Tax Code of 1966 and the Federal Income Tax Code. Taxes are payable by all private business entities resident in Brazil, including companies, limited liability companies, partnerships and sole partnerships, and branches and agencies of corporations with head offices abroad.

Taxes are levied by the federal, state and municipal governments.

Brazil has a complex system of corporate taxation in which the federal government imposes: (1) corporate income tax (IRPJ); (2) social contribution tax on profits (CSLL); (3) federal value-added or excise tax on manufactured goods (IPI); (4) financial transactions tax (IOF); (5) excise tax on cross-border royalties and services (CIDE); (6) tax for social security financing (COFINS); (7) the Social Integration Program (PIS/PASEP); (9) employer social security contributions (INSS); and (10) rural property tax. Import and export duties also are levied.

The Brazilian states and the Federal District of Brasília impose a value added tax (VAT) on the circulation of goods and services (ICMS), and taxes on inheritances and gifts and motor vehicles.

Municipalities and the Federal District charge taxes on services (ISS), urban property and transfers of urban real estate.

Brazilian accounting rules are being changed to incorporate IFRS rules. Those new rules do not have a tax impact when companies choose to be treated under the Transitional Tax Regime (RTT). The option had to be done in the 2008 tax return. For companies under RTT, the accounting rules in force at 31 December 2007 are still applicable for tax purposes. RTT is in force until calendar year 2010 or until a new law is enacted.

5.2 Taxable income and rates

Resident companies are taxed on worldwide income. A corporation is resident in Brazil if it is incorporated in Brazil.

A foreign company is only subject to Brazilian taxation if it carries out certain sales activities in Brazil through agents or representatives that are domiciled in the country and that have the authority legally to bind the foreign seller before the domestic purchaser, or through a domestic branch of the foreign seller. A representative acting as an agent, with the final transaction being concluded by the nonresident company abroad, will not give rise to a legal presence in Brazil.

Corporate income tax or IRPJ is levied on the taxable profits of an entity at a rate of 15%. In addition to the IRPJ, a 10% surtax is imposed on taxable income exceeding BRL 240,000 on an annual basis.

CSLL is levied on entities subject to the IRPJ to finance the Brazilian federal social security system. The CSLL rate is 15% for financial institutions and 9% for other institutions.

The basic income tax applies to operating profits derived by a company in Brazil. Operating profits are defined as gross operating receipts, less the cost of goods sold or services rendered;

commercial, administrative and operating expenses; and other charges, reserves and losses authorised by law. Dividends received from other Brazilian companies and income from premiums received on the issuance of new shares are not included in taxable income.

Brazilian companies may opt to be taxed on actual or presumed income. The *Lucro Real* method is based on actual annual or quarterly taxable income, and the *Lucro Presumido* method is based on estimated or deemed taxable income.

Under the *Lucro Real* system, the taxable basis is net income before IRPJ and CSLL, adjusted by add backs (nondeductible expenses) and exclusions (nontaxable income, such as dividend income). IRPJ and CSLL must be paid up to the last business day of the following month.

The deemed taxable income system (*Lucro Presumido*) is an optional tax regime for companies whose gross revenue in the previous year was less than BRL 48 million, and is calculated on a quarterly basis. The IRPJ and CSLL are levied on presumed profits, which are determined by applying a specific percentage to the revenue of each quarter, and that result increased by the other revenue and capital gains accrued. For the IRPJ, the taxable income is determined by application of the following coefficients: 32% for services revenue and 8% for sales of products and goods revenue. For payment of the CLL, the estimated profit margin is 32% for services revenue and 12% for sales of products and goods revenue. The IRPJ and CSLL must be paid quarterly, up to the last business day of the month following the quarter.

Deductions

Expenses generally may be deducted if they are necessary for the activities of the company. Exchange gains and losses on obligations in foreign currencies may be taxed on an accrual or cash basis, according to the taxpayer's election for the calendar year. Under the accrual basis, monthly exchange gains will be taxable and exchange losses will be deductible (whether or not realised). Under the cash basis, exchange gains or losses will be taxable or deductible only when realised.

Special provisions may limit the deductibility (e.g. limits on the deductibility of royalties and fees). Fringe benefits paid to directors are nondeductible expenses.

