TozziniFreire Advogados

# Investments in Brazil
# Tax aspects

Specially prepared to:

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- **Professional experience:** Head of Tax Area at TozziniFreire Advogados, with over 18 years of experience in Tax Practice, including Tax Consulting Area of a former "Big Six" auditing firm, and another large Brazilian firm. Member of the Permanent Scientific Committee of the International Fiscal Association ("IFA").
- **Education:** Doctor of Laws degree in Economic Financial Law from the Law School of Universidade de São Paulo (USP) in 2006. LL.M. in Tax Law from the Law School of São Paulo Catholic University (PUC-SP) in 2001. MBA in Finance and Capital Markets from IBMEC Business School in 1996. Graduation: Law (USP Law School, 1994) and Business Administration (Getulio Vargas Foundation, 1992)
- **Other Professional Activities:** Member: IFA and Director of Brazilian IFA Branch (Brazilian Association of Financial Law - ABDF); Brazilian Institute of Tax Law (IBDT); Brazilian Association of Tax Law (ABRADT); Brazilian Institute of Tax Researches (IPT); Brazilian Institute of Tax Studies (IBET); International Center of Tax Studies (CIEST); Brazilian Institute of Financial Professionals Certification (IBCPF) and IBCPF Certification Committee (2003-2004). Contributor to BNA Transfer Pricing Forum and BNA Global Tax Guide.
- **Academic Activities:** Visiting professor in different post-graduation courses of the most reputable business schools in Brazil, including Law School of Fundação Getúlio Vargas (FGV/RJ – 2002/2005); USP School of Economy and Administration (USP/FIPECAFI); International Business MBA Program at Fundação Instituto de Pesquisas Econômicas, in association with USP (USP/FIPE); Corporate Management MBA Program at Fundação Instituto de Administração, in association with USP (USP/FIA); among other important post-graduation courses in Brazil
- **Publications and speeches:** Author of several articles related to Tax Area, and lecturer in various seminars and conferences, local and international, including 2007 IFA Congress in Kyoto (Seminar B: International Tax Issues on Emission Allowances), 2009 ABA Section of Taxation May Meeting, and 2009 IFA Congress in Vancouver (Plenary Session II: Foreign Exchange Issues).
- **Awards and Recognitions:** Included by Latin Lawyer Magazine, in August/September 2002 edition, among "40 under 40 – Brazil's Raising Stars" (40 leading Brazilian lawyers under 40 years old); in August/September 2003 edition among "Latin America's Top Tax Lawyers" (Fiscal Responsibility – Latin America's top tax lawyers); in June 2006 edition among the 40 of the Latin America's women lawyers who have excelled in their chosen area of practice ("The Glass Ceiling"). Frequently ranked among the most recognized tax lawyers in Brazil, by different companies and publications.

# Ways to Invest in Brazil

- (a) Direct foreign investment ("4131") - Equity
- (b) Debt
- (c) Investment in Brazilian financial and capital markets
- (d) Foreign market investor ("2689")
- (e) Investment via Brazilian Private Equity Fund ("FIP")

# Direct Foreign Investment

## – Inflow of funds

- ✓ Registration of the amount invested with the Brazilian Central Bank
- ✓ Tax on Foreign Exchange Transactions (“IOF/FX”)
  - Levied on any conversion of foreign currency into Reais and vice-versa
  - Rate: 0.38% (general rule)
    - 0% if investment is in a company with shares listed in the Brazilian stock exchange
    - IOF/FX rates may be changed at any time by means of Presidential Decree

# Direct Foreign Investment

- Asset deal x share deal
  - ✓ Asset deal
    - Does not eliminate tax succession if the assets comprise a business unit
      - Secondarily liable, if the seller remains with the same or other activities
      - Primarily liable, if the seller stops operating
    - Price should be allocated "item-by-item"
      - Asset value may be subject to depreciation or amortization
    - Selling an entire plant ("establishment") reduces State VAT (ICMS) and Excise Tax (IPI) impacts
      - Sale of isolate assets may subject to those taxes

