



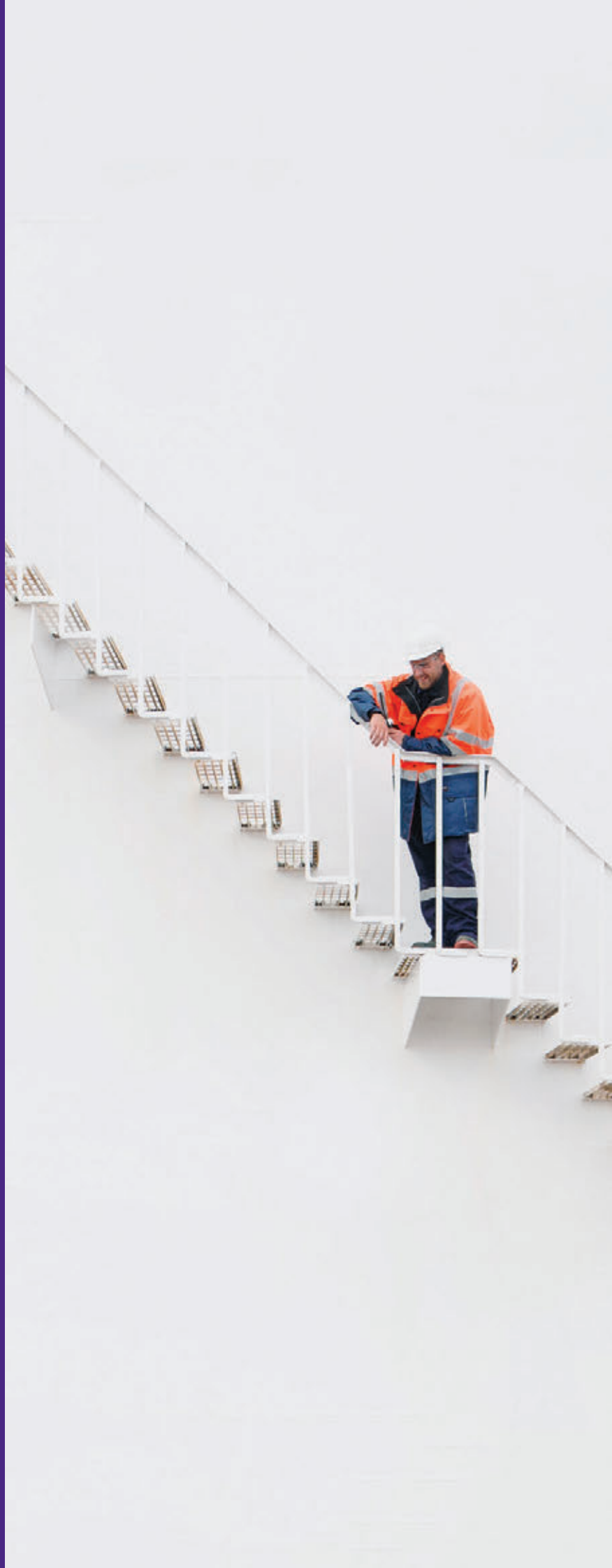
# A Guide to Brazilian Oil & Gas Taxation

**Tax**

2016 edition

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# Welcome Introduction

As one of the world's leading commodity and natural resources producers, Brazil has been a player on the world stage.

The new Oil & Gas discoveries have increased the optimism and investments in this sector. It is within this context that Brazil is consolidating its image as one of the preferred destinations for foreign investments, increasing the participation of major players and interest of newcomers, capable of participating in important alliances with international petroleum exporters and capable of alleviating pressure on price highs as a result of the length of its coastline and the potential for its reserves, which total around 16,200 million barrels in 2014, according to the Brazilian Agency for Petroleum, Natural Gas and Biofuels (ANP).

Such new discoveries, especially in the pre-salt area located off the coast, are considered as the largest discoveries in the world since the year 2000 and the largest discoveries in the West since 1976. Market analyses made by KPMG Oil & Gas Center of Excellence have revealed that the present capacity of the Brazilian Oil & Gas industry represents only 3% of what it will be in 25 years. The projections show that the sector in Brazil should double its size on every five or six years.

Based on the National Petroleum, Natural Gas and Biofuel Agency

(ANP), the Oil & Gas industry has grown by more than 300% since 1997, which means that the sector's contribution to the GDP has grown from 2.75% to around 12% in 2012. For the period from 2006 to 2010 the investments that have been reported to ANP by the current concessionaires total US\$ 33.8 billion, a figure that may grow up to US\$ 400 billion in 2020 as a result of the discoveries.

After 5 years of waiting, 2013 marks the return of the bidding rounds in Brazil. In 2013, ANP organized three bidding rounds, including shale gas and pre-salt areas.

Within this scenario, Brazil has become one of the most attractive countries for investments in the Oil & Gas sector and a number of much larger investments have been already announced by major players. Due to that, it has been noticed an increasing volume of M&A activity, as well as an unprecedented presence of newcomers starting operating in different levels of the supply chain.

Despite the above, it is also well known that Brazil has been facing the perfect storm in the last 18 months: oil prices below \$40 represents a great challenge for operations in Brazil as the local production depends of deep water operations (which involves high costs); economy in recession and the main rating agencies reducing Brazil's investment grade; huge political instability

with possibility of impeachment of Brazilian president; and the biggest oil and gas company, Petrobras, under heavy investigation due to allegations of fraud in contracts with the main constructing companies in Brazil. Although these scenarios seem to be negative, the transformation in place will bolster constructive and stronger policies in key sectors of the economy, such as infrastructure and energy, bringing great business opportunities for companies and investors. While a more business-friendly framework is expected for both sectors, implementation will be slow and difficult, which reduces the prospect of significant investments to drive a robust economic recovery in the near future. We are very positive with those changes and strongly believe that Brazil still has great potential in energy (oil and gas, utilities, etc.) and infrastructure (logistics in general) sectors. Pre-salt reservoirs are still there, certified by international organizations and the technology is already proved.

This publication is an initiative, of the Oil & Gas Tax team of KPMG in Brazil, which updates, every two years, the latest information on the main taxes applied to the industry. It brings information that was updated up to February, 2016.

# Oil & Gas industry in Brazil

Oil & Gas industry in Brazil is regulated by Law 9,478/97 and ANP, which is responsible for regulating, contracting and supervising the activities of exploration, development, production, refining, distribution and retail.

According to the mentioned legislation, activities related to the Oil & Gas industry in Brazil should be, in principle, performed exclusively by the Federal Government. It is also stated in the law that private entities may develop such activities by way of concession agreements, authorizations or production share regime contracts.

As a general rule, O&G contracts in Brazil are usually based on concession agreements, which require industry players to incorporate a local entity to carry out activities in Brazil.

The use of the production share regime is relatively new in Brazil as the rules for this type of contract were only approved by way of Law 12,351/10. The production share regime is mandatory for the pre-salt and other areas of interest by the government.

Under this regime, the hired company will bear the risk of solely financing the exploration, evaluation, development and production activities. In case of a commercial discovery, it will acquire the rights to appropriate a portion of the production profits corresponding to

- (i) the costs and investments incurred in both the production and exploration phases and
- (ii) the payment of the royalties due. The profits should be proportionally shared between the parties as per the conditions pre-established in the production share contract.

The Production Share Regime requires that Petrobras acts as the operating company with a minimum participation of 30% in each block. In addition, PPSA (Administração de

Petróleo e Gás Natural S.A. – Pré-Sal Petróleo S.A.), a government owned company (that represents the interests of the Federal Government) must also be part of every pre-salt consortium where PPSA will have 50% of the votes in the Operational Committee of the consortium.

Bill of Law 131/2015 proposes having Petrobras as the operating company in each block with a minimum participation of 30% as an option offered to Petrobras instead of an obligation. The bill was approved in the Senate and it is under discussion in the Brazilian House of Representatives.

Periodically, ANP promotes bidding rounds – also known as Brazil Rounds – for companies intending to participate in public concessions or production share agreements for the exploration, development and production of Oil and Natural Gas. In general, the public bidding stipulates eligibility requirements, usually involving tax clearing certificates and local content policy, for instance.

It is important to outline that companies involved in O&G contracts are subject to Governmental takes, a compensation due by companies for the exploration of the O&G. Currently, there are four types of Governmental takes foreseen in Law 9,478/97 and Law 12,351/10:

- (i) Signature Bonus;
- (ii) Royalties;
- (iii) Special Participation; and
- (iv) Area Retention Tax.

Governmental takes (i) and (ii) are applicable to both concession agreements and production share contracts while (iii) and (iv) are exclusive of concession agreements.

In addition, it is also important to note that concession agreements have been stipulating an obligation to invest 1% of the gross revenues in Research & Development. This issue is also found in the “Tax overview” section.

In most cases, concessions public biddings are won by the best Signature Bonus offer, while in a production share bidding, as the Signature Bonus is previously fixed by the ANP, the winning offer is based on the best sharing offer of the exceeding O&G profits to the Federal Government.

## Local Content

O&G industry is an extremely competitive sector with an increasing demand of goods and services to support the development of its projects, a characteristic that pushes O&G players to search for prices and resources in the international market. In order to foster the development of the local industry and mitigate an excessive use of resources from international suppliers, governments may impose a local content policy, in which O&G players are required to acquire goods and contract services from local suppliers and service providers.

In practical terms, the public bidding rounds stipulate a minimum percentage of local content. The percentage of local content utilized by each bidder may be an aspect to be considered by the government authority to rank the bidding companies in the round.

After each bidding round, the percentage of local content utilized by the winner of the bidding process is included in the concession contract. The non-compliance with the agreed local content shall



give cause to fines established in the concession agreements. In general terms, local content may be measured by the proportion between the sum of values of the goods and services acquired, direct or indirectly, by the concessionaire from a Brazilian source and the total amount of goods and services acquired related to the whole operation.

The minimum percentage for local content was firstly required in the 5th and 6th rounds with different percentages according to where the blocks were located: ground, shallow waters or deep waters. As from the 7th round, the minimum requirements were expanded for a list of items for exploration and development phase.

It is important to note that the local content policy is relatively new in Brazil and has suffered several modifications in the last years. Due to that, investors shall take proper attention to the compliance of local content policy which is one of the key drivers when doing business in the O&G industry in Brazil.

#### **Pre-salt**

In the year of 2007, Brazilian Government announced the discovery of a deep-sea field of large oil and gas reserves. This area has been named Pre-Salt, considering its location about 7 Km below the sea bed, under a series of layers of rock and salt.

This announcement has been very commented in the global community,

emphasizing the impact of this new resource for the Brazilian economy.

Because of the significance of these reserves, the Brazilian government has been studying a potential change in the exploration and production (E&P) model adopted up to now. Several discussions have arisen regarding the current contracting practices and royalties distribution in this industry and it is still uncertain what should be the extent of the changes that may come up in the next years.

Based on a change in Law 9,478, made in 2010, the exploration, development and production of oil and gas shall be carried out through the production share regime in the pre-salt and strategic areas.



# How to invest in Brazil

Brazil's rapidly growing economy, in addition to the Brazilian tax law, which is considered firm, create an attractive environment for investors, and with careful planning, companies and funds can take advantage of several benefits of choosing Brazil for its investments.

## Setting up the business

Foreign investors may enter the Brazilian market directly through a branch or a subsidiary or through third parties by means of distribution and sales representation activities. Exploration and production activities usually require the incorporation of a local company, because, for example, of the concession bidding rounds rules. On the other hand, the decision on whether to establish a local company for the suppliers of the O&G chain would depend on a variety of factors, such as, comparison between the costs associated with import of goods and services versus the local operation, as well as, local content requirements.

In most cases, distribution and sales representation save costs when compared to the incorporation of a local company. However, these alternatives may be accompanied by a lack of control of the foreign investors over the way third parties distribute or sell their products in Brazil and deal with their trademarks.

## Subsidiaries

In general, foreign investors tend to incorporate a subsidiary rather than set up a branch in Brazilian territory due to the following:

- (i) the shareholders are not responsible for the Brazilian subsidiary's debts, except for specific provisions set forth by corporate, tax, labor and bankruptcy rules, and
- (ii) the process of establishing a subsidiary in Brazil is fairly simple and much less time consuming when compared to establishing a branch.

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

Nonresident individuals or legal entities may adopt any type of legal entity recognized by Brazilian legislation, being the more common structures, the Limitadas (Limited Liability Companies) or SAs (Corporations).

## Limitadas (Limited Liability Companies)

The articles of incorporation of a Limitada follow the form of a partnership contract, requiring at least two investors. Nevertheless, it is considered an entity that is separate from its quotaholders. Nonresident

quota holders must grant a power of attorney to a representative in Brazil to receive service of notice and act on their behalf at quota holders' meetings.

The corporate capital, which must be denominated in Brazilian currency, is divided into quotas with fixed or different unit values as specified in the articles of incorporation. In this regard, the responsibility for the payment of any corporate obligation is limited to the quotaholder's participation.

Recently Brazilian government introduced the limited liability company, in which it is possible to have just one single investor (EIRELI, or empresa individual de responsabilidade limitada), to be in force as from January, 2012.

This legal entity should have a minimum amount of 100 times the Brazilian minimum wage as capital (current minimum wage at R\$ 880.00).