Depreciation

Depreciation allowances are calculated on a straight-line basis. Fixed assets are depreciated at rates specified for established asset classes, unless special provisions allow a higher rate. Annual rates are 4% for buildings; 20% for vehicles, computer hardware and software; and 10% for machinery, equipment and fixtures.

Companies operating two shifts a day may depreciate assets used in production at one-and-a-half times the ordinary rate. Companies that operate three shifts a day may use double the normal rate.

Accelerated depreciation is allowed for machinery and equipment used in R&D programs.

Losses

Losses must be segregated as "operational" and "nonoperational." Nonoperational losses may only be set off against nonoperational gains. Tax losses incurred in one fiscal year may be carried forward indefinitely but the amount of the carryforward is limited to 30% of taxable income in each carryforward year. The carryback of losses is not allowed.

5.3 Capital gains taxation

Capital gains are treated the same as ordinary profits (subject to restrictions on the offsetting of capital losses against ordinary profits in certain cases). Capital gains realised by nonresidents on investments registered with the central bank are subject to a 15% withholding tax. If the capital gain is derived by a tax haven resident, the rate is increased to 25%. Foreign investors on the financial market may be subject to different rates.

5.4 Withholding tax

Dividends

Dividends paid to nonresidents are not subject to withholding tax.

Interest

Interest paid to nonresidents is generally subject to a 15% withholding tax. The rate is increased to 25% if the recipient is resident in a jurisdiction that is deemed to be a low tax jurisdiction, i.e. a country that taxes income at a rate lower than 20%.

Royalties

Royalty payments to nonresidents are generally subject to a 15% withholding tax, as well as the 10% CIDE (discussed in section 5.8). The rate is increased to 25% if the recipient is resident in a jurisdiction that is deemed to be a low tax jurisdiction.

5.5 Foreign income and tax treaties

Brazil has concluded a number of tax treaties that generally reduce the withholding tax on dividends, interest, royalties and technical assistance fees.

The table below contains the tax treaty withholding tax rates that apply to dividend, interest and royalty payments by Brazilian companies to nonresidents. Domestic (D) rates apply if they are lower than the treaty rate or where the treaty does not provide for a reduced rate.

Withholding tax rates under Brazil's tax treaties			
Treaty Partner	Dividends*	Interest	Royalties
Argentina	D	D	D
Austria	D	15/25	10/15/25
Belgium	D	0/10/15/25	10/15/20
Canada	D	10/15/25	15/25
Chile	D	15/25	15/25
China	D	15/25	15/25
Czech Republic	D	10/15/25	15/25
Denmark	D	15/25	15/25
Ecuador	D	15/25	15/25
Finland	D	15/25	10/15/25
France	D	10/15/25	10/15/25
Hungary	D	10/15/25	15/25
India	D	15/25	15/25
Israel	D	15/25	10/15/25
Italy	D	15/25	15/25
Japan	D	12.5/25	12.5/15/25
Korea (R.O.K.)	D	10/15/25	15/25

Withholding tax rates under Brazil's tax treaties			
Treaty Partner	Dividends*	Interest	Royalties
Luxembourg	D	10/15/25	15/25
Mexico	D	15/25	15/25
Netherlands	D	10/15/25	15/25
Norway	D	15/25	15/25
Philippines	D	15/25	15/25
Portugal	D	15/25	15
Slovakia	D	10/15/25	15/25
South Africa	D	15/25	10/15
Spain	D	15	10/15
Sweden	D	15/25	15/25
Ukraine	D	15/25	15

* Dividends payments are exempt from withholding tax.

5.6 Transactions between related parties

Transfer pricing

Brazil's transfer pricing regime includes provisions aimed at preventing Brazilian subsidiaries of multinational companies from sending profits abroad by over-charging intercompany exports or reducing taxable income in Brazil by under-charging intercompany exports. The rules apply to cross-border transactions between related parties and transactions with entities located in tax havens.

The Brazilian rules deviate substantially from the OECD Transfer Pricing Guidelines—they do not adopt the "arm's length principle," but use fixed margins to calculate the transfer price.