# Direct Foreign Investment

– Asset deal x share deal

✓ Asset deal

- Capital gains arising from the sale of assets subject to
  - Social Contributions on Revenues (“PIS/COFINS”) at 9.25% - only sale of permanent assets is exempt
  - Corporate Income Taxes (“IRPJ/CSLL”) at 34% (40% in case of financial and insurance institutions)
    - Possible to offset operating losses against capital gains
    - NOLs from previous year can be offset up to 30% of the taxable income of the year

# Direct Foreign Investment

## – Asset deal x share deal

- ✓ Share deal
  - Possibility of registering goodwill if the buyer is another Brazilian company
    - – Goodwill = Price paid (-) Market value of Target's net equity
    - – Brazil is moving to IFRS
      - Must be justified by the future profitability of Target
      - Goodwill is no longer amortizable for accounting purposes – subject to impairment test

# Direct Foreign Investment

## – Asset deal x share deal

- ✓ Share deal
  - Upstream or downstream merger
    - – Goodwill based on future profitability can be amortized for tax purposes
      - Transitional Tax Regime (“RTT”)
      - 5 years – 1/60 per month
    - – Difference between market and accounting value of tangible assets:
      - Step-up on the asset value for tax purposes – increase of basis for depreciation, amortization or depletion
    - – Intangibles and other economic reasons: no tax benefits

# Direct Foreign Investment

## – Shareholders´ remuneration

- ✓ Payment of dividends by Brazilian companies
  - Limited to accounting profits
    - – Exception: preferred shares with fixed dividends – possible to use capital reserve to pay dividends
  - Exempt from withholding tax
  - IOF/FX: Zero (may be changed at any time by means of Presidential Decree)

# Direct Foreign Investment

– Shareholders´ remuneration

✓ Interest on net equity

- Possibility of deducting and paying notional interest to shareholders (“interest on net equity”)
  - Limit of payment:
    - Net equity (x) long-term interest rate (TJLP)
  - Limit of deduction – greater between:
    - 50% of earnings before taxes and before interest on equity deduction, or
    - 50% of accumulated profits account
  - Withholding income tax at 15% (25% in case of tax  haven jurisdiction
  - IOF/FX: Zero (may be changed at any time by means of Presidential Decree)

# Tax haven jurisdiction

– Country or jurisdiction that:

- ✓ Does not impose taxes on income; or
- ✓ Where such income tax is lower than 20%; or
- ✓ Does not permit access to information on shareholders of companies; or
- ✓ Does not permit identification of beneficial owners of income

# Tax haven jurisdiction

## – Blacklist - Rule #1.037/2010, from Federal Tax Authorities

- ✓ American Samoa; American Virgin Islands; Andorra; Anguilla; Antigua and Barbuda; Aruba; Ascension Islands; Bahrain; Barbados; Belize; Bermudas; British Virgin Islands; Brunei; Campione D'Italia; Cayman Islands; Channel Islands (Alderney, Guernsey, Jersey and Sark); Commonwealth of Bahamas; Cook Islands; Costa Rica Republic; Cyprus; Djibouti; Dominica; Federation San Kitts and Nevis; French Polynesia; Gibraltar; Granada; Hong Kong; Kiribati; Labuan; Lebanon; Liberia; Liechtenstein; Macau; Madeira Island; Maldives; Man Island; Marshall Islands; Mauritius Islands; Monaco; Montserrat Island; Nauru; Netherlands Antilles; Niue Island; Norfolk Island; Oman Sultanate; Panama; Pitcairn Island; Queshm Island; Saint Helena Islands; Saint Lucia; Saint Vincent and Granadines; San Marino; San Peter and Miguelão Islands; Seychelles; Singapore; Solomon Islands; Swaziland; Switzerland (temporarily suspended); Tonga; Tristão da Cunha; Turks and Caicos Islands; United Arab Emirates; Vanuatu; West Samoa
- ✓ Excluded from the previous blacklist: Luxembourg and Malta