Regular independent audits are required for Limitadas which holds total assets higher than R\$ 240 million or accrued annual gross revenues higher than R\$ 300 million.



## **SAs (Corporations)**

The organization and operation of an SA is governed by the Law 6,404/76 and it was designated to stimulate the development of the Brazilian capital market and to provide additional protection for minority shareholders.

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

The corporate capital is divided into negotiable shares which are indivisible in relation to the company. In this sense, shares can be ordinary (essential rights of a shareholder, especially in respect to participation in the company's results and right to vote in the company's general meeting) and preferred (preferential rights with respect to dividends and/or reimbursement of capital, however with no right to vote in the company's general meeting).

The shareholder's responsibility is limited to the value of shares held.

In addition, as a general rule, legal entities incorporated as SAs are required to follow publicity rules and are obliged to carry out regular independent audits.

## **Branches**

In addition to subsidiaries, foreign investors may also enter the Brazilian market directly through a branch.

In general, the O&G industry does not operate through a branch because of the lengthy process of incorporation and the need of authorization from the Ministry of Development, Industry and Commerce.

It is important to bear in mind that a branch is subject to Brazilian law and

courts with regards to its business and transactions carried out in Brazil.

## **FIP – Investment Fund in Participations**

Fundo de Investimento em Participações or "FIP" is a feasible and efficient investment vehicle in Brazil.

It is not a legal entity but a pool of resources, incorporated by investors as co-ownership, aiming at investing in securities. As a matter of fact, a FIP is only permitted to invest in shares, debentures, subscription bonuses and other securities convertible into shares issued by corporations ("S.A.").

The advantage of using the FIP structure investments in Brazil is that (i) this investment vehicle is not subject to taxation in Brazil; and (ii) its distributions to foreign investors are not subject to withholding income tax either, provided that the following requirements are met:

- Investors are not located or residing in low tax jurisdictions.
- One single investor cannot alone, or in conjunction with its related parties, own more than 40% of the total quotas (akin to shares conceptually) issued by the FIP.
- One single investor – solely or along with its related parties – cannot have the right to receive 40% or more of the total income and proceeds distributed by the FIP.

## **Consortiums (JV Agreements)**

The E&P agreements are usually structured as consortiums in Brazil. The consortiums are not regarded as legal entities and involve a specific project, for a pre-determined period of time while maintaining the corporate autonomy of each party of the consortium.

The consortium is regulated by arts. 278 and 279 of Brazilian Corporate Law

(Law 6,404/76) and is managed by one of the entities, designated as the lead-company, which will be responsible for the accounting records, bookkeeping and safekeeping of documents that evidence the consortium operations.

The company's responsibility for the consortium's operations is generally defined in the agreement. In this regard, it is a common practice to stipulate the company's responsibilities in the same proportion to their participation in the consortium. Thus, in principle, companies do not share joint responsibility for consortium's operations from a corporate perspective. New rules of joint withholding tax responsibility were introduced for cases where the consortium fails to collect the withholding taxes levied on services contracted by the own consortium.

Because of the limited provisions in the Brazilian corporate law, there is some flexibility to define the terms of the consortium agreements which shall define the contribution of each party, share of revenues or production, costs and other operational aspects of the parties' relationship.

## **Joint Operating Agreements (JOAs)**

It is common for a joint venture or consortium contract to be accompanied by a Joint Operating Agreements (JOA), which aims to define the sharing terms of risks, costs and even technology between the parties as well as the establishment of rules of execution of the operation to be followed by the consortium's operating company in the E&P phases. The supervision of such rules falls under an Operating Committee formed by a representative of each of the parties of the consortium.

Usually, a JOA is an extensive contract with terms and conditions that range from the rights and obligations of the involved parties to cash calls, accounting procedures, intellectual property and even conflict of interest resolution.

### Repatriation of Profits and Investment Proceeds

Brazil's tax system provides strategies that a foreign investor can find useful in structuring its investment in Brazil.

### Dividends

Dividends paid to foreign shareholders are exempt from withholding tax. Dividends may be paid out of net accounting income (after taxes) for the year or profit reserves.

### Interest on Net Equity ("INE")

Another option for remitting income to foreign shareholders is the Interest on Net Equity, which is a hybrid remuneration with characteristics resembling both interest and dividends.

INE is calculated by applying the long-term interest rate (TJLP-Taxa de Juros de Longo Prazo) to the Brazilian entity's adjusted equity (accounting value, adjusted for the increases and decreases to equity during the year).

Deductibility of INE is limited to the greater of: (1) 50% of the net accounting income (before corporate income tax), and (2) 50% of retained earnings and profit reserves. The applicable tax to foreign shareholders receiving INE payments is a withholding tax of 15% (or 25% for recipients located in a low tax jurisdiction).

### Interest

Remittances of interest to foreign parties are subject to 15% withholding tax (or 25% for recipients in low tax jurisdictions).

It should be noted that Brazil has thin capitalization rules (generally 2:1, or 0.3:1 for low tax jurisdictions, for

the debt to equity ratio) and transfer pricing rules. Both rules may apply on interest payments, and in this case, the non-deductible excess amount is added back for corporate income tax purposes (disallowed) and may not be carried forward.

As per transfer pricing rules, interest due to or by a related party abroad (or a party located in a low tax jurisdiction or privileged tax regime) in connection with a loan agreement must observe a maximum (or minimum) transfer pricing parameter which is defined by one of the indexes below plus a spread margin:

- (i) market rate of Brazilian foreign sovereign debt bonds issued in United States Dollars;
- (ii) market rate of Brazilian foreign sovereign debt bonds issued in Reals; or
- (iii) the LIBOR rate for six-month U.S. dollar deposits.

The spread margin is defined by an Ordinance of the Ministry of Finance at the rates:

- 3.5% for interest due to a party located abroad; and
- 2.5% for interest due by a party located abroad.

### Capital gains

Nonresidents' capital gains deriving from a sale of an asset located in Brazil, including shares in a Brazilian company, are subject to withholding income tax at 15% (25% if the seller is located in a listed low tax jurisdiction). In case of a sale between two non-residents of an asset located in Brazil, the representative of the nonresident buyer is responsible for withholding and paying the Brazilian tax on capital gains.

On September 22, 2015, Provisional Measure 692/2015 ("MP 692/15") introduced new different rates to be

applied over ranges of capital gains earned by individuals, which should be in force as of January 1st, 2017. Even though MP 692/15 makes clear reference to individual tax residents in Brazil, such rates may also apply to the capital gains earned by nonresidents based on the interpretation of the tax law. However, MP 692 is currently pending sanction by the president, who may still line item veto the bill.

New progressive capital gain tax rates (MP 692/15)	
Parcel of the gain	Rate
Lower than 5 millions	15%
Between 5 and 10 millions	17.5%
Between 10 and 30 millions	20%
Higher than 30 millions	22.5%



# Foreign Exchange Controls

All foreign exchange transactions must be contracted with an authorized agent (normally a private financial institution authorized by the Central Bank to operate in the exchange market). Most foreign exchange transactions do not depend on Central Bank's pre-approval or approval, which make the exchange operation process simple and straightforward.

Foreign direct investments in Brazil must be registered with the Brazilian Central Bank (RDE-IED). Their proper registration is very important in enabling the future repatriation of capital and remittance of dividends, interest on equity, and capital gains. Foreign investors that make certain financial investments in the Brazilian financial and

capital market (e.g. FIP and FII) are also required to register such investments in an electronic Central Bank registration system, the so-called RDE-Portfolio.

In addition to that, most cross-border financial transactions such as loans, rentals, leases, as well as agreements involving transfer of

technology (royalties, know-how, technical assistance, etc.), should be also subject to Brazilian Central Bank's online electronic registration system RDE-ROF (Registro Declaratório Eletrônico de Operações Financeiras) in order to allow future remittance to funds abroad in connection to such agreements.



# Tax Overview

## Introduction

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

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

The federal tax system is managed by the Receita Federal do Brasil (RFB), which is part of the Ministry of the Economy (Ministério da Fazenda). States and municipalities have similar agencies.

## Corporate taxation

### Federal corporate income taxes

Brazilian tax legislation does not foresee specific provisions for companies involved in the Oil & Gas industry from an income tax perspective.

There are two income taxes in Brazil: the corporate income tax (IRPJ – Imposto de Renda das Pessoas Jurídicas) and the social contribution tax on profits (CSLL – Contribuição Social sobre o Lucro Líquido). They are charged on similar bases.

Profits, income and capital gains earned worldwide are subject to Brazilian corporate income taxes. There is no distinction made as to the origin of the capital (i.e. whether the investors are foreign or domestic).

Branches of foreign companies, although rare, are generally taxed in the same manner as standalone subsidiaries. A company is, in principle, considered resident in Brazil if it has been incorporated under Brazilian corporate law and is domiciled in Brazilian territory.

In addition, Brazilian law requires the company's effective management to be in Brazil. Please refer to permanent establishment issues in the chapter on International Tax Matters.

The two main methods to calculate corporate income tax and social contribution tax due on profits foreseen by legislation are: actual profit and presumed profit.

### Corporate income tax (IRPJ)

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

### Social contribution tax on profits (CSLL)

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

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

### Actual profit system

Under the actual profit system, net taxable income corresponds to the

company's net book profit, adjusted by certain inclusions and deductions provided by the Brazilian legislation.

Deductible expenses are generally all items related to the ordinary business of a company, properly documented and which are necessary to maintain its source of income.

### Tax losses

Under the actual profit system, companies may accrue tax losses to offset with its future taxable profits. In this regard, it is important to outline that there is no tax consolidation in Brazil and, therefore, it is not possible to offset tax losses from other group companies.

The main aspects in connection to tax losses that should be considered are the following:

- Tax losses may be carried forward indefinitely.
- The offset is limited to a maximum 30% of annual taxable income.
- No carry back of losses is allowed.
- Non-operational losses may be carried forward, but they may only be utilized to offset non-operational profits (e.g., capital gains).
- Tax losses are lost if there is a change in a taxpayer's control and type of activity between the time the losses are generated and the time they are utilized.

### Presumed profit system

Brazilian companies may elect to compute corporate taxes based on presumed net profits, provided they (a) do not have total revenues in the preceding year higher than R\$ 78 million, (b) are not financial institutions, similar entities or factoring

companies, (c) do not earn foreign profits, income or gains (i.e. directly or through foreign subsidiaries) and (d) do not qualify for an exemption or reduction of the corporate income tax.

The election is made annually, at the beginning of the year and the choice may be renewed every year. The election is valid for both corporate income tax and social contribution tax on profits. The presumed profit is measured by applying a certain 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.

For instance, for the income tax, the percentage for the revenues derived from the sale of products is 8%, while the percentage for service revenue is 32%.

For the social contribution tax on profits, the percentages are 12% and 32%, respectively.

### **Transitional Tax Regime (RTT)**

At the end of 2007, Law 11,638 was enacted and started the process of harmonizing the Brazilian generally accepted accounting principles (BR-GAAP) with the international accounting standards (IFRS).

Law 11,941 created the Transitional Tax Regime (so called "RTT") through which the tax computation shall follow the prevailing accounting rules in force in 2007. Brazilian tax authorities regulated that all tax adjustments, for Brazilian corporate

taxes purposes, should be performed in an electronic system (FCONT – Controle Fiscal Contábil de Transição) and informed on annual basis.

Such regime has been extinguished in 2014 calendar year, by way of Law 12,973/14 which introduced the harmonization of the tax law with the IFRS.

### **Tax Audits**

Tax audits are performed by federal tax inspectors on a random basis. The scope and frequency of auditing does not follow a set pattern. In general, the right of the tax authorities to make corporate income tax assessments (statute of limitation for tax purposes) expires 5 years after the end of the tax year in which the tax return should have been filed.

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

### **Gross revenues taxes**

PIS (Programa de integração Social) and COFINS (Contribuição para o Financiamento da Seguridade Social) are federal social contributions charged on revenues, on a monthly basis, under two regimes: cumulative and non-cumulative.

Under the non-cumulative system, taxpayers may generally recognize PIS and COFINS credits corresponding to 1.65% and 7.6% of certain inputs.

Such tax credits may be also used to offset future PIS (1.65%) and COFINS (7.6%) or other federal

taxes due, provided certain requirements are observed.

The PIS and COFINS non-cumulative regime is mandatory for companies subject to the actual profit method of computing corporate income taxes. The PIS and COFINS cumulative system remains applicable for certain entities, such as companies under the presumed profit system. In addition, the cumulative system still applies to revenues deriving from telecommunications, transport and software development services.

Such activities are generally subject to a 0.65% tax rate for PIS and 3% tax rate for COFINS, and no credits are available.

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

Additionally, as of May 1, 2004, the import of goods and services are also subject to PIS and COFINS at combined rates of 11.75% (other tax rates may apply depending on the good) or 9.25% (services). This applies to taxpayers under both cumulative and non-cumulative regimes. In some cases, taxpayers may recognize PIS and COFINS credits on the import.

In what regards to the O&G industry, it is important to outline that most of the products derived from oil and gas are subject to a tax concentration special regime of PIS and Cofins. Under this special regime, also known as "PIS/ Cofins Monofásico," the PIS and Cofins are levied at specific rates on the sale of certain products derived from oil in order to concentrate the calculation and payment of social contributions in one specific taxpayer within the operational chain.