The salient features of the Brazilian transfer pricing regime are as follows:

- Exclusive use of transactional methods—comparable uncontrolled price, resale price and cost plus—for determining the price of uncontrolled transactions in property, services and commercial rights;
- Statutory fixed margins (e.g. 15%, 20%, 35%) must be applied through the prescribed methods, unless a different margin is established by data from official publications or research conducted by a technically qualified firm;
- Export safe harbour rules are available to avoid application of the prescribed transactional methods;
- Regulation of transactions between Brazilian taxpayers and certain uncontrolled agents, distributors or consortium partners, or transactions with a related party or a party resident in a tax haven or in a jurisdiction that allows secrecy regarding equity participations; and
- Specified interest rates for controlled cross-border loans.

Thin capitalisation

Brazil's first thin capitalisation rules entered into effect on 1 January 2010 for IRPJ and take effect on 16 March 2010 for CSLL. Under the rules, interest paid to related parties that are not located in a tax haven jurisdiction or that do not benefit from a preferential tax regime

may be deducted on an accruals basis for corporate income tax purposes only (i) if the expenses are necessary for the company's activities, and (ii) both of the following thresholds are met: (a) the related party debt-to-equity ratio does not exceed 2:1 calculated based on the proportion of related party debt to direct equity investment made by related parties; and (b) the overall debt-to-equity ratio does not exceed 2:1 based on the proportion of total debt to total direct equity investment made by related parties.

Interest paid to an entity or individual located in a tax haven or that benefits from a preferential tax regime (regardless of whether the parties are related) may be deducted only if the expenses (i) are necessary for the company's activities, and (ii) both of the following thresholds are met: (a) the amount of the Brazilian entity's indebtedness to the tax haven resident does not exceed 30% of the net equity of the Brazilian entity; and (b) the Brazilian entity's total indebtedness to all entities located in a tax haven jurisdiction or benefiting from a preferential tax regime does not exceed 30% of the net equity of the Brazilian entity.

Any excess interest will be treated as a nondeductible expense for IRPJ and CSLL purposes. The transfer pricing rules affecting cross-border loans (agreements registered with the central bank or LIBOR plus a 3% spread) remain in effect, as do the general requirements for deductibility.

Controlled foreign companies

Profits earned by controlled foreign corporations (CFCs) and certain foreign affiliates (non-controlled subsidiaries) of Brazilian entities will be included in the base for calculating the IRPJ and CSLL liability of the Brazilian controlling or parent company. Profits earned by CFCs and non-controlled subsidiaries of Brazilian companies will be considered available to the controlling or parent company in Brazil (and subject to taxation) at the end of each fiscal year.

Consolidation

Brazil does not have tax consolidation rules. Each corporate entity is taxed separately from other related entities.

5.7 Turnover and other indirect taxes and duties

The most important indirect taxes are as follows:

Import duty

II is a federal tax levied on imports of goods into the Brazilian territory. The tax basis is the CIF value and the corresponding tax rates vary according to the nature of the goods and its respective classification under the Mercosur Common Nomenclature – NCM (it usually ranges from 0% to 35%). The amount paid is part of the importation cost, i.e. II is not recoverable.

Profit participation contribution (PIS) and social security financing contribution (COFINS)

PIS and COFINS are federal taxes imposed monthly on gross revenue earned by legal entities. PIS is a mandatory employer contribution to an employee savings initiative and COFINS is a contribution to finance the social security system. The calculation method is generally non-cumulative, under which PIS and COFINS are levied on gross revenue at 1.65% and 7.6%, respectively, with deductions of input tax credits for expenses strictly connected to the company's business and prescribed by the regulating laws. Other calculation methods and special schemes may apply to certain industries and type of revenue. If a company is paying corporate income tax based on a deemed taxable income regime, i.e. under the *Lucro Presumido* system, the rates are reduced to 0.65% and 3.0%, respectively, and the company is not entitled to input tax credits (cumulative taxation). As from May 2004, PIS and COFINS are due on importations of goods and services from abroad (i.e. PIS-Import and COFINS-Import). The applicable rates are also 1.65% and 7.6%, and the amount paid is usually recoverable as input tax credits if the taxpayer assesses PIS and COFINS under the regular non-cumulative regime. The export of goods and services are exempt provided funds effectively enter the country.