# Tax haven jurisdiction

– Consequences of having a beneficiary in a tax haven jurisdiction

- ✓ Increase from 15% to 25% (or from 0% to 25%, depending on the type of income) of withholding income tax in most of the Brazilian sourced income and gains
- ✓ Restrictions to deduct expenses related to payments performed to such beneficiary
- ✓ Application of transfer pricing controls
- ✓ Application of more strict thin capitalization rules
- ✓ Impossibility of claiming the benefits granted to foreign investors under financial and capital markets ("2,689 Investors")
  - As of the date in which the foreign investor's jurisdiction is included in the black list (Instruction nº 1,043/2010)

# Direct Foreign Investment

## – Sale of the investment

- ✓ Brazilian sourced gains:
  - Buyer located in Brazil
  - Asset located in Brazil - even if buyer and seller are non-residents
- ✓ Capital gains
  - Capital gains = Sale Price (-) Acquisition cost
  - Acquisition cost = amount paid for the investment or Foreign capital registered with the Central Bank of Brazil
- ✓ Withholding tax on capital gains
  - 15% or 25% (tax haven resident)
  - Responsible: (a) Brazilian buyer; or (b) attorney-in-fact of non-resident Buyer
- ✓ IOF/FX
  - 0.38% on the remittance of funds (may be changed at any time by means of Presidential Decree)

# Direct Foreign Investment

- Sale of the investment
  - ✓ Repatriation of capital
    - No withholding tax up to the amount of foreign investment registered with the Central Bank of Brazil
      - Any excess amounts are understood as capital gains
    - IOF/FX at 0.38% on the remittance (may be changed at any time by means of Presidential Decree)
  - ✓ Treaties to avoid double taxation that Brazil has entered into:
    - Capital gains are taxable in both Countries
    - Exception:
      - Brazil-Japan Treaty:
        - Capital gains are taxable only in the country of residence

# Treaties to Avoid Double Taxation

- Treaties signed by Brazil follow OECD model in most of their articles
- No anti-treaty shopping rules
  - ✓ Treaties do not bring clauses on limitation on benefits
  - ✓ Some treaties bring the beneficial owner concept
- No treaty to avoid double taxation with the USA
  - ✓ Recognition, by Brazilian Government, of reciprocal treatment of tax credits
    - Income taxes paid in the USA allow tax credit in Brazil
    - The same occurs with the UK and Germany

# Treaties to Avoid Double Taxation

- Africa:
  - ✓ South Africa
- Asia:
  - ✓ China, India, Israel, Japan, Korea, Philippines
- Europe:
  - ✓ South Austria, Belgium, Czech Republic, Denmark, France, Finland, Hungary, Italy, Luxembourg, Netherlands, Norway, Portugal, Slovak Republic, Spain, Sweden, Ukraine
- North America:
  - ✓ Canada, Mexico
- South America:
  - ✓ Argentina, Chile, Ecuador, Peru
- Signed but not yet in force:
  - ✓ Paraguay, Russia, Venezuela

# Debt Investment

- Withholding income tax on interest
  - ✓ 15% or 25%, if the lender is resident in a tax haven jurisdiction

- IOF/FX (rates may be changed at any time by means of Presidential Decree)
  - ✓ Inflow of funds:
    - Average maturity term of the loan:
      - 720 days or less: 6%
      - More than 720 days: Zero
  - ✓ Outflow of funds: Zero

# Debt Investment

- Rules against thin capitalization:
  - ✓ Loans with related companies (not resident in tax haven jurisdictions):
    - Interest expenses are deductible as long as:
      - Borrowed funds are used to develop the company's businesses
      - Market interest rate
      - Interest does not exceed the amount of interest calculated on:
        - two times the amount of net equity participation held by the lender into the borrower
        - two times the amount of net equity of the borrower, in the case of related party as lender that does not hold any participation in the borrower's capital
    - Total amount of debt with related parties does exceed two times the borrower's net equity
    - Also applicable on loans with third parties if any related company is guarantor or intervenient in the agreement