## Indirect taxes

### IPI

IPI (Imposto sobre Produtos Industrializados) is a federal tax levied on the import and manufacturing of products. In many aspects, it operates like a value added tax, which is charged on the value aggregated to the final merchandise. As a general rule, IPI paid on a prior transaction can be used to offset the IPI liability arising out of subsequent taxed operations. The applicable rate depends on the product and its classification under the IPI tax rates table (TIPI). The classification within TIPI generally follows the Brussels Harmonized Tax Codes.

IPI also has a regulatory nature, i.e., the Brazilian Government may increase its rates at any time by decree as a way to implement financial and economic policies. Additionally, IPI rates can be increased for products considered non-essencial.

In the O&G industry, it is important to note that IPI is not levied on sale of oil, gas and other products derived from petroleum due to a special tax exemption set forth in the Brazilian Constitution.

### ICMS (*Imposto sobre Circulação de Mercadorias e Serviços*)

ICMS is a state tax levied on the import of products and transactions involving the movement of goods (which also encompass electricity), inter-municipal and interstate transportation services and communication services. Tax rates may be higher depending on the local legislation and type of operation. In many aspects, it operates like a value-added tax.

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

within the same state and in the case of imports, the rates may be 17%, 18% or 19%. Certain products and services are subject to 25% ICMS.

Regarding imports, the ICMS tax base is equal to the CIF value, plus the applicable import tax, IPI, certain customs expenses, the ICMS itself and PIS and COFINS due on the import.

ICMS is also due either when a product is resold in the domestic market or when it is physically removed from a manufacturing facility. The taxable base is equal to the value of the transaction, including the ICMS itself (gross-up), insurance, freight and conditional discounts. IPI must also be added to the ICMS tax base when the transaction is carried out between non-ICMS taxpayers or when it involves a product that will not be further manufactured or resold (e.g. fixed assets).

In general, ICMS taxpayers are entitled to a tax credit in the amount of the tax paid in the previous transaction. The tax credit may be offset against future ICMS payables. If the purchaser is not an ICMS taxpayer, and depending on whether its sales are subject to this tax, ICMS may become a cost and will not be recoverable as a credit.

Brazilian tax legislation also foresees special tax treatments in regard to ICMS for activities related to the Oil & Gas industry, as follows:

- (i) Brazilian constitution stipulates that interstate operations involving sale of oil, natural gas and biofuel should be assessed by ICMS only in the State where the product is consumed. This model of ICMS taxation has raised several discussions in the past in regard to tax leakage for the State where the oil was produced.
- (ii) Downstream-related activities are usually subject to a tax substitution/concentration

system where oil refineries are supposed to compute and collect the ICMS assessed in future operations.

- (iii) Special tax reductions on ICMS calculation are available for natural gas commercialization; etc.

Besides the above, there are several tax benefits available for manufacturers and other foreign companies related to REPETRO that may grant the exemption of ICMS on the industrialization and commercialization of equipments, parts and products related to the O&G industry.

### Recent changes in the ICMS rules of Rio de Janeiro

In the last days of 2015, the governor of Rio de Janeiro has introduced new tax rules imposing ICMS on the circulation of oil through sites for production measuring (Law 7,183 of 2015).

The tax basis in this case is the production measured at the oil reference price and the base tax rate is 18%.

A similar ICMS rule was created in Rio de Janeiro (so-called Lei Noel from 2003) in the past, but it was never regulated due to a strong debate over its constitutionality raised by the market.

### ISS (*Imposto sobre Serviços*)

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

The tax base is the price of the service and the rates vary from 2% to 5%, according to the municipality where the service provider is located, where the service is provided and the type of the service. For most services, there is significant debate



as to whether the ISS should be paid to the municipality where the service provider is located or where the service is performed. The taxpayer is, in principle, the service provider.

However, the municipal tax legislation may impose a withholding responsibility on the company acquiring the services.

ISS also applies on the import of services. In this case, the taxpayer is the service provider. Furthermore, Lei Complementar 116/03 introduced an ISS exemption to certain exports of services.

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

### Other federal taxes

#### Import tax (II)

The import tax is a federal tax applied to the CIF value of imported products upon its customs clearance at variable rates.

The taxable event is the physical entry of foreign goods into the country. Specific applicable rates depend on the classification of the

imported products in the Mercosur Common External Tariff tables ("TEC"), which generally follow the Brussels Harmonized Tax Codes.

Import tax is a cumulative tax, meaning that no credits are granted.

#### Withholding income tax

Withholding income tax applies on certain domestic transactions, such as payment of fees to some service providers, payment of salary and financial income resulting from banking investments. In most cases, the withholding tax is a prepayment of income tax on the individual or entity's final tax return. However, in some cases it is considered a final taxation. Also, withholding income tax is due on most nonresidents' income that has a Brazilian source of payment (e.g., royalties, service fees, capital gains, interest, etc.).

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

#### CIDE Social Contribution

CIDE (Contribuição de Intervenção no Domínio Econômico) is a contribution levied on payments due to non-residents in the form of royalties, technical and administrative services and technical assistance, among others, at a rate of 10%. Note that, unlike the withholding tax, CIDE is a tax imposed on the Brazilian payer of the fees and, therefore, may not be reduced by tax treaties and does not generate a tax credit abroad.

There is a limited tax credit granted to the Brazilian entity for CIDE paid on royalties for the use of trademarks or trade names which reduces the tax's effective rate. Law 11,452, enacted on February 27, 2007, established that royalties for a software license are no longer subject to this levy.

The Oil & Gas industry also has the CIDE Oil tax (CIDE Combustíveis), which tax event is the import and sale of specific products derived from oil, such as gasoline and diesel. Export transactions are not subject to CIDE Oil Tax.

The tax base is the quantity of product imported or sold. The tax rates correspond to fixed prices based on the volume sold or imported.



## IOF

IOF is a federal tax levied on credit, exchange, insurance and security transactions and may be assessed at a maximum rate of 25%. The tax rates are defined by government's decrees any changes and may become effective immediately. Some examples of IOF taxation:

- (i) Exchange operations: The inflow or outflow of foreign capital imply on an exchange transaction. In case of direct investment, the inflow of capital is subject to 0.38%. The IOF is zero-rated in case of dividends and interest on equity remitted abroad. The IOF is 6% in relation to foreign loans which average term is less than 720 days and for foreign loans with average term higher than 720 days, IOF is zero-rated. IOF is also zero-rated on interest on loans.
- (ii) Investment in the Brazilian Financial and Capital markets: For general investments in the Brazilian financial and capital markets, IOF is charged at a 6%. However, IOF is levied at 2% rate in case the foreign capital is invested in (i) variable income bonds within the Stock/Future Exchange Markets, (ii) acquisition of shares issued by listed entities during public offerings, (iii) acquisition of quotas of participation investment fund (FIP), emerging business investment fund or fund that invest on the referred funds, (iv) conversion of ADRs/GDRs into local shares and (v) change in the foreign investor regime from direct investment (Law 4.131) to investment in shares traded in the stock exchange market (Resolution 2.689). Capital repatriation associated with these investments is zero-rated.
- (iii) Currency exchange operations related to the inflow of revenue derived from the export of goods and services and outflow of funds derived from the import of goods are subject to an IOF rate of 0%. The import of services, however, is subject to IOF at 0.38%.
- (iv) For local loans, IOF may be levied up to a maximum rate of 1.88% depending on the length of the outstanding balance.
- (v) Insurance operations: IOF tax rates may range from 0% to 7.38%. For securities transactions, the IOF tax rate may vary from 0% to 1.5% depending on the type of investment.

## Contribution for Renovation of the Merchant Marin (AFRMM)

The AFRMM is a federal tax levied on the maritime transportation price (including specific insurance and general port expenses) which is regulated by the Law 10,893/04. The tax event is the unload of goods in the Brazilian port and has the following rates:

- 25% for long distance transportation (cross-country transportation);
- 10% for cabotage freight (transportation between Brazilian ports);
- 40% for river and lake transportation involving liquid bulk cargoes in the north and northeast regions of Brazil.

However, the AFRMM should be exempt on the maritime transportation related to the import of products under special customs regimes which foreseen that the manufactured good shall be further exported. It is important to highlight that the exemption or suspension of this contribution depends on a previous analysis and approval by the Ministry of Transportation.

## Governmental Takes

The Brazilian government introduced specific taxes charged from investors of the exploitation of O&G. Find below a brief description of the generally referred to as governmental participations, imposed by Law 9,478/97 and regulated by Decree 2,705/98 (concession agreements) or by Law 12,351/10 (production share contracts) for the Oil & Gas industry.

Note that additional remuneration to the oil field land owner may be determined by the ANP on the bid.

## Royalties

A monthly tax due by field concessionaires for the exploration and production of Oil & Gas. Tax rates vary from 5% to 10% and are applied on sales revenue (ANP price reference is considered for this purpose).

Under a production share contract, the rate is of 15% over sales revenue.

## Special Participation

A quarterly tax due by field concessionaires for the exploration and production of Oil & Gas of high volume or high profit margin fields. Tax rates vary from 10% to 40% and apply on sales revenue adjusted by deductions allowed by the law (ANP price reference is considered for this purpose).

## Signature Bonus

A lump sum tax due by field concessionaires or by companies under a production share contract for the exploration and production of Oil & Gas. Amounts due are determined by the ANP on the bid.

## Area Retention Tax

An annual tax due by field concessionaires for the exploration and production of Oil & Gas. Amounts due are determined by the ANP on the bid and vary depending on field size and geological characteristics.

### Payment to Land Owners

A payment due by both concessionaires and companies under a production share contract for the exploration and production of Oil & Gas on onshore fields. The amount, to be distributed to the owners of the lands in which such fields are located, corresponds to 1 % of the oil and gas production revenues. In the case of concession agreements, this percentage may vary from 0.5% up to 1 %, at the ANP's discretion.

### Investments in R&D

ANP has been imposing on concession agreements a clause obliging O&G companies to carry out R&D investments. This measure aims to foster the technological research and development of new technologies, products and processes for the Oil & Gas industry, as well as to encourage the creation of O&G centers of excellence and development of national R&D institutions.

According to the referred clause, the O&G company should invest in Brazil a minimum amount of 1 % of the gross revenue derived from the E&P of oil fields which are assessed by the Special Participation mentioned above. Note that up to 50 % of the amount invested in R&D may be applied for the own O&G company's projects. The remaining amount should be invested in universities and other R&D related institutions authorized by ANP.

The amount destined to R&D may be deducted in the calculation of the Special Participation.

### Other Taxes

In addition to the taxes previously described, Brazilian tax environment foresees additional federal, state or municipal taxes that may also be assessed on companies' regular operations. Please find below a brief overview of the main taxes applicable for companies.

ITR (Imposto sobre a Propriedade Territorial Rural) is an annual federal property tax levied on the ownership or possession of real estate located outside urban perimeters. Tax basis vary according to the value, size and location of the real estate, and tax rates vary in accordance with land use.

In regard to state taxes, ITCMD (Imposto sobre Transmissão "causa mortis" e Doação de quaisquer Bens ou Direitos) is a tax levied on the transfer of the ownership of goods and rights by way of causa mortis succession and donations. Tax rates vary according to state legislation.

In addition, IPVA (Imposto sobre a Propriedade de Veículos Automotores) is a state tax levied on the ownership of motorized vehicles (cars, trucks, boats, etc.). The tax base is the value of the vehicle with rates varying according to state legislation.

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

Finally, ITBI (Imposto sobre Transmissão de Bens Imóveis) is a real estate transfer tax charged at variable rates (from 2 % to 6 %). This tax is usually not levied if real estate is transferred under a corporate reorganization (e.g., mergers, spinoffs, capital contribution in kind, etc.).

### Inspection fee (Rio de Janeiro)

The State of Rio de Janeiro created a new inspection fee for E&P activities carried out by O&G companies in Brazil in December 2015 (Law 7,182 of 2015).

A fee of BRL 2.71 per oil barrel produced (or similar gas unit) will due by taxpayers located in Rio de Janeiro as from March, 2016.

### Withholding obligations

According to Brazilian tax legislation, payments in connection to render of services and supply of goods between legal entities may be subject to withholding taxes, specifically income tax (IR), social contribution (CSLL), PIS and Cofins social contributions, Service tax (ISS) and social security (INSS), when applicable.

Brazilian tax legislation sets forth specific rates for the withholding taxes mentioned above. In principle, this withholding obligation was imposed to companies as an anticipation of the taxes regularly assessed on its operations.

Specifically in relation to the ISS, there are a number of discussions regarding to which municipality the tax is due and that usually depends on the type of service being rendered or the location of the service provider.

Also, for services involving manpower supply, social security tax (INSS) is usually withheld upon the payment of the invoice at tax rates ranging from 11 % to 15 % (depending on the risks related to the activity to be performed). In some cases, unrecoverable tax credits should be recognized in connection to INSS withheld greater than the tax effectively due based on the company's regular operation.



# Trade & Customs

Brazil remains one of the world's largest exporters of agricultural products, although exports of manufactured goods have largely increased and products such as airplanes, steel, electronics and many more have reached similar statistics. The expansion of Brazilian sales to nontraditional countries or those countries with a small share in total exports has been an important feature in the success story of Brazilian exports. Exports to Eastern Europe, Africa, Latin America, Asia and Oceania have shown an impressive growth.