Federal VAT (IPI)

IPI is a federal excise tax levied on manufacturer's sales and imports and sales carried out by importers. As a VAT-type tax, the amount paid on imports and other taxed inputs are usually recoverable as tax credits to be offset against company's IPI output debits. The tax rates range from 0% to 335% depending on the type of goods.

State VAT (ICMS)

ICMS is a VAT levied by the Brazilian states on the circulation of goods and the provision of interstate and intermunicipal transportation and communications services. The tax applies even when a transaction and the provision of services commence in another country. A non-cumulative tax, ICMS is collected by most states at the rate of 17%, except for São Paulo and Minas Gerais, whose tax rates are 18%. There are also interstate rates of 12% and 7%, depending on the location of the recipient.

Service tax (ISS)

The tax on services or ISS, a municipal tax, is imposed on the supply of services, other than services subject to ICMS. The list of relevant services is found in Complementary Law. The taxable base of ISS is the price of the service rendered. ISS is generally levied by the municipality in which the company that provides the service is established, although in exceptional cases, ISS may be levied by the municipality where the services are performed. ISS rates vary between 2% and 5%, depending on the municipality and the type of service. The importation of services is also subject to ISS, whilst exportations may be exempt if the result of the supply is exclusively found abroad. As a cumulative tax, ISS is not recoverable, i.e. no input tax credits are available.

5.8 Other taxes

Tax on financial operations (IOF)

The IOF applies to various types of transactions, including loans, insurance policies and short-term money market applications. The rate is 0.0041% per day for credit transactions within Brazil, with an additional surtax of 0.38% on all credit transactions. IOF is also levied at the rate of 0.38% on foreign exchange (the acquisition or sale of foreign currency).

Real estate property and real estate transfer taxes

The real estate property tax is an annual tax assessed on the ownership of real property. The tax, collected by the municipality where property is located, is calculated on a deemed "sales price" of the property. The tax rate varies from city to city, but may be estimated in the range of 0.3% to 1.0%.

The real estate transfer tax is due upon the transfer of title to real property. The tax rate is progressive, from 2% to 6%, calculated, roughly, on the sales price. The buyer is responsible for payment of the tax.

Rural property tax

Rural property tax is an annual tax assessed on the ownership of rural property at rates ranging from 0.03% to 20%, depending on the region and the utilisation of the property.

Vehicle property tax

Vehicle property tax is assessed annually, on the ownership of vehicles such as motorcycles, boats and airplanes. The tax rate varies from state to state, but may be estimated in the range from 1% to 6%.

Contribution for intervening in economic domain (CIDE)

The CIDE is assessed on outbound royalties and service payments when there is a transfer of technology or when the services provided are considered technical assistance. The rate of the CIDE is 10%. The burden of the CIDE falls on the Brazilian company and is not creditable by the foreign beneficiary. The CIDE on software payments was abolished in 2007. As a result, CIDE is not levied on payments relating to a license or right to trade or distribute software programs, as long as no transfer of technology is involved.

Social insurance (INSS)

Employers are required to make a contribution of 8% of wages to each worker's deferred salary account to the Length of Service Guarantee Fund (FGTS). Employers must also contribute 20% of an employee's wages to the National Institute for Social Security (INSS), the country's public pension system, and a maximum of 8.8% on other social security taxes. Employees contribute 8%-11%, depending on their salary.

5.9 Tax compliance and administration

The tax year in Brazil is the calendar year and each tax has a specific due date.

Every business entity in Brazil (including corporations, partnerships, branches and agencies of companies domiciled abroad) must file an annual income tax return for the previous calendar year. The return must be submitted by the last working day of June. Corporate taxes (IRPJ and CSLL) are usually due on annual adjusted profit, with monthly advance payments; excess tax paid is available to offset future taxes. Refunds of corporate income tax are usually not practical.

Other tax returns, such as Return for Federal Tax Payments and Statement of Social Contribution Calculation are due monthly or semi-annually (depending on gross revenue).

Late payments of federal, state and municipal taxes are subject to penalties and interest.

The tax authorities require the maintenance of the Brazilian Public Digital Bookkeeping System (SPED). SPED aims to modernise and unify the receipt, validation, storage and authentication of books and documents that comprise the commercial and tax bookkeeping of Brazilian companies, using a single computerized flow of information. The deadline for companies to comply with SPED requirements varies depending on the company activities.