# Debt Investment

- Rules against thin capitalization:
  - ✓ Loans with related or unrelated entities in tax haven jurisdictions or subject to favorable tax regimes:
    - Interest expenses are deductible as long as:
      - Borrowed funds are used to develop the company's businesses
      - Market interest rate
      - The debt does not exceed 30% of the Brazilian company's net equity, nor the total debts with tax haven jurisdiction creditors exceed such limit
    - The total debt with parties in tax haven jurisdictions cannot exceed 30% of the Brazilian company's net equity
    - Also applicable on loans with parties not residing in tax haven jurisdiction if any tax haven entity is guarantor or intervenient in the agreement
    - Not applicable for financial institutions in relation to the portion of intercompany debts used for the purposes of lending to clients

# Beneficial Tax Regime

- Beneficial Tax Regime List ("Gray List") – Rule # 1037/2010:
  - ✓ in relation to the legislation of Uruguay, the regime applicable to the companies incorporated "Sociedades Financeiras de Inversão (Safis)" until December 31, 2010;
  - ✓ in relation to the legislation of Denmark, the regime applicable to the companies incorporated as holding company that do not develop substantial economic activity
  - ✓ in relation to the legislation of Island, the regime applicable to the companies incorporated as International Trading Company (ITC);
  - ✓ in relation to the legislation of Hungary, the regime applicable to the companies incorporated as offshore KFT;
  - ✓ in relation to the legislation of United States of America, the regime applicable to the companies incorporated as state Limited Liability Company (LLC), which corporate ownership is formed by non-residents, not subject to the federal income tax; or
  - ✓ in relation to the legislation of Malta, the regime applicable to the companies incorporated as International Trading Company (ITC) and International Holding Company (IHC);
  - ✓ in relation to the legislation of Spain, the regime applicable to the companies incorporated as Entidad de Tenencia de Valores Extranjeros – ETVE **(temporarily suspended)**;
  - ✓ in relation to the legislation of Netherlands, the regime applicable to the companies incorporated as holding company that do not develop substantial economic activity **(temporarily suspended)**.

# Investments in Brazilian Financial and Capital Markets

– General rule

- ✓ Same taxation as Brazilian individuals
  - Fixed yield investments
    - – Withholding tax rates vary from 22.5% to 15%, depending on the term of the investment
    - – Hedge transactions are considered "fixed yield investments" for purposes of taxation
  - Variable yield investments: withholding tax at 15%

- ✓ On inflow of funds:
  - IOF/FX at the general rate of 6% (may be changed at any time by means of Presidential Decree)
  - Reduction to zero to invest in certain long-term bonds issued in accordance with Law no. 12.431/2011 to finance infra-structure or innovation projects (research/development)

# Foreign Market Investor (“2689”)

## – Foreign Market Investor

- ✓ Special regime that requires:
  - To choose a Brazilian bank as the representative in Brazil
    - – responsible for the compliance of all tax obligations
  - To be registered with the Central Bank
  - To be registered with the Brazilian Securities and Exchange Commission
  - Not to be resident in a tax haven jurisdiction

# Foreign Market Investor ("2689")

- IOF/FX (rates may be changed at any time by means of Presidential Decree)
  - ✓ 6% on inflows related to deposit of initial or additional margin requested to operate in the Brazilian stock, futures and commodities exchange
  - ✓ 0% on inflows to invest in Brazilian stock, futures and commodities exchange
  - ✓ 0% on inflows related to investment in investment funds (including Brazilian Private Equity Funds – "FIP")
  - ✓ 0% of the conversion of depositary receipts into shares of Brazilian companies
  - ✓ 0% on the conversion of a foreign direct investment register into a portfolio (4,131 Investment to 2,689 Investment)
  - ✓ Zero on outflows
    - Including the payment of dividends or interest on net equity
- Tax on Transactions with Bonds and Securities ("IOF/Securities"):
  - ✓ 1.5% on the deposit of stock into ADR program