With respect to operational import and export chains, Brazilian importers and exporters are required to obtain specific registrations. However, in reality, most imports are not subject to pre-licenses, while exports are, in general, tax-free. Brazilian foreign exchange regulations still play a significant role in the operational side due to registration requirements – currency exchange contracts associated with imports and exports are linked with federal tax and customs systems. Penalties may be enforced in cases where a Brazilian importer or exporter fails to settle such contracts in due time.

## **Exports** **General Comments**

Trade policy is conducted by the Chamber of Foreign Trade (CAMEX)

which works under the Ministry of Development, Industry and Commerce (MDIC). Exporters must register, usually through the assistance of a forwarder, with Secretariat of Foreign Commerce (SECEX) – a governmental agency responsible for controlling imports and exports.

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

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

Export transactions generally do not require preapprovals, except for transactions involving certain listed products. This list includes animals or products of animal origin, oil, gas, goods

containing nuclear and radioactive materials, and weapons, among others.

## **Tax Implications**

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

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

Generally speaking, exports are not subject to Excise Tax (IPI), State Value-Added Tax (ICMS) or Social Integration Program (PIS) and Social Security Contribution (COFINS), while a credit mechanism is allowed for the same taxes paid on inputs used in the manufacturing of exported products. The credits related to federal taxes (IPI, PIS and COFINS) are normally easily consumed by exporters as they generally may be used to offset any federal taxes payable. On the other hand, several restrictions and the associated bureaucracy make the utilization of the ICMS tax credits very difficult for companies with a high level of exports.

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





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

### Export Financing

Banks provide financing for exporters against forward sales contracts and by discounting drafts accepted by foreign importers. This financing is also made available for “indirect exporters” or manufacturing companies, which export through trading companies. Exporters may use these funds to buy raw materials to be used in the manufacturing of finished products to be exported.

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

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

### Imports

#### General Comments

Considering that foreign trade balance is one of the main objectives of federal economic policy, imports have been of critical importance and have played a significant role in recent years in Brazil. Since the opening of the Brazilian economy at the beginning of the 1990’s, when a strong spike on imports ensued what would become the trademark of the last decade, this adverse condition has been largely reversed in recent years by the historical improvements on exports. This is largely due to the development, modernization and increased competitiveness of the Brazilian industries exposed to the global economy.

While import restrictions have been a major element of Brazilian trade policies, import tariffs have been reduced across the board in recent years. The negotiation of a Mercosur Common External Tariff (TEC) has not only made Brazil one of the major players in the region but also demanded the simplification of import regulations to the extent that imports, with some exceptions, do not require pre-licenses. In addition, the introduction of the electronic system for the registration of imports and exports SISCOMEX has contributed to speeding up registrations and customs clearance as a whole.

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

In case a pre-license is necessary, this may vary according to the type of product imported and the import

system adopted, it must be obtained prior to the shipment of products to Brazil and is generally valid for a 90 day period starting from the date of issuance. This is also obtained through the SISCOMEX electronic system. Certain products, such as petrochemicals, human blood, weapons, herbicides and pesticides, and leather, among others, also require preapproval from certain government agencies before the import license is issued.

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

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

### Tax Implications

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

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

### RADAR

RADAR is a system that sets access to the registration and tracking of performance of companies on customs transactions. The purpose of the system is to provide objective, real-time information, including customs, tax and accounting information to enable the

identification of the behavior and infer the risk profile of various agents relating to foreign trade.

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

### Trading Companies

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

### Trade Treaties

#### Mercosur

Mercosur is a customs free trade zone comprised of 5 member countries: Argentina, Brazil, Paraguay, Uruguay and Venezuela (Venezuela has still not adopted all necessary obligations and commitments required due to its inclusion in the group).

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

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

However, each member country may include certain products in an "exception

list," under which listed products are not necessarily subject to the common rate applicable to non-Mercosur members, but to a higher or lower rate, depending on the case.

### Other Agreements

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

### Origin Rules

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

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

Imports of products originating from Mercosur member countries (Argentina, Paraguay and Uruguay) generally benefit from a 100% reduction of import tax, provided that a minimum local added value of 60% occurred in the exporting country. A different local added value percentage may apply depending on the traded product and also the specific trade agreement.

### Customs Valuation

Brazilian customs rules provide for a customs valuation policy based on the 1994 General Agreement on Trade and Tariffs (GATT), effectively introduced in Brazil in 1996. The main purpose of the methods provided by Brazilian customs rules is to demonstrate the fair market value of the import transaction when compared to an actual transaction. This is made by means of using the methods foreseen under Brazilian customs valuation rules, which are generally based on either: (a) the value of the transaction (b) comparables, (c) resale, or (d) cost methodologies. The import price is verified for customs valuation purposes at the moment an import declaration is registered in the SISCOMEX system. It is based on internal lists of prices that are not publicly available and are used by Brazilian customs authorities as an initial basis for comparison. There should be no customs valuation issues to the extent that the customs value is within these parameters.

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

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

# Special Custom Regimes and Tax Incentives

A wide range of government incentives are available for startup projects in Brazil. Generally speaking, the international investor has equal access to these incentives and treatment when compared with local investors. The use of government incentives is a significant feature of the Brazilian business environment. Usually, incentives take the form of subsidized loan financing and tax exemptions or reductions, rather than cash grants.

## REPETRO

The REPETRO tax regime is a special benefit that applies to the imports and exports of goods destined to the exploitation of Oil & Gas in the Brazilian territory.

Under the REPETRO regime, the purchase of the permitted products shall benefit from II, IPI, PIS, COFINS federal taxes suspension.

The companies that have authorization or concessions to carry out such activities in Brazil may benefit from the regime provided some requirements are met and previous authorization is obtained from the federal tax authorities.

There are basically three types of benefits:

- Temporary import of foreign equipment without II, IPI and PIS and Cofins;
- Import of raw material, parts and pieces to be used in the manufacturing of goods to be exported (drawback); and
- Presumed export, which allows the Brazilian suppliers of goods to sell them to foreign parties with the benefits applicable to exports with the possibility of keeping the goods in the Brazilian territory; this last type of Repetro needs to be combined with a subsequent temporary import of the goods.

The tax suspension on the temporary administration regime under Repetro should expire in December 2020. Although the Government has extended the tax suspension several times in the past, it is not possible to assure that it will be renewed again in the future.

ICMS Tax benefits may be also available, depending on the provisions of ICMS Tax legislation in force in the State where the activities will be carried out. In

this regard, note that Covenant ICMS 130/2007 authorized Brazilian States to grant tax reductions in connection to importation of goods supported by REPETRO's special custom regimes.

### *Who is eligible?*

Regarding eligibility, the following may benefit from the REPETRO:

- The owner of concession or permit to carry out the activities of research or exploration of oil or natural gas reserves.
- Those contracted by the legal person mentioned above, for the rendering of services employed in the execution of the activities object of the concession or permit, as well as other sub-contracted parties.

### *Which products are permitted?*

The list of products and goods which are permitted to be imported through this special custom regime is included in the Appendix of the Normative Instruction SRF 1,415/2013. However, this list is not extensive. Therefore, it does not encompass all the products and equipment currently utilized by the O&G companies in the research or extraction of oil.



### REPEX – Special Regime for the Import of Crude Oil and its Derivatives

It allows the import of crude oil and its derivatives, with tax suspension, in order that afterwards it may be exported in the exact state in which it was imported.

The import shall be done with or without cover exchange and the export must be done exclusively in free convertible currency.

### Other Special Custom Regimes

- **Drawback** grants the beneficiary an exemption from import tax, IPI, PIS and COFINS and exempts imports of raw materials to be used in the manufacturing of products to be exported. A minimum level of local manufacturing is required. ICMS benefits may also be available.
- **Temporary admission** system allows the import of goods which will remain in the country on a temporary basis with a total or partial exemption from taxes levied on imports. This may benefit, for instance, goods that enter the country under a lease or rental transaction and those related to sports and cultural events and commercial fairs and exhibitions. In some specific situations, this benefit may be applicable to goods that are used in certain restricted manufacturing processes of products to be exported.
- **Special Temporary Admission System for Manufacturing Purposes** (temporary admission to upgrade another product) is similar to the regular temporary admission system, but the exemption from taxes is granted on the import of goods to be applied to certain restricted manufacturing processes of products to be exported. In principle, it does not apply in cases where the manufactured goods are sold locally.
- **Temporary export** system applies to the export of goods that will be out of the country on a temporary basis and provides a total or partial exemption from taxes levied on the export and on the subsequent re-import. This may benefit, for instance, goods that leave the country to sports and cultural events and commercial fairs and exhibitions. In other cases, it allows the export and re-import of goods that will be subject to certain restricted manufacturing processes abroad.
- **Special Temporary Export System for Manufacturing Purposes** (Temporary admission to be upgraded by another product) is similar to the regular temporary export regime and allows the export and re-import of goods that will be subject to certain restricted manufacturing processes abroad. Import taxes are due, however, on the foreign products aggregated to the re-imported good.
- **Bonded warehouse** (entrepoto aduaneiro) is a special import system whereby the Brazilian party may defer the payment of taxes due on the import by keeping the imported goods stored in a bonded warehouse. The taxes are due only upon the customs clearance, i.e., the removal of the goods from the bonded warehouse. Note that Brazilian tax legislation foresees a specific bonded warehouse regime for Oil & Gas related platforms (Normative Instruction 513 issued by Brazilian Revenue Service). In accordance to this special custom regime, parts, materials and other components utilized in the construction/conversion of oil platforms may be subject to a tax deferment of federal taxes assessed upon its importation.
- **DAC** (Depósito Alfandegado Certificado) is a regime under which products are presumed exported but physically remain in a bonded warehouse in Brazil. This is a federal benefit and might not apply in case of state taxes.
- **Manaus Free Trade Zone** allows companies located in a Trade Zone (Zona Franca de Manaus) to benefit from an exemption of IPI and PIS and COFINS on products to be consumed and/or manufactured within the Zona Franca de Manaus. ICMS tax incentives may also be available. Projects applying for this benefit must meet the requirements set forth in the legislation.
- **Export Processing Zones** (ZPEs – Zonas de Processamento de Exportação) are planned industrial areas in which the operations of established companies are exempt from federal taxes (II, IPI), surcharges on freight for merchant marine renovation, Finsocial and taxes on financial transactions (IOF). They also enjoy exchange freedom which means they are not obliged to convert the foreign currency obtained in their exports into Reais, provided that most of their products are sent to the foreign market.
- **Presumed export** (exportação ficta) occurs when goods are sold to a nonresident, but do not physically leave the country. The transaction is still considered an export for customs, foreign exchange and tax purposes. This benefit only applies in specific cases provided by law.
- **Tariffex** (Ex-tarifário) is another import tax benefit available on imports of equipment in cases where there is no similar equipment in the country. The tax benefit consists of an exemption from or reduction of the import tax and is granted after the importer submits and obtains approval from the authorities.
- **Linha Azul (Blue Line)** allows the benefited company to speed up



the customs clearance process. In order to benefit from this regime, the company must comply with a number of requirements including an audit of its external controls over the customs processes.

- **Authorized Economic Operator (OEA)** – Certification program for intermediaries in the logistic chain. Parties enrolled in this program are benefited with faster and simpler clearance process.
- **Special Deposit** is a special custom regime permits tax suspension for the stocking of replacing items, parts and pieces for vehicles, machines, equipments, devices and others, according to the Brazilian rules and provided that the imported goods are without exchange cover. The accepted items should have the following destination: (i) Re-exportation; (ii) Exportation; or (iii) Transfer to another special customs regime.

### Federal, state, and local tax incentives

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

State and local governments commonly grant an exemption or defer indirect and property taxes that they are entitled to levy, and provide assistance to potential investors in obtaining access to available federal programs. Thus, a company that has decided to establish a new plant for export production and which is eligible for federal programs will seek the best available package of local incentives when deciding where to locate a plant.

Brazilian government incentive programs are subject to frequent revisions, both in relation to their basic approach as well as the specific categories and rates of tax incentives granted. Accordingly, companies planning to avail themselves of incentive programs should, as a first step, obtain the latest available information.

Usually, federal and state governments do not give cash grants to reduce initial outlays on industrial buildings and equipment. As an exception, capital grants in the form of land can be obtained from local governments and are often provided through state development agencies.

Additionally, there are various government incentive programs providing low cost financing. In former years, Brazil has experienced chronic inflation and even presently continues to have high bank interest rates. Under these circumstances, subsidized rate financing has long been very important for certain sectors of the Brazilian economy, and has formed the basis for the expansion and modernization of Brazilian agriculture.

### Regional and Industry Incentive Programs

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

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

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

SUDAM and SUDENE are both administratively and financially independent special agencies.

SUDAM oversees development in the Amazon region. The region encompasses the states of Acre, Pará, Roraima, Rondônia, Amapá, Amazonas, Tocantins, Mato Grosso, Mato Grosso do Sul, Goiás and part of Maranhão.

The purpose of SUDENE is to promote inclusion and sustainable development in the Northeast region. The geographical definition of the Northeast region encompasses the states of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia and part of the states of Minas Gerais and Espírito Santo.