6.0 Personal taxation

Individuals in Brazil are subject to a number of taxes, including personal income tax, social security tax and gift and inheritance tax. Capital gains are subject to a flat 15% rate. There is no local or state income tax for individuals.

Tax is paid on a monthly basis either through withholding from salaries or by advance payment for the self-employed. Monthly advances are required for income received outside of Brazil by Brazilian tax residents. All residents who are subject to income tax must prepare an annual tax return (due at the end of April of each subsequent tax year).

Personal taxes are calculated and paid based on income earned in the tax period. Three rates of personal tax are imposed (tax table applicable for tax year 2010):

- 0% on annual income up to BRL 17,990;
- 7.5% for income between BRL 17,990 and BRL 26,961;
- 15% for income between BRL 26,961 and BRL 35,948;
- 22.5% for income between BRL 35,948 and BRL 44,918; and
- 27.5% for income exceeding BRL 44,918.

Nonresidents are taxed at a flat rate of 25% (on earned income) or 15% (on other income), except for dividends paid from a Brazilian entity, which are tax exempt. The source of income is determined according to where the payer is located.

6.1 Residency

The following individuals are considered residents for tax purposes: (1) an individual who resides permanently in the country; (2) naturalised foreigners; (3) foreigners who hold a permanent visa or a temporary visa with a local employment contract, from the date of arrival; and (4) foreigners who hold a temporary visa but no local employment contract, after completing 183 days (whether or not consecutive) of physical residence in Brazil in any 12-month period.

Residents are taxed on worldwide income, with a foreign tax credit for taxes paid in the country of origin (subject to an applicable tax treaty or bilateral reciprocity). Nonresidents are taxed on Brazilian-source income. The source of income is determined by the location of the payer, regardless of where the work is performed.

6.2 Taxable income and rate

Determination of taxable income

Residents are taxed on their gross income, which includes domestic and foreign-source income, with a foreign credit for taxes paid abroad. Gross income is normally taxable whether

received in cash or in-kind. Taxable income includes wages, salaries, bonuses, fringe benefits, consulting fees and commissions, premiums, directors' fees, and interest and dividends from foreign sources. It also includes most allowances connected with employment, including housing allowances and allowances for home leave provided by an employer. Schooling allowances are considered indirect salary and taxed accordingly. No distinction is made between personal expenses paid directly by the company or those reimbursed to the individual. Actual moving expenses, however, are generally not taxable.

The formal profit sharing paid by a Brazilian employer to its employees can be exempt only for INSS (social security) and severance fund purposes. For withholding income tax purposes, the profit sharing is taxed at progressive rates ranging from 0% to 27.5%. Dividends received from local sources are tax exempt.

Taxpayers may deduct certain expenses when calculating monthly income tax liability and other expenses when they file their annual federal income tax return. Deductions permitted in calculating monthly income tax liability include the following:

- Social security taxes paid by the employee to federal, state or municipal entities;
- Contributions to private Brazilian pension plans, up to 12% of gross income, provided contributions are also made to the official social security;
- Alimony or pension payments under a court order (special limits apply for alimony paid to beneficiaries resident abroad); and
- A standard monthly deduction of BRL 151 (for tax year 2010) per dependent.

The following deductions may be taken when the annual return is filed:

- Payments by the taxpayer or a dependent for educational expenses, up to an annual limit of BRL 2,831 (for tax year 2010);
- Payments made and not reimbursed during the year for medical or dental expenses, health insurance plans, or psychotherapy or physiotherapy; and
- Documented contributions to approved Brazilian cultural, artistic and audiovisual activities and donations to Brazilian Child and Youth Counsels, up to 6% of taxable income.

Instead of itemizing deductions, the taxpayer may elect the standard annual deduction of 20% of taxable income up to a maximum of BRL 13,317 (for tax year 2010).

6.3 Special expatriate tax regime

There is no regime that specifically applies to expatriates.

6.4 Capital taxes

There are no capital taxes.