# Foreign Market Investor (“2689”)

– Exemption or zero withholding income tax rate applicable to:

- ✓ Gains obtained with sale of assets in a Brazilian stocks, futures or commodities exchange, including organized OTC markets
- ✓ Income generated by governmental bonds
- ✓ Income generated by Brazilian Private Equity Funds (“FIP”) if certain conditions are met
- ✓ Dividends

– Withholding income tax:

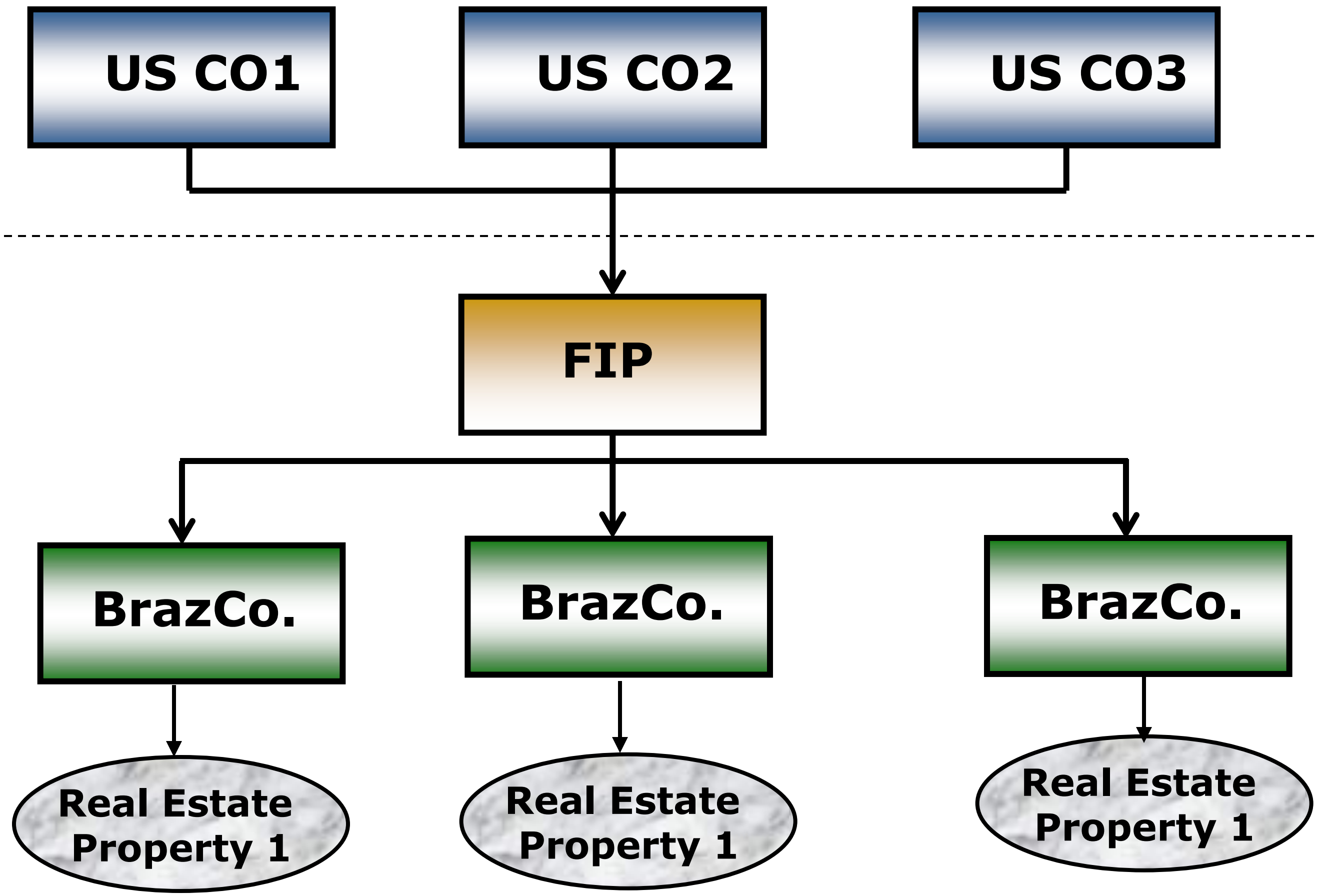
- ✓ Variable yield funds and swaps: 10%
- ✓ Any other income or gains: 15%