Both programs are administered by the Brazilian federal government, and are affiliated to the Ministry of National Integration. Under these programs, companies can receive either partial or complete tax exemption on income taxes for Brazilian companies. The tax exemption applies only to income from facilities operating in the designated regions and the benefits are available for companies that have setup, modernization, extension and diversification projects in the region.

Eligibility for these concessions depends on SUDAM/SUDENE's approval of an industrial project or a project for the expansion of an existing industry. SUDAM/SUDENE not only evaluate the project in terms of its technical and economic feasibility, but also verify whether the project is appropriate within the overall economic development of the region.

Currently, projects must be approved until December 31st, 2018 in order to benefit from the tax incentives granted by SUDAM/SUDENE. As it has been done many times in the past, it is possible for this date to be postponed in the future.

### Minimum Manufacturing Process (PPB)

The PPB benefit is usually applicable to Brazilian companies engaged in the manufacturing and sales of products and services related to specific types of technology, such as goods and services related to information technology and automation. The incentive was initially addressed to the computer industry, but later expanded to include a wider range of electronic products and telecommunication equipment.

The PPB benefit is granted to Brazilian companies that have a project approved by the Ministry of Technology and Science (MTC) and that annually invest a percentage (5% minimum) of their gross revenues derived from the sale of technology related goods and services with Research and Development (R&D) in the country. The percentage varies per year. The benefits are basically related to Excise Tax (IPI) and State Value-Added Tax (ICMS).

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

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

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

### Technology Innovation Incentives

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

Technology innovation is defined as the creation of a new product or manufacturing process as well as the inclusion of new functionalities or characteristics to a product or process, which results in incremental improvements and in an effective quality or productivity increase, resulting in more competitiveness in the market.

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

- Special deductions and tax reductions on the income tax computation in connection to expenses incurred during technological research.
- 50% tax reduction of the IPI levied on machines, equipment or spare parts and tools in connection to technological research.
- Full depreciation in the year of acquisition of new fixed assets in connection to technological research.
- Accelerated amortization for intangible assets acquired in connection to technological research.
- WHT zero-rated on remittances abroad related to trademarks, patents and cultivars.
- Deduction of the expenses incurred in technological research along with the possibility to exclude up to 100% of these expenses on the income tax calculation (from 60% to 80% depending on the number of researchers employed by the legal entity, plus 20% in case of research projects linked to patents granted and registered cultivars).
- In addition to that, the national government may also grant a financial support by way of subventions of up to 60% of the value paid as remuneration to researchers (holding Masters or PhDs) employed in activities of technological innovation located in the Brazilian territory.

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

### Benefits for Information Technology and Information and Communication Technology Companies

Law 11.774/08 grants benefits for companies in the Information Technology (IT) sector. These benefits apply to companies from the aforementioned sector seeking to improve their professional capability to develop new software.

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

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

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

There is a list of products that may be imported under such systems (mainly parts for vehicles, aircrafts and electronics). There are several requirements that must be met, including rigid control over the imported inventory. The main advantage of these systems is that the products may be imported without foreign exchange coverage, i.e., the

foreign party may keep title over the products and contract the Brazilian importer for the manufacturing function.

### **Special Acquisition Regime of Capital Goods (RECAP)**

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

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

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

exemption of the already suspended taxes in case it proves the utilization of the inputs in the infrastructure work.

### **Special Incentive Regime for Infrastructure Development (REIDI)**

REIDI is a special tax regime created with the purpose of fostering development and implementation of projects in the infrastructure sector. The main tax benefit granted is exemption from PIS and COFINS upon local and foreign acquisitions. Legal entities must have a previously approved infrastructure project in order to qualify for the REIDI benefits.

### **Law 12,431/2011**

Law 12,431 (which converted the Provisional Measure 517) was recently enacted by the Brazilian government which granted specific tax incentives associated to infrastructure projects for the raising of funds through the issuance of debentures.

In general terms, income paid by special purpose entities (incorporated to implement infrastructure projects) through debenture instruments

should be exempt of income tax when paid to Brazilian individuals and, for Brazilian entities, the income tax was reduced to 15% (withheld).

Although this benefit was not extended for non residents who directly acquires debentures, non residents may benefit from a zero-rated WHT for income received from investments funds which has at least 85% of its equity invested in debentures issued by entities involved in infrastructure projects.

This tax benefit should not be applicable for beneficiaries located in low tax jurisdictions.

### **Corporate Income Tax Reductions**

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



# International Tax Matters

## Permanent establishment

As a general rule, only companies incorporated in Brazil are generally subject to taxation as residents.

In principle, Brazilian companies must register for tax purposes. Companies that carry out taxable activities in the country, but have not properly registered for tax purposes, are also subject to taxation.

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

There is also a lack of guidance from the tax authorities, and we are aware of only a few administrative precedents (tax assessments) on the matter. This may be because in certain cases, the tax burden on nonresident's income is even higher than the eventual resident's taxation that a permanent establishment characterization would generate.

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

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

- De facto branch: the foreign company has an unregistered branch or office.

- Consignment: sales are made under consignment and proper accounting records are not kept by the consignee in Brazil.
- Binding agent: sales are made in Brazil through a resident agent or representative of a foreign company who has, and habitually exercises, the authority to bind the company to a contract.

## Tax treaties

Brazil has signed double taxation treaties with various countries. The main method of tax relief under the treaties is the foreign tax credit. The existing treaties offer very limited opportunities to reduce or eliminate withholding taxes on payments abroad. Additionally, tax sparing clauses are also found in most treaties currently in force.

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

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

## Withholding tax rates

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. The most common rates

range from 15% to 25%. As a general rule, income paid to beneficiaries located in low tax jurisdictions is subject to 25% withholding tax.

The following are the main withholding tax rates applicable to payments made to nonresidents:

Type of Payment	Withholding Tax Rate
Interest	15%
Interest on Equity	15%
Royalties	15%
Technical Service and Technical Assistance Fees	15%
Lease and rental fees	15%

These rates may be increased to 25% if the beneficiary of payments is located in low tax jurisdictions.

The following are currently not subject to withholding tax (some requirements may apply):

- Dividends (if related to post-January 1996 profits) – 0%
- Interest and commission on export financing – 0%
- Interest and commission on export notes – 0%
- Export commissions – 0%
- Interest on certain government bonds – 0%
- International hedging – 0%
- Air and sea rentals, charters, demurrage, container and freight payments to foreign companies – 0%

Note that the WHT rate applicable for charter of vessels may represent



a key advantage for O&G players operating in Brazil. However, it is important to stress that this benefit has been subject to several challenges by the Brazilian tax authorities.

### Low tax jurisdictions

Previously, the concept of the low tax jurisdiction included: (i) low tax jurisdictions that do not tax income or when doing so impose a rate equal to or lower than 20%, and (ii) jurisdictions whose national legislation allows confidentiality as to ownership of shares or the corporate organization of legal entities. This definition was brought about by Law 9,430/96 and Law 10,451/02, and it was only applicable for transfer pricing purposes.

However, due to the changes in the Brazilian legislation:

- The applicability of the concept was broadened. With Law 9,779/99, cross border remittances or payments of any kind made to low tax jurisdictions became subject to a higher 25% withholding tax (instead of the standard 15% rate).
- The definition of low-tax jurisdiction was expanded by Law 11,727/08 to “a country or a place where legislation does not allow the access to the information related to the corporate structure of legal entities, its ownership, or to the identification of the ultimate beneficiary of the earnings attributed to non-residents.”

Due to the broad concepts in the Brazilian provisions, and difficulties in determining whether or not payments were being made to a tax haven jurisdiction, the Brazilian Revenue Services has

listed (in Normative Instruction – IN 1,037/2010) the following jurisdictions as “tax havens”:

Andorra, Alderney (Channel Island), American Samoa, American Virgin Islands, Anguilla, Antigua and Barbuda, Aruba, Ascension Island, Bahamas, Bahrain, Barbados, Campione d’Itália, Belize, Bermuda, British Virgin Islands, Brunei, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Djibouti, Dominica, Eastern Samoa, French Polynesia, Guernsey (Channel Island), Gibraltar, Granada, Hong Kong, Isle of Man, Jersey (Channel Island), Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Madeira Island, Maldives, Marshall Islands, Mauritius Islands, Montserrat, Monaco, Nauru, The Netherlands Antilles, Niue Isle, Norfolk Island, Oman, Panama, Pitcairn Island, Queshm Island, Saint Cristobal and Nevis, Saint Helena Island, Saint Pierre and Miquelon, Saint Kitts and Nevis, Saint Vincent and the Grenadines, San Marino, Santa Lucia, Sark (Channel Island), Seychelles, Singapore, Solomon Island, Swaziland, Switzerland, Tonga, Tristan da Cunha Island, Turks and Caicos Islands, United Arab Emirates, and Vanuatu.

Even though Ordinance 488/14 partially altered the definition of “low tax jurisdiction” as defined in Law 11,727/08, any country that wishes to no longer be listed as a tax haven by the Brazilian authorities needs to present a formal request demanding its exclusion. In view of that, the Brazilian definition of a “tax haven” may no longer apply to all of the countries listed above. However, the country’s exclusion from the list will only be issued through a formal request made by the country itself.

### Privileged tax regimes

Law 11,727/08 (amended by Law 11,941/09) has also created a new concept, the so-called “privileged tax regime” for transfer pricing purposes.

In 2014, through Ordinance 488/14, the definition of “privileged tax regimes” suffered new alterations. According to the current law, a “privileged tax regime” is a regime that:

- I does not tax income, or taxes it at a maximum rate equal to or lower than 17%.
- II grants tax advantages to non-resident individuals or legal entities:
  - a.) without requiring the performance of a substantial economic activity in the country or jurisdiction.
  - b.) provided that no substantial economic activity is performed in the country or jurisdiction.
- III does not tax earnings originated abroad or taxes them at a maximum rate equal to or lower than 17%.
- IV does not allow the access to information related to the corporate structure, ownership of goods or rights, or to the economic transactions performed.” (Loose translation)

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

- Holding Companies in Denmark, which do not perform a substantial economic activity.

- Uruguay (only with respect to “Sociedad Anonima Financiera de Inversion – Safis” until December 31, 2010).
- Iceland (only with respect to International Trading Companies – ITCs).
- Hungary (only with respect to Offshore KFT companies).
- United States of America (only with respect to Limited Liability Companies, or LLCs, with participation of non-resident investors and that are not subject to federal income tax in the USA).
- Spain (only with respect to “Entidad de Tenancia de Valores Extranjeros” – ETVE) (\*).
- Malta (only with respect to International Trading Company (ITC) and International Holding Company (IHC)).
- Holding companies in Netherlands, which do not perform a substantial economic activity
- Switzerland (only with respect to corporations constituted as holding companies, domiciliary companies, auxiliary companies, mixed companies and administrative companies subject to an income tax assessment lower than 20%, as well as any other type of corporation subject to the same tax treatment).

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

### Transfer pricing rules

Transfer pricing rules have been in place in Brazil since 1997 and apply to: pricing transactions between related parties, to transactions with companies in tax haven jurisdictions (and under a privileged tax regime),

and also to transactions between a Brazilian company and its exclusive distributor, regardless of the ownership relationship between the parties.

It is important to bear in mind that Brazilian TP methods does not follow OECD standards and also does not expressly utilize Arm's length principle. Brazilian tax legislation provides specific methods which generally foresee fixed profit margins regardless the company's profit margins. There is no “best method rule” and, therefore, taxpayers are free to opt for any of the methods available.

Brazilian taxpayers may choose one of the following methods for valuing import transactions:

- The Comparable Uncontrolled Price Method (PIC – Método dos Preços Independentes Comparados) uses the average of similar or identical purchase and sale operations between unrelated parties, on the Brazilian market or the market of other countries, under similar payment conditions.
- The Resale Price Method (PRL – Método do Preço de Revenda menos Lucro) uses the average resale price for transactions with unrelated buyers, less unconditional discounts granted, taxes and contributions on sales, commissions, brokerage fees paid, and a profit margin of 20% on the resale price.
- The Resale Price Method II (PRL II – Método do Preço de Revenda menos Lucro II) uses the average resale price for transactions with unrelated buyers, less unconditional discounts, taxes and social contributions on the sales, commissions and fees paid, plus a profit margin of 60% on the resale price after deducting the value added in Brazil.

- The Cost Plus Method (CPL – Método do Custo de Produção mais Lucro) uses the average cost of production in the country where the products were originally produced, plus taxes and charges imposed by that country on exports, and a profit margin of 20%.

On export transactions, safe harbors exist to ease the compliance burden for certain exporters, for example, when the price of the exported goods is greater than 90% of the same product sold in Brazil, or when income from exports makes up less than 5% of net income. When none of the safe harbors are applicable and the transfer pricing analysis is required, one of the following methods should be used:

- The Comparable Uncontrolled Price Method (PVEx – Método do Preço de Venda nas Exportações) uses the average sales price on exports to non-related parties for equivalent or similar goods, services, or rights during the same tax year and under similar payment conditions.
- The Wholesale Price Method (PVA – Método do Preço de Venda por Atacado no País de Destino, Diminuído do Lucro): Comparison of the sales price with the wholesale market price of similar or equivalent goods sold in the wholesale market of the country to which the product is exported under similar payment conditions, less sales taxes in that country and a profit margin of 15% on the wholesale price.
- Retail price method (PVV – Método do Preço de Venda a Varejo no País de Destino, Diminuído do Lucro): Comparison of the sales price with the average price of similar or equivalent goods sold between unrelated parties on the retail market of the country to which the

(\*) Spanish government requested the Brazilian tax authorities to be excluded from the privileged tax regime list and, until a final decision is issued, Spain should not be treated as privileged tax regimes for tax purposes.

goods are exported under similar payment conditions, less sales taxes in that country and a profit margin of 30% on the retail price.