7.0 Labour environment

7.1 Employees' rights and remuneration

Labour relations in Brazil are governed by the Consolidated Labour Laws and numerous complementary laws and regulations. The 1988 constitution contains several labour provisions. Among other things, it legalises unions, collective bargaining negotiations and the right to strike in both the public and private sectors. The constitution also sets overtime rates, provides for a monthly minimum wage and regulates working hours. It lists a variety of labour entitlements, including maternity leave, vacation, worker's compensation, social services, medical assistance and unemployment benefits.

Working hours

The constitution establishes a 44-hour work week and overtime pay of 50% of base pay. It requires that round-the-clock operations have six-hour shifts, with overtime paid for work beyond six hours. Minors (younger than age 18) may not work more than eight hours a day. Most foreign and local firms have a working week of five eight-hour days.

7.2 Wages and benefits

Labour costs are high because of the mandatory charges and taxes attached to employment. Wages remain moderate, but they account for at most two-thirds of the total costs of hiring labour.

Annual negotiations normally set basic wage levels for industrial workers. Wages are typically adjusted annually rather than monthly or semi-annually. States are free to raise the “minimum” beyond the federal level if they prove they have the budgetary resources to do so.

Salary adjustments are determined through free negotiation between the parties. If the parties fail to reach an agreement, they can refer the dispute to a labour court for arbitration.

Pensions

The value of pensions is based on the employee’s contributions during that person’s working life, and capped at BRL 3,416 per month (for tax year 2010). Benefits are indexed to inflation.

Social insurance

Employers are required to contribute 8% of wages to each worker’s deferred salary account at the Length of Service Guarantee Fund, 20% of an employee’s wages to the National Institute for Social Security (INSS), the country’s public pension system, and a maximum of 8.8% on other social security taxes. Employees contribute 8%-11%, depending on their salary categories. The INSS coverage includes medical and hospital assistance; sick pay covers 91% of the contribution salary after 15 days of absence; maternity benefits of up to one month’s minimum wage; and retirement pay.

With few exceptions, all companies subject to the INSS tax must also contribute 0.2% of payroll to the National Institute of Colonisation and Agrarian Reform. An additional 0.6% wage tax is assessed to support the activities of the Small Business Administration.

Other benefits

Compulsory benefits add 50%-80% to base wages of full-time employees on permanent contracts. Paid vacations of 30 calendar days are granted after a full year of service with no more than six absences. Employees have the right to work one-third of the vacation period, at double pay. A bonus of one-third of one month’s base pay is due at the time vacation is taken. Other paid absences include national, state and local holidays, which can be changed during the course of the year and a few days for the death of a relative or for marriage.

Employees are granted full sick pay for the first 15 days of a documented illness. Female employees receive mandatory maternity leave of four months and male employees receive paternity leave of five days (both paid by the Social Security Agency). Employers have the option to offer an additional maternity leave of two months, and deduct the amount paid for this period from its corporate income tax. A mandatory bonus of one month’s pay (called the 13th salary) must be 50% paid by November of each year. The remaining balance is traditionally paid at year-end.

A transport subsidy for workers is mandatory for all employers. Companies must provide their employees with transport to and from work or subsidise their mass transit expenses by paying all such costs exceeding 6% of an employee’s gross salary. Although the system varies by locality, industrial firms normally deduct 6% from payroll and use the funds for the purchase of transit vouchers accepted by mass transit companies. Expenditure incurred by employers is deductible for income tax purposes.

Companies must pay into a national subsidised savings programme for workers (PIS), administered by the national savings bank system. Payments include monthly deposits in an amount equal to 1.65% of total revenue (except for financial income) for companies under the non-cumulative tax system or 0.65% of total revenue (including financial income) for companies under the cumulative tax system. Such payments are deductible for purposes of corporate income tax and the social contribution on net profit.

A company may set up a voluntary profit-sharing scheme for its employees called the Workers’ Individual Retirement Plan (PAIT) as a type of unemployment/retirement fund. All PAIT contributions made by firms are fully tax deductible. Employee contributions are also deductible up to 12% of gross income. A company must enrol at least 50% of its employees to start a PAIT fund.

Other voluntary benefits vary widely, but both local- and foreign-owned firms generally provide medical services and in-plant dining rooms. Some larger firms offer child care services, gym facilities, and fuel and food vouchers.