# Brazilian Private Equity Fund ("FIP")

- General rules:
  - ✓ FIP portfolio is exempt from taxation
    - Taxation at the level of the quotaholders
  - ✓ 15% withholding tax on the redemption of shares
  - ✓ IOF/FX on inflows: 0%; on outflows: Zero
- 2,689 investors
  - ✓ Withholding tax reduced to zero on income distributed by the FIP if the following conditions are met:
    - Maximum direct or indirect participation of 40% of total quotas, and of 40% of economic interests
    - FIP cannot have in its portfolio debt bonds exceeding 5% of its net equity
      - except convertible debentures, warrants and governmental bonds
    - No tax haven residence

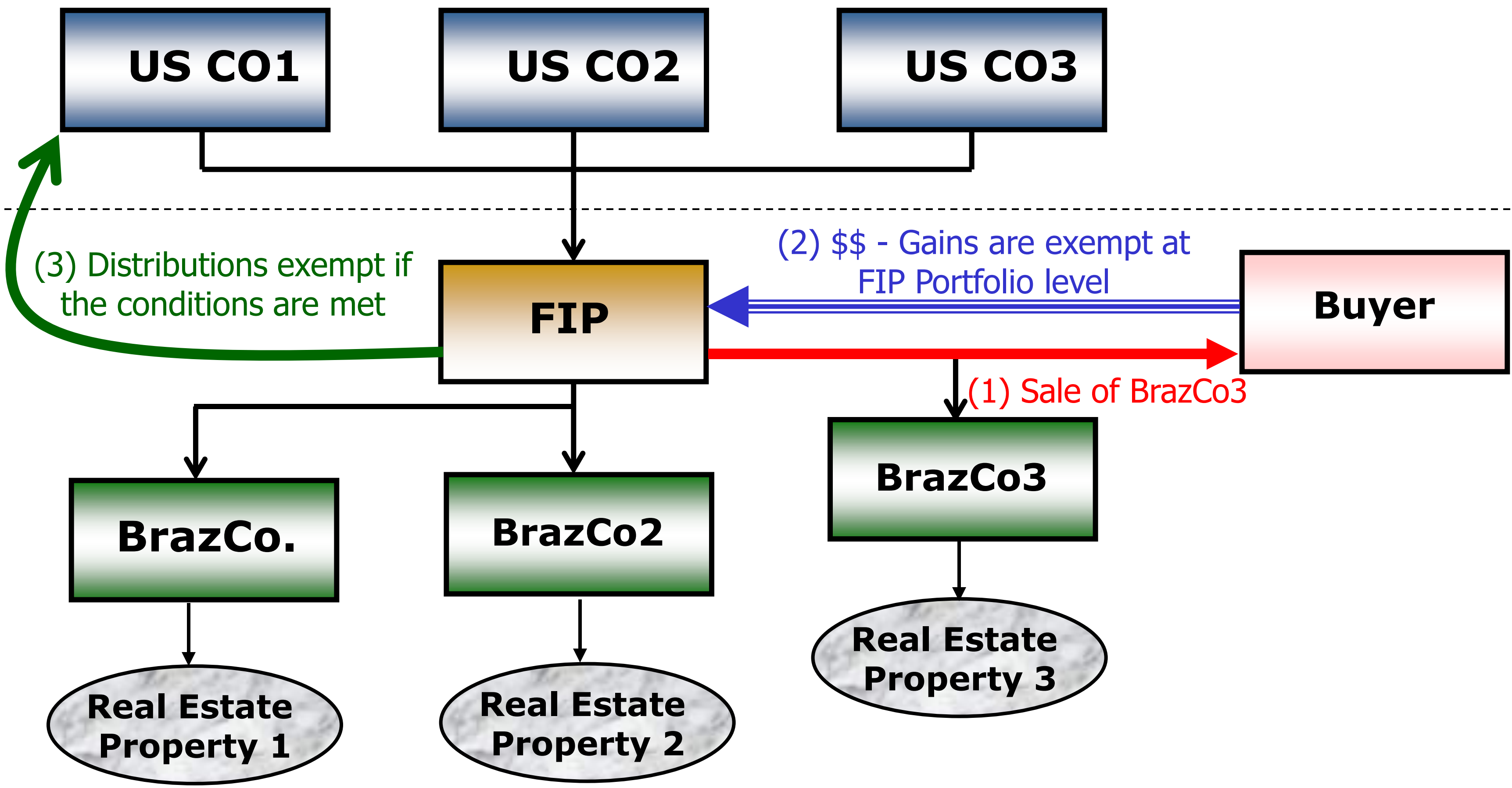
# Brazilian Private Equity Fund ("FIP")