- Purchase or Production Cost plus Taxes and Profit Margin Method (CAP – Custo de Aquisição ou Produção Mais Tributos e Lucro): Weighted arithmetic average of the costs of acquisition or production of the exported goods and services, increased by taxes levied in Brazil and profit margin of 15% over the sum of the costs plus taxes.

Service transactions are also subject to transfer pricing rules, but royalties and fees for technical, scientific, administrative or similar assistance are not, provided some conditions are met (e.g. registration of the agreement with the INPI (Intellectual Property Agency)).

The transfer pricing analysis must be prepared by Brazilian companies on an annual basis, and general information must be disclosed on the annual income tax return.

### Thin capitalization rules

Brazil's new thin capitalization rules were recently introduced by Provisional Measure 472/2009 (and converted into Law 12,249/2010).

According to the thin capitalization rules, some requirements must be satisfied for an entity to be allowed to deduct certain interest expenses. For the interest expense arising from business operations financed by debt, the debt cannot be greater than:

- 1) Two times the amount of the participation of the lender in the net equity of the borrower.
- 2) Two times the amount of the net equity of the borrower, if the lender is a foreign party without participation in the borrower.
- 3) 30% of the net equity of the borrower when the lender is located in a tax haven

jurisdiction or operating under a privileged tax regime (whether a related party or not).

On cases 1 and 2 above, the total amount of the Brazilian entity's debt cannot exceed twice the amount of the foreign related parties' participation in the Brazilian entity's net equity.

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

### Deductibility on payments abroad

Law 12,249/2010 also provides requirements that must be met by taxpayers in order for the payments to beneficiaries located in a tax haven jurisdiction or under a privileged tax regime to be deductible:

- i. the identification of the beneficial owner must be obtainable.
- ii. the operational ability of the foreign party to effectively carry out the operation agreed with the Brazilian party must be demonstrated.
- iii. the payment, and the proof of the delivery of the goods, services, or rights to the Brazilian party must be able to be substantiated.

### Royalties

Withholding tax is levied on royalty payments at a standard rate of 15% or at the applicable treaty rate. Royalty payments are also subject to CIDE (contribution for intervention in the economy) at 10%. CIDE is not a withholding tax. It is charged to the entity that pays the royalties and CIDE generates a partial tax credit in the case of royalties for trademarks and patents. In addition, there is also discussion as to whether royalties are also subject to PIS and COFINS (and ISS). In fact, Brazilian Federal Revenue has recently come up with decisions in favor of the non-triggering of PIS and COFINS on the remittance of royalties' payment abroad. The

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

Royalties for trademarks, patents and know-how as well as other agreements involving the transfer of technology (specialized technical services and technical assistance) are subject to specific requirements for both remittances abroad and deductibility. The agreements must be registered with the Central Bank and the INPI (Federal Intellectual Property Agency).

Royalties are limited to certain global and individual limits based on net revenue.

For example, royalties for trademarks are limited to 1% of net revenue and royalties for patents are limited to a percentage of net revenue that varies according to the type of industry (from 1% to 5%). Collectively, they may not exceed 5%. However, as there are specific tax deduction limitations, they are not subject to Brazilian transfer pricing rules.

### Service fees

Different taxation applies to service fees depending on whether the services are considered technical or non-technical. There is no clear definition in Brazilian legislation for technical and non-technical services. However, in recent withholding tax regulations the tax authorities described technical services as the work or enterprise whose performance requires specialized technical knowledge and that is rendered by independent professionals or artists.

Non-technical services are subject to 25% withholding tax while technical services are subject to 15% withholding tax and also to the CIDE at a 10% rate. Both technical and non-technical services are subject to PIS and COFINS and ISS. PIS and COFINS rates are 1.65% and 7.6%, respectively. ISS rates can vary from 2% to 5%, depending on the municipality regulations.

Transfer pricing rules must be observed if the fees are to be paid to related parties and general tax deductibility requirements, such as evidence of the work performed, formal agreements, etc., should be considered as well.

If the services involve the transfer of technology, specific requirements may apply to remittances abroad as well as to tax deductibility, as mentioned in the royalties section above.

### Taxation on foreign profits (CFC rules)

On November 21, 2013, Provisional Measure 627 was issued introducing changes to the Brazilian CFC rules. Such Provisional Measure, after undergoing some amendments, was converted into Law 12,973/14, which became effective on January 1, 2015. Shortly after, Normative Instruction 1,520/14 was issued to regulate the new CFC rules brought by Law 12,973/14.

According to the new CFC rules, the profit earned abroad shall be subject to taxation in different moments, depending on whether the foreign company is a controlled company or an affiliate of the Brazilian company:

- Controlled foreign companies: the corresponding foreign profits should be subject to taxation in Brazil on the calendar year they were earned by the foreign company, regardless of any action that implies their distribution to the Brazilian controller ("accrual basis").
- Affiliated foreign companies: provided that the other requirements set forth in legislation are met, the taxation should only take place upon the actual distribution of profits to the Brazilian company ("cash basis").

If the affiliated company is located in a low tax jurisdiction or under a privileged tax regime, the same taxation rules applicable to controlled foreign companies should apply.

As per the new tax rules, the profits earned abroad should be computed in Brazil on an individualized way, i.e. the profits of each controlled/affiliated company of the group should be taxed in Brazil separately.

### Consolidation

Even though legislation requires the Brazilian controller to keep an individualized registry, through separate sub-accounts, reflecting the variation of its investments (profits/losses), in the directly controlled foreign company and in each indirectly controlled company, the consolidation of results is allowed until calendar year 2022. This option, however, is not available to companies located in low tax jurisdictions or under privileged tax regimes and neither to companies directly controlled by such companies.

### Compensations

It should be noted that, if foreign profits are subject to income tax in the country in which the foreign company is located, the Brazilian parent company is entitled to the same amount in tax credit in Brazil, which can be used to offset the CIT due in Brazil in connection to such profits. However, this deduction is limited to the amount of CIT due in Brazil with no carry forward option unless the Brazilian company presents no taxable income in the given period.

On the other hand, losses incurred by the Brazilian entity through a foreign company, which may only be used to offset future profits of that same company, are not subject to limitations and can be carried forward indefinitely.

### Deferral

A deferral rule, subject to limitations, is available for the income tax due in Brazil over the profits earned from the foreign companies provided that such companies are not located in a low tax jurisdictions or under a privileged tax regime or controlled by such companies. This option is limited to an eight-year period.

### Presumed Credit

Until calendar year 2022, the Brazilian controller is allowed a 9% presumed tax credit that can be deducted from the CIT due over the profits earned from its investment in foreign companies that perform specific activities including the exploration, under a concession agreement, of public assets located in the subsidiary's country. Among other limitations, this benefit is not available to companies located in low tax jurisdictions or under privileged tax regimes and neither to companies directly controlled by such companies.

### O&G industry

Until the end of calendar year 2019, the Brazilian controller is allowed not to compute in its income tax calculation the parcel of profits accrued by foreign subsidiaries or affiliated companies in association to, among others, the rental of goods/equipment or the provision of services to E&P activities in Brazil.

### Other considerations

It is mandatory that Brazilian companies holding investments abroad use the actual profits method (*lucro real*) to compute corporate taxes.



# M&A Tax Matters

## Introduction

Brazil has been an attractive market for foreign investors due to a variety of economic factors, including relative economic and political stability, control over inflation and a large and growing consumer market.

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

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

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

In this sense, merger and acquisition transactions commence with preliminary negotiations between the parties on purchase terms and conditions, representations and

warranties, and noncompete and indemnification provisions, which may be reflected in a memorandum of understanding providing for further exclusive negotiations and due diligence investigations. As a preliminary discussion point, the parties of the transaction should consider whether to pursue it through an asset or share acquisition, at which time it should be noted that the outcome of due diligence investigations may determine the most cost-effective alternative.

## Acquisition

The acquisition of an existing business may be accomplished through the purchase of either the company's shares or its assets. In principle, the sale or purchase of shares is a relatively simpler transaction in comparison to an asset deal, specially because of operational matters and indirect taxation.

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

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

On the other hand, the acquisition of a privately held S.A. is effective upon the approval and execution of a share transfer in the Share Transfer Book. A purchase and sale agreement is usually executed, including purchase terms and conditions, confidentiality and non-compete provisions and, based on due diligence investigation results, representations and warranties, indemnification clauses and guarantees, among other case specific provisions.

Besides other regulatory requirements, the acquisition of a publicly held company must be communicated to the CVM (Brazilian Securities Exchange Commission) and disclosed to the market as a material event. In addition, the purchaser of the controlling stake is required to make a tender offer for the acquisition of the remaining



common shares of the company for a price equal to at least 80% of the price paid for the controlling shares.

The acquisition of companies in the O&G industry may be subject to specific regulatory approvals (e.g. ANP).

### Succession issues

The succession of tax attributes and liabilities is among the most significant issues involved in acquisitions. In this regard, the buyer is responsible for the past tax and labor on a share deal. Even when the transaction is structured as an asset deal, tax succession is still a major concern, specially when the assets purchased fall within the definition of commercial, industrial or professional establishment.

### Due diligence

The main purpose of due diligence investigations is to allow the prospective purchaser to better assess the value of proposed transactions and identify related contingencies. In addition, due diligence results may be taken into account in the drafting of specific provisions in the transaction documents, especially when it is necessary to address any issues verified during the investigations.

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

The scope and length of the due diligence process will depend on the circumstances of each transaction. Various aspects of the target company may be analyzed, and many times a separate investigation by an audit firm is conducted simultaneously with the legal investigation conducted by qualified attorneys.

In Brazil, certain public records can and should be checked during a due diligence. The ownership of real

estate, for instance, is reflected in records kept by the appropriate Real Estate Registry. Corporate documents such as articles of incorporation can be obtained with the Registry of Commerce.

Additionally, Brazilian courts, including labor and tax courts, are prepared to issue certificates indicating any pending lawsuits involving the target company. In addition to the examination of public records, various documents are requested from the target company and then analyzed by the attorneys representing the prospective purchaser.

While good acquisition due diligence is important worldwide, it is particularly important in Brazil.

The complexity of the tax system, the large amount of tax litigation necessary to resolve tax issues, and the protective labor regulations, among other issues, complicate the evaluation of Brazilian targets, and sometimes the negotiations, significantly. It is common to observe a number of potential tax contingencies (issues not yet identified/assessed by the tax authorities or included in a tax lawsuit) that may sum to significant amounts. Some of the the most common issues encompass:

- Informal practices – income not recorded /false invoices entered in the accounting ledger.
- “Outsourced” or unregistered employees.
- Doubtful /aggressive tax planning.
- Low quality of financial information /controls.
- Inclusion of private/ shareholders’ interests with the company’s interests.

### Premium Tax Benefit

Premium is the difference between the purchase price and the net equity of the acquired entity. Provided

some requirements are met and provided the buyer is a Brazilian entity, the premium may generate a tax deduction over a certain period. This may be achieved after a merger between the buyer and the acquired entity. A number of considerations arising from the accounting harmonization process, towards IFRS, may impact the amount and the period of the premium tax benefit

The tax benefit associated to this premium depends on several factors and would, in principle, correspond to approximately 34% of its value.

### Anti-Avoidance Rules

Brazilian tax legislation (National Tax Code) currently provides that tax authorities may have the power to disregard, for tax purposes, the acts or transactions intended to:

- (i) reduce the amount of a tax due,
- (ii) avoid or postpone the payment of a tax due, or
- (iii) conceal aspects of a taxable event or the true nature of elements that give rise to such an event. However, such provisions are still pending ordinary law and administrative regulation in order to be fully effective from a legal perspective.

Although there is still a lack of regulation, this provision has been limiting tax planning in Brazil and created a change of the mindset of Brazilian tax authorities as well as administrative judges. Lately, tax courts in Brazil have increased their scrutiny of transactions and are looking for business substance. Thus, the tax system has been moving towards the adoption of the “substance over form” principle. Several decisions from our administrative courts (and also from our civil courts) corroborate this tax environment.

### **Government Inspection**

Employers must submit all accounting records and other documentation to government inspectors, upon their request, to demonstrate compliance with social security rules.

### **Union Contributions**

Employers' contributions to labor unions are paid in January of each year and are calculated on the basis of a company's registered capital per a progressive chart prepared by the Union.

All employees must pay Union contributions equal to one day's wages. This contribution is deducted from employee salary in March.

### **Foreign workers**

Two thirds of the employees of all companies must be Brazilian citizens, both in terms of numbers and total payroll. Exceptions may be made for skilled professionals and technicians in the event that Brazilians are not available for a particular position.

Portuguese citizens, as well as foreigners residing in Brazil for over 10 years, who have a Brazilian spouse or child born in the country, qualify as Brazilian citizens for the above purposes. However, there is a debate as to whether this provision of the Labor Law Consolidation was revoked by the Federal Constitution/88.