7.3 Termination of employment

A worker contracted for a specific assignment or for a fixed period (maximum of two years) may be dismissed at the expiration of the contract without further employer liability. If a contract is terminated without just cause, the employer must pay one-half of the balance of the remuneration due over the remainder of the contract. Otherwise, the employer must give eight days notice (or equivalent compensation) if the employee is paid weekly or 30 days if the employee is paid at longer intervals or has been employed for more than one year. An employee who resigns must give the same notice. Accumulated vacation time must be paid when an employee leaves a company.

The severance pay system requires employers to contribute 8% of payroll into blocked accounts — the FGTS — for all workers. The accumulated balance is transferable when the worker changes jobs voluntarily and is payable in cash on retirement or unjustified dismissal. Employees may draw on FGTS accounts at other times for certain purposes, such as health emergencies or for a down payment on a house.

Unjustified dismissals also entitle employees to a bonus payment of 40% of their FGTS accounts, which constitutes a penalty borne by employers. An additional 10% (total of 50%) must be paid by employers in such cases.

7.4 Labour-management relations

A single union represents all Brazilian workers of an industrial sector in a given geographical area. The central body collects mandatory dues paid by all workers. The constitution grants ample freedom to strike, which is limited only by a law mandating warning periods, protection of essential services (such as utilities and public transport) and minimum quorums for strike votes.

Companies may hold discussions and negotiations with labour representatives to avoid or settle strikes. If the two sides fail to reach a mutually agreeable compromise, labour may opt to strike. Industrial action is then usually resolved in a renewed round of collective bargaining between labour and management. If the parties fail to reach an agreement, the dispute is referred to the regional labour tribunal for arbitration. The labour tribunal can declare on the legality of the strike.

Wages and other issues are often negotiated with representatives of industrial federations and union confederations for entire sectors. Negotiations at the company level are also common, and a settlement that encompasses a whole company (or a group within a company) is called a collective agreement.

7.5 Employment of foreigners

Employers must obtain work cards for all employees from the local office of the Ministry of Labour and Employment. For a company that employs more than three persons, two-thirds of all employees must be Brazilian nationals, earning two-thirds of the total payroll. Foreign specialists that are not available locally are excluded from the calculations, as are directors who are not employees.

A permanent visa is normally required for individuals who intend to live permanently in Brazil, such as the general manager of a Brazilian company. Other types of visas include: (1) transit visas (valid for 30 days); (2) tourist visas (valid for five years), which entitle multiple entries into the country and presence of up to 90 days, renewable for an equal term; (3) special visas (more than 180 days without the intent to reside); (4) temporary visas (two years and possibly longer); and (5) business visas, valid for 90 days and renewable once (easily obtainable at any Brazilian consulate).

The government has tightened the entry of foreign technicians. International companies that seek to employ foreign nationals must present a well-documented case to the immigration secretariat at the Ministry of Labour and Employment. The following documents must be included: a formal request for entry into Brazil on a permanent or temporary visa, providing the name and address of the company, the amount of registered capital and the number of Brazilian and expatriate employees of the firm in Brazil; the reason for the transfer of the foreign national (e.g. to compensate for the lack of locally available employees with such skills or to act as director of a firm or banking establishment); the name, address and passport number of the foreign national; the monthly salary to be received in Brazil and abroad; and all fringe benefits involved.

Companies must also file: (1) for legal permission to allow an employee to represent the foreign national before the ministry; (2) the foreign national's curriculum vitae and university diploma (which must indicate the foreign national's relevant experience), with the latter authenticated by a Brazilian consulate and accompanied with an official translation; (3) a labour contract between the foreign national and the Brazilian employer, stating the type of work, salary and length of stay or,

alternatively, a services agreement signed between the Brazilian and foreign companies; and (4) a completed application form (obtainable from the Ministry of Labour and Employment).

Specific requirements vary, depending on whether the firm is an *SA* or a *Limitada*, and whether the candidate is being contracted for a supervisory position, as a regular employee of the Brazilian company or to render a technical service. Individual income tax consequences vary depending on the type of visa of the foreign national.

8.0 Office locations

To find out how our professionals can help you in your part of the world, please contact us at the headquarters office listed below or through the “contact us” button on <http://www.deloitte.com/tax>.

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