– Example:



# Brazilian Private Equity Fund ("FIP")

– Sale of Real Estate Property 3:



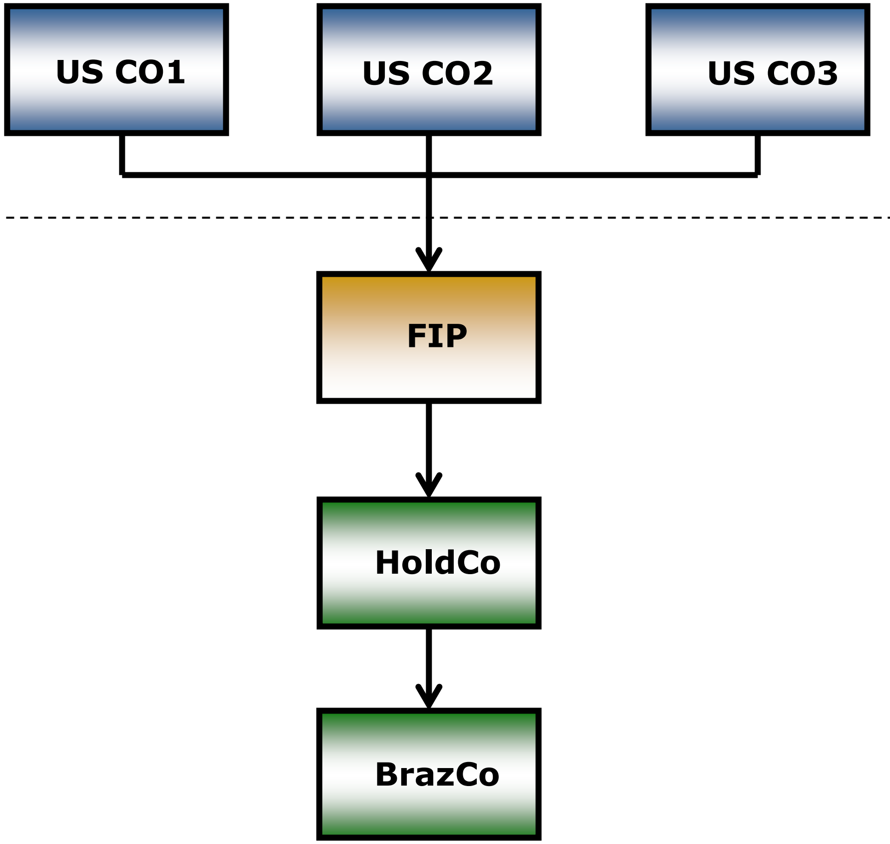
# Brazilian Private Equity Fund ("FIP")

– Combine FIP with Brazilian Holding Company Structure

✓ Possible to create a holding company to buy the shares of Brazilian target company

- Recognition of Goodwill

  – Goodwill deduction after downstream or upstream merger



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