All foreigners coming to work in Brazil must obtain a valid visa. Generally, visas are issued to the directors and employees of a foreign company, an individual establishing a significant new investment in Brazil and to new transfers of a foreign company with existing operations in Brazil, where the transfer has skills not available in the Brazilian labor market. In practice, the latter requirement is not rigidly applied.

Therefore, sponsoring companies must obtain residence visas and work permits for expatriate personnel. Experience varies depending on the type of job position, the industry in which the company operates and the current labor policy. The work visas issued to foreigners are either temporary visas (valid for up to two years) or permanent visas (no time restriction on residence – the restriction is in regards of the activity that is developed, for up to five years). Temporary visas can be renewed for a further period of two years and changed into a permanent visa after the fourth year. Permanent visas may be issued to the directors of entities with at least US\$150 thousand or US\$ 600 thousand in equity investments depending on the case.

Foreign companies who wish to employ foreign citizens must provide the following documents and information to the Ministry of Labor:

- the amount of registered capital in the local company.
- the number of Brazilian and foreign employees in the local company.
- the justification for the employment of the applicant.
- name and passport number of the applicant.
- information on salary and benefits.
- Power of Attorney, for representation of the applicant before the Ministry of Labor.
- résumé (C.V.), diploma and academic transcripts.
- the employment contract.
- completed application form.

The Federal Constitution/88 ensures equal protection of the basic rights of liberty, personal security and property ownership to both Brazilian nationals and foreign residents. However, foreigners are prohibited from engaging in certain activities, are limited as to the amount of rural land they may own, and may not own property in frontier areas.

### **Split payroll**

Brazilian legislation does not expressly foresee the treatment to be applied to cases in which a split payroll scheme is put in place. In practical terms, due to the lack of specific provisions and considering that the general provisions of the social security code are broad, the authorities may understand that the social security would be due in Brazil on top of the total remuneration received. Brazilian income tax must be paid on total income on a worldwide basis. Visa issuance consequences must also be considered.

### **Labor Regime in the Oil & Gas Industry**

The labor regime in the Oil & Gas Industry is regulated by Law n. 5,811/72, which foresees specific provisions for employees involved in Oil & Gas activities. As per the mentioned law, employees may be kept in their work stations under a shift rotation regime in cases when an operational continuity is indispensable.

Two distinct workloads are eligible for this shift rotation regime: 8 hours or 12 hours, where the 12 hours regime is restricted to activities of exploration, drilling, production of petroleum located in the sea or in distant land areas or with difficult access as well as transfer of petroleum from the sea. In principle, the employee should not remain in this shift rotation regime for more than 15 consecutive days.

In consideration, the employer must provide the additional labor rights:

- (i) night shift work payments;
- (ii) free food and transportation;
- (iii) 24 hour of rest for every three turns worked; and
- (iv) payment in double for the suppressed rest hours.

# Labor Law

Until the 1940s, labor rules in Brazil were found in laws, decrees and various regulations, and no specific code or standard existed consolidating all rules in force. This made it extremely difficult to follow all changes and regulations. In 1943, through the enactment of Decree-law No. 5452/43, known as Consolidation of Labor Laws (CLT), the entire labor legislation was consolidated into a single piece of legislation, which has been governing all labor relations to this day.

At that time, the strength of the Brazilian economy was based on the manufacturing sector, and this sector was chosen as the main basis for the creation of standards and rules that would comprise the CLT. However, the current labor market is considerably different from the one of 60 years ago, since the service sector has been accounting for an increasing portion of the Gross Domestic Product (GDP). Additional factors, such as new technologies, the use of more specialized workforce and more flexible labor agreements have contributed and shaped the current labor market.

Nevertheless, since the time of its enactment, the CLT has never been significantly updated or revised and in some cases, its provisions are obsolete for the current day and age.

This situation becomes more serious as the labor environment evolves in line with a more global economy. Currently, market practices in terms of benefits and human resource relationships have become more flexible and provide more comfort for employees to carry out their work. For this purposes various benefits are granted to employees, such as a car, cell phone, bonuses and others. However,

by virtue of the legislation, such benefits may be treated as compensation for services performed and be subject to all taxes and contributions applicable to salary payments. In addition, these benefits must be included in the calculation of severance payments.

Some may argue that the labor legislation has been favorable to employees. In addition, employees do not assume the possible costs of the process (burden of the defeated party) should their claims fail to be based on circumstances that have actually resulted in loss for employees during their work for an employer. Thus, there are a high number of claims in the Labor Court, which result in increased expenses for companies involved in such litigation.

As a result, many companies may be in an unfavorable, even vulnerable, situation regarding the labor legislation. In many cases, human resource policies are adopted that are not provided in the current legislation with the intent to benefit employees and to follow market trends and practices. Thus, the great majority of companies may be subject to the risk of questioning by their employees and/or the competent authorities.

The Labor Law Consolidation encompasses the Labor Law Code and amendments introduced by the Federal Constitution (FC) of 1988. The following is a summary of the principal CLT items of general interest. Labor inspectors regularly enforce the numerous detailed requirements covering such matters as recordkeeping and payment of overtime and benefits. It is essential that the personnel department is knowledgeable about current labor laws in order to effectively deal with these matters.

## General Requirements Terms of Employment

Since the law establishes most provisions of an employment contract, it is uncommon to have an extensive written contract with lower level employees. Employees have a work booklet Employment Record Card and Social Security Card (CTPS), signed by the employer stating the position and salary, thus, establishing the formal labor contract.

A foreign employee may not be hired unless he presents his foreigner identity card issued by the Brazilian authorities. All employees must be registered in the employee's register of the firm and have their work booklet signed by the employer.

An annual return must be filed with the local office of the Ministry of Labor reporting the total number of employees and specifying the number of foreigners and minors employed, if any.

## Working Conditions

Employers are required to make reasonable provisions for the comfort and convenience of their employees. Appropriate dining facilities or meal vouchers must be provided on premises where more than 300 persons are employed.

## Working Hours

The workweek, determined by the FC, is 44 hours per week, conventionally treated in Brazil as 8 hours a day from Monday to Friday and 4 hours on Saturdays. For employees paid on a monthly basis, the number of hours per month is 220 hours and 30 days are always considered in computing the number of working days per month.



### Transfer of Employees

An employee may be transferred to a new location if the arrangement is justified by the requirements of the organization. If the assignment is temporary, the employee must receive a payment increase of at least 25%. Moving expenses must also be paid by the employer.

### Trial Period

Employees may be hired for a trial period, which cannot exceed 90 days.

### Termination of Employment

After the experimental period, if an employee is dismissed without just cause, the employer must pay a penalty equivalent to 50% of the amount deposited in the employee's Government Severance Indemnity Fund for Employees (FGTS) account (retirement fund). The employee will receive 40% of this amount and the other 10% will go to the government as a social contribution.

### Litigation

Historically, Brazilian labor law has been notoriously partial to employees. Brazilian labor courts generally allow the admittance of oral evidence to prove the existence of an employment relationship and favor settlements as a means of resolving disputes.

Additionally, employees are not required to assume the costs of litigation. As a result, labor claims tend to cause expenses for the company involved.

Typically, a labor claim is filed against a company after an employee's contract is terminated. Brazilian labor law allows an employee to file a labor claim seeking rights for an employment during the 5 years period prior to the date the claim is filed and up to 2 years after the dismissal.

### Employee Remuneration Remuneration Frequency

Employees must be paid in Brazilian currency on a monthly basis or on a shorter time period if stipulated by the employment contract.

Therefore, salaries are generally referred to in terms of a monthly salary as opposed to an annual salary. The salary amount is paid 13 times during the year (see details below).

Employers may not reduce salaries except under extraordinary circumstances.

### Fringe Benefits

Assuming certain requirements are met, some benefits such as transportation, meal payments, pension plans and insurance policy premiums are not considered part of employee remuneration and, therefore, are not subject to the payment of the labor rights or social security.

### Additional Salary

In certain instances, additional remuneration is required, as follows:

- overtime rate must be at least 50% greater than regular pay;
- night shift work must be paid at a rate at least 20% higher than equivalent daytime work;
- for hazardous work, the salary must be increased by 30%;
- for work dangerous to health, the salary may be increased by 10% (minimum), 20% (medium), or 40% (maximum) depending on the level of potential harm to health and well-being.

### Minimum Wage

The federal minimum monthly salary is currently equivalent to R\$ 880. Note that different minimum salary requirements may be granted to specific regions, states and for specific categories of professionals.

### Equal Pay

There are general provisions in Brazilian law prohibiting employment discrimination based on gender, religion, race or other nonmaterial factors. The only affirmative action programs relate to the employment of individuals with physical handicaps.

Labor law provides that all work of equal value must be paid at the same rate regardless of the nationality, age, gender or marital status of the employee performing the function. However, differences in length of service, if over 2 years, may be taken into account to justify different salary levels. Companies that have a career track plan may have differences in salary levels in accordance with seniority and merit; however, such career plans need to be registered with the Brazilian Ministry of Labor.

### Labor Rights Vacation

Upon completion of each 12 month work period, employees are entitled to paid vacation of up to 30 calendar days. The employee can choose to have up to 10 days of vacation paid in cash. Vacation compensation is equivalent to one month salary, plus a 1/3 monthly salary as a vacation bonus. Vacation bonuses must be included in the basis for calculating unemployment insurance and social security contributions.

Employees should not accumulate 2 or more years of vacation entitlements, otherwise the excess must be compensated at twice the normal rate of pay.

If an employee is dismissed (other than with cause) he/she must be compensated for unused vacation time, even if proportionally to the worked period.

### 13th Month's Salary (Christmas Bonus)

An additional one-month salary, also known as the 13th salary, is paid to employees as an annual bonus. Every year employers are obligated to pay a bonus in the month of December equal to 1/12 of the salary earned for each month of service during that calendar year. This bonus must be included in the basis for calculating unemployment insurance and social security contributions. Part of the bonus must be paid during the year

(normally when vacations are taken), and the remainder is paid in December.

Dismissed employees are entitled to receive proportionally to the period effectively worked during the year.

### Profit Sharing

The legislation provides that agreements for profit sharing must be agreed upon by the employer and commissions appointed by the employees. It is debatable on whether the payment of profit sharing is mandatory or optional, but there are several companies, which have not been paying it. However, if a company has a profit sharing policy in place then pursuant to current legislation profit sharing payments are not subject to payroll taxes and are not included in labor rights calculation basis, but they do attract personal withholding income tax.

### Prior Notice on Dismissal

The employer or the employee wishing to terminate an employment relationship should give a thirty days notice. If the company wants to terminate the working contract without giving or before the end of prior notice, it must pay the related days to the dismissed employee.

Other labor rights agreed and payments may be also due, depending on the employment contract signed with the individual, his activities and on the Collective Bargain/Agreement negotiated with the respective labor union.

### General Disclaimer

Note that the labor rights described above are those to which all employees are generally entitled to according to Brazilian labor laws. Other rights may exist that may be provided for in the labor convention applicable to a specific company. Although detailing all possible rights that may be granted to employees in Brazil is outside the scope of this publication, the most significant issues are highlighted above.

### Payroll Taxes

Retirement Fund (FGTS) – Government Severance Indemnity Fund for Employees

Each month, the employer must contribute the equivalent of 8% of total salary of each employee for FGTS purposes. This amount is deposited in

each employee's name in a separate account with the bank designated by the government. An employee may only use this fund in special circumstances, such as retirement or dismissal without just cause. In any case, the employer must pay the employee 40% of the actual balance of the FGTS account as well as an additional 10% to the federal government. The contributions to FGTS are not applicable for payments to independent professionals and are not mandatory for compensation of directors that are not employees.

### Social Security (INSS) Employers Contributions

Social security contributions have to be paid monthly by the employer to the Federal Social Security Agency (INSS). The contribution rate of 20% is applied on gross salaries without limits. The contribution is further increased by working accident insurance, education contribution and contributions to other governmental institutions such as National Service for Commercial Learning (Senac), Social Service Of Commerce (Sesc) and Service of Support to Micro and Small Companies (Sebrae), resulting in a total social security contribution rate of 27% to 29%. Note that these rates may be higher depending upon a company's activity, number of employees and history of work related accidents.

Payments to independent contractors, directors or managing directors without an employment relationship with the company (e.g., service and management fees) are subject to INSS at a rate of 20%.

It is important to note that entities engaged in specific business activities may calculate the social security tax (INSS) based on 2% or 1% of the gross revenue, instead of 20% over the employees gross salaries.

### Employee Contributions

Employee contributions are made at lower rates (between 8% and 11%) based on a specific progressive table and must be withheld monthly and paid to INSS by the employer.

For instance, the monthly social security contributions paid by employees who receive salaries equal to, or higher than, approximately R\$ 5,189.82 per month are limited to 11% of the salary amount.

### Withholding Income Tax

Income taxes on Brazilian source payments made to individuals as remuneration for services must be withheld on a monthly basis in accordance with a specific progressive table, as further listed below. The withholding rate for individual income taxes ranges from 7.5% to 27.5%.

Income – from (R\$)	Income – to (R\$)	%	Portion to be deducted (R\$)
0.00	1,903.98	0.00%	0.00
1,903.98	2,826.65	7.50%	142.80
2,826.65	3,751.05	15.00%	354.80
3,751.05	4,664.68	22.50%	636.13
4,664.68	-	27.50%	869.36

For more information of individual taxation please refer to the specific topic.

### Social Security Benefits

The Brazilian social security system provides minimal benefits. Health, disability and senior pension benefits are very small for the vast majority of Brazilians. In addition, a significant proportion of the population is engaged in occupations where access to the social security system is limited.

The state health care system is rudimentary and is generally overloaded. Accordingly, the majority of employees have access to private health insurance plans provided by corporate employers or trade unions.

### Basis for Calculation

Benefits paid by the state are calculated based on the "benefit wage". The benefit wage is that part of an employee salary on which the employer's social security contributions are calculated. The specific rules to calculate may vary in accordance with the nature of the benefit.

### Health Insurance

During the first 15 days of sick leave the employer pays the employee salary. If the insured is unable to work for a period longer than 15 day, the benefit wage is paid to the insured by the INSS for the remaining duration of the sick leave. This insurance may be converted into a disability pension.

### Retirement Pension

This benefit is paid to men over 65 and to women over 60 years old, provided they have made 180 monthly contributions. For farm workers, the age threshold drops to 60 years for male and 55 years for female workers.

An early retirement pension may be granted if a man has worked for at least 30 years and a woman for at least 25 years. The maximum pension is available after 35 years of service for men and 30 years for women.

### Other Benefits

Other benefits are available to employees in Brazil. These include, among others, maternity insurance, funeral insurance and disability pension, all of which are calculated in a similar manner to the 13th month salary.

### Government Inspection

Employers must submit all accounting records and other documentation to government inspectors, upon their request, to demonstrate compliance with social security rules.

### Union Contributions

Employers' contributions to labor unions are paid in January of each year and are calculated on the basis of a company's registered capital per a progressive chart prepared by the Union.

All employees must pay Union contributions equal to one day's wages. This contribution is deducted from employee salary in March.

### Foreign workers

Two thirds of the employees of all companies must be Brazilian citizens, both in terms of numbers and total payroll. Exceptions may be made for skilled professionals and technicians in the event that Brazilians are not available for a particular position.

Portuguese citizens, as well as foreigners residing in Brazil for over 10 years, who have a Brazilian spouse or child born in the country, qualify as Brazilian citizens for the above purposes. However, there is a debate as to whether this provision of the Labor Law Consolidation was revoked by the Federal Constitution/88.

All foreigners coming to work in Brazil must obtain a valid visa. Generally,

visas are issued to the directors and employees of a foreign company, an individual establishing a significant new investment in Brazil and to new transfers of a foreign company with existing operations in Brazil, where the transfer has skills not available in the Brazilian labor market. In practice, the latter requirement is not rigidly applied.

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The Federal Constitution/88 ensures equal protection of the basic rights of liberty, personal security and property ownership to both Brazilian nationals and foreign residents. However, foreigners are prohibited from engaging in certain activities, are limited as to the amount of rural land they may own, and may not own property in frontier areas.

### Split payroll

Brazilian legislation does not expressly foresee the treatment to be applied to cases in which a split payroll scheme is put in place. In practical terms, due to the lack of specific provisions and considering that the general provisions of the social security code are broad, the authorities may understand that the social security would be due in Brazil on top of the total remuneration received. Brazilian income tax must be paid on total income on a worldwide basis. Visa issuance consequences must also be considered.

### Labor Regime in the Oil & Gas Industry

The labor regime in the Oil & Gas Industry is regulated by Law n. 5,811/72, which foresees specific provisions for employees involved in Oil & Gas activities. As per the mentioned law, employees may be kept in their work stations under a shift rotation regime in cases when an operational continuity is indispensable.

Two distinct workloads are eligible for this shift rotation regime: 8 hours or 12 hours, where the 12 hours regime is restricted to activities of exploration, drilling, production of petroleum located in the sea or in distant land areas or with difficult access as well as transfer of petroleum from the sea. In principle, the employee should not remain in this shift rotation regime for more than 15 consecutive days.

In consideration, the employer must provide the additional labor rights:

- (i) night shift work payments;
- (ii) free food and transportation;
- (iii) 24 hour of rest for every three turns worked; and
- (iv) payment in double for the suppressed rest hours.

### Auxiliary obligation (eSocial)

Starting 2017, all currently existing labor auxiliary obligations should be replaced by a sole electronic declaration, so-called eSocial.

The eSocial shall compile all information previously reported in other forms and statements, which should no longer be due by those obligated to present the new declaration.

# Individual taxation

## Basis of assessment

Residents in Brazil, whether Brazilian or foreign nationals, are subject to tax on their worldwide income. Individuals reporting foreign income received may recognize a foreign tax credit for the respective taxes paid, provided there is a tax treaty or a reciprocity agreement in place between Brazil and the particular foreign country. The credit taken must be net of any refund and supported by original documents evidencing payment to the foreign taxing jurisdiction.

Income subject to tax includes all monetary compensation and fringe benefits.

For foreigners working in Brazil this includes, among others, the cost of travel for family home leave, as well as allowances for housing, education, automobiles, medical and other living expenses. In addition, any reimbursement of taxes paid is included in taxable income. Non-monetary fringe benefits, such as the use of a company car or country club membership, are also included in taxable income. No distinction is made between personal expenses reimbursed by the company to the employee and personal expenses paid directly to a third party by the company. Moving allowances are generally nontaxable but in certain cases may be treated differently.

Brazilian companies making payments to individuals must withhold the personal income tax on a monthly basis in accordance with the applicable progressive tax rate. Specific allowances and deductions are available for income tax computation of individuals.

## Foreign income carnê-leão

The withholding tax mechanism only applies to payments made by Brazilian companies to individuals. The tax due on foreign income is calculated in accordance with the same progressive table, but the individual himself (or a service provider) must compute and pay the tax through the regime known as Carnê-leão.

The deadline for both the reporting of the foreign income and the payment of the corresponding tax is the last working day of the month following the month when the income was received. Foreign tax credits can generally be used to offset the Brazilian tax liability.

## Annual income tax return

An annual income tax return must be filed by the last working day of April reporting the income earned in the previous calendar year (January 1 to December 31).

All Brazilian tax residents are required to disclose their worldwide personal assets and liabilities held as of December 31 of each year. Although part of the filing obligation, there is no tax assessed on the gross or net assets of a fiscal resident.

## Taxation of capital gains

Real estate capital gains are taxable at a 15% rate. Capital gains are exempt from taxation if all of the following conditions are met: a similar transaction has not occurred within the previous five years, the residential real estate is sold for a price lower than or equal to R\$ 440,000 and the individual does not own other real estate. There is also an exemption if the taxpayer uses the sales proceeds

to purchase another piece of real estate within the following six months.

On September 22, 2015, Provisional Measure 692/2015 ("MP 692/15") introduced new progressive rates over capital gains earned by individuals, which may come into force as of January 1st, 2017. This measure is still pending sanction by the president, who may still line item veto the bill.

An illustrative table containing the new rates, ranging from 15% to 22.5%, can be found in the Capital Gains topic in the first section.

Gains from the sale of foreign stock or personal property that was acquired prior to becoming a Brazilian resident are not taxable.

## Concept of residence Permanent visa

Individuals transferring to Brazil on a permanent visa are subject to tax as residents from the date of arrival. Permanent working visas are generally granted only to applicants who will perform management activities as business administrators, general managers or directors of Brazilian professional or business companies duly appointed as stated in the their articles of incorporation. The Brazilian company has basically two options to formalize the recruitment of an individual with a permanent visa:

- (i) with an employment contract, where the company will pay a monthly salary and will incur in other labor charges, as well as being included in the Brazilian company's payroll; or
- (ii) without an employment contract, where the company will pay a pro labor remuneration in Brazil.





### Temporary visa

Individuals transferring to Brazil with a temporary visa to work as an employee of a Brazilian entity are considered residents for tax purposes as of the date of arrival and, as such, are taxable on their worldwide income.

If an individual enters for any other purpose on a temporary visa and does not have an employment contract with a Brazilian entity, he will be working under a technical agreement for the rendering of technical assistance in Brazil but remains an employee of the parent company. In this case, the individual's tax status for the first 183 days of physical presence in Brazil will be that of a nonresident.

### Business visa

A business visa holder is allowed to remain in the country for 90 days (renewable) and would only be able to conduct business as allowed under the rules applicable to the holder of this type of visa. For these purposes, the short-stay business visa is applicable to persons who wish to travel to Brazil.

### Repatriation process

Upon departure from Brazil, a fiscal resident must report his income and pay any taxes until that date. The taxpayer must file a final income tax return and obtain a tax clearance certificate (granting nonresident tax status) that will enable him to request Central Bank permission to repatriate all assets held in local currency, provided these assets have been properly reported in the annual tax returns.

# Oil & Gas industry in Brazil and KPMG

The Oil & Gas industry has been undergoing very rapid development, mainly due to technological advances and the way world prices have been changing. This development is also due to companies that are striving to be recognized on the global market and are competing for the capital required to discover new opportunities.

KPMG, which operates with the Oil & Gas industry and provides services to small, middle-sized and large companies, from the beginning of the review of feasibility studies, through the development of the area and right up to the commercialization stage, has the resources to offer you a service that may suit your company's strategic needs.

These resources have been obtained by KPMG through gathering together professionals from the Audit, Tax and Advisory practices, all of whom are dedicated to companies of the Oil & Gas industry, to create one of the largest practices in Oil & Gas in Brazil, providing services to approximately 60% of the main companies in the world that operate in this industry.

Our Center of Excellence in Oil & Gas located in Rio de Janeiro and KPMG's Global Centers of Excellence located around the world can provide direct access to the most recent knowledge in terms of industry, capabilities, resources and technical development.

The aim in our Centers of Excellence is to obtain immediate, direct responses for the rapid evolution of the Oil & Gas industry.

KPMG Centers of Excellence perform a significant role in the development of a global market focus by recruiting experienced professionals, and keeping abreast of what impacts global industries, and developing value-adding products. Each center:

- Includes professionals dedicated to the Oil & Gas industry.
- Is led by a recognized senior industry practitioner who takes part in monthly Global Centers of Excellence meetings to ensure we keep abreast of industry trends, share knowledge, and provide coordinated service offerings.
- Supports our global client service teams to provide quality services, training, and knowledge to our member firms' clients.
- Drives the mobility of our member firms' resources and the consistency of our service deliverables.
- Develops regular publications for the industry focusing on key issues impacting business across the globe.
- Provides ongoing training aimed at the Oil & Gas industry for our member firms' professionals and clients.

The services that the KPMG member firms can offer are the following:

- Support for international investors investing in the region, through tax, financial and regulatory advisory services.
- Support in Merger and Acquisition processes, and divestment of assets and companies.

- International tax advisory, compliance and organization.
- Project due diligence for assessing new investments and initiatives.
- Independent assessments and reports.
- Monitoring expenses for intensive capital projects.
- Support for joint ventures, and advisory services in investment management and in the efficiency and effectiveness of the investment, at the same limiting the risk.
- Assessment and corporate governance of knowledge, security and risk management information systems.
- Assistance to clients in the effective communication of their business performance.
- Quick responses in a changing corporate governance environment.
- Advisory on environmental and stakeholding issues, including reviews of sustainability reports, development of global reporting initiatives and audits of problems arising from greenhouse effect gases.
- Preparation and advisory for the conversion to IFRS.
- Audit of the statutory financial statements and risk advisory services.
- Internal audit advisory and services.
- Support for the team and for Brazilian and foreign executives.

# KPMG in Brazil

KPMG in Brazil employs approximately 4,000 professionals work in 22 cities located in 13 States and the Federal District. KPMG in Brazil has offices located in São Paulo (head office), Belo Horizonte, Brasília, Campinas, Curitiba, Florianópolis, Fortaleza, Goiânia, Joinville, Londrina, Manaus, Osasco, Porto Alegre, Recife, Ribeirão Preto, Rio de Janeiro, Salvador, São Carlos, São José dos Campos and Uberlândia.

Through Audit, Tax and Advisory services, the Organization offers, worldwide, a consistent set of accounting and financial skills and competences, based on a profound knowledge of the market segment of each client, a very significant differential feature.

In order to offer quality services, KPMG transforms its knowledge and experience accumulated over the years, in many various areas, into value for its clients, through multidisciplinary engagement teams.

Organizing and carrying out accurate market intelligence work is considered by KPMG as a decisive point in building the strategies adopted by the organization for providing

services to its clients. This methodology provides detailed knowledge of each sector of the market and makes it possible to develop leading service practices with respect to the individual particularities of each client.

## KPMG Latam Energy Institute

Virtual platform that acts as a support network for organizations and related interest groups to understand the challenges, new trends, risks and opportunities in the sector, and to support their decision making. The Latin American division of the Institute, which at a global level already brings together 35 thousand business representatives, provides articles and organizes debates and talks with sector leaders and forums. The institute was launched with a wide range of content and issues relevant to the sector, such as Cost Optimization, the Regulatory Framework for Energy in Mexico, Tax Incentives applied to the renewable energy market, Mergers and Acquisitions in the sector and other exclusive content. The Latam Energy Institute can be accessed at the following web address [kpmg.com/energylatam](http://kpmg.com/energylatam), and registration is free.





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