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HIGH GROWTH MARKETS

Webinar – Brazil Tax Update

Current Tax issues and incentives for investors in Brazil

03 September 2009

TAX



HIGH GROWTH MARKETS

Brazil Tax Update

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TAX

Introductions



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Agenda

- **Brazil's Economy**
 - Main facts and figures
 - Why is Brazil gaining relevance worldwide
- **Doing Business in Brazil – A brief overview covering**
 - Brazilian taxes and corporate features
 - Cross-border operation and related tax treatment
 - Brazilian tax structures for investments
 - Profit repatriation alternatives, capital gains taxation and others
- **Tax Updates – Important changes and others under discussion**



Brazil's Economy – Main facts and figures

Brazil's Economy – Main facts and figures



- **5th largest** country in the world
- Population: 195 million (estimated for 2009)
- Urban population: approximately 80%
- 27 states and over 5,500 municipalities
- Major city: São Paulo (20 million),
- Federal capital: Brasília (2.5 million)
- Local currency: “Real (BRL)”

Brazil's Economy – Main facts and figures

- **Brazil reached the investment grade in 2008**

(Standard & Poor's, Fitch)

- **Figures**

- Inflation in 2008: 5.9%; expected inflation for 2009: 4.5% (Central Bank of Brazil)

- Interest rate (SELIC rate – August, 2009): 8.75% (reached 26.5% in 2003)

- GDP growth:

2008	2009*	2010**
5.3%	- 1.0%	3.3%

Source: The Economist Intelligence Unit (EIU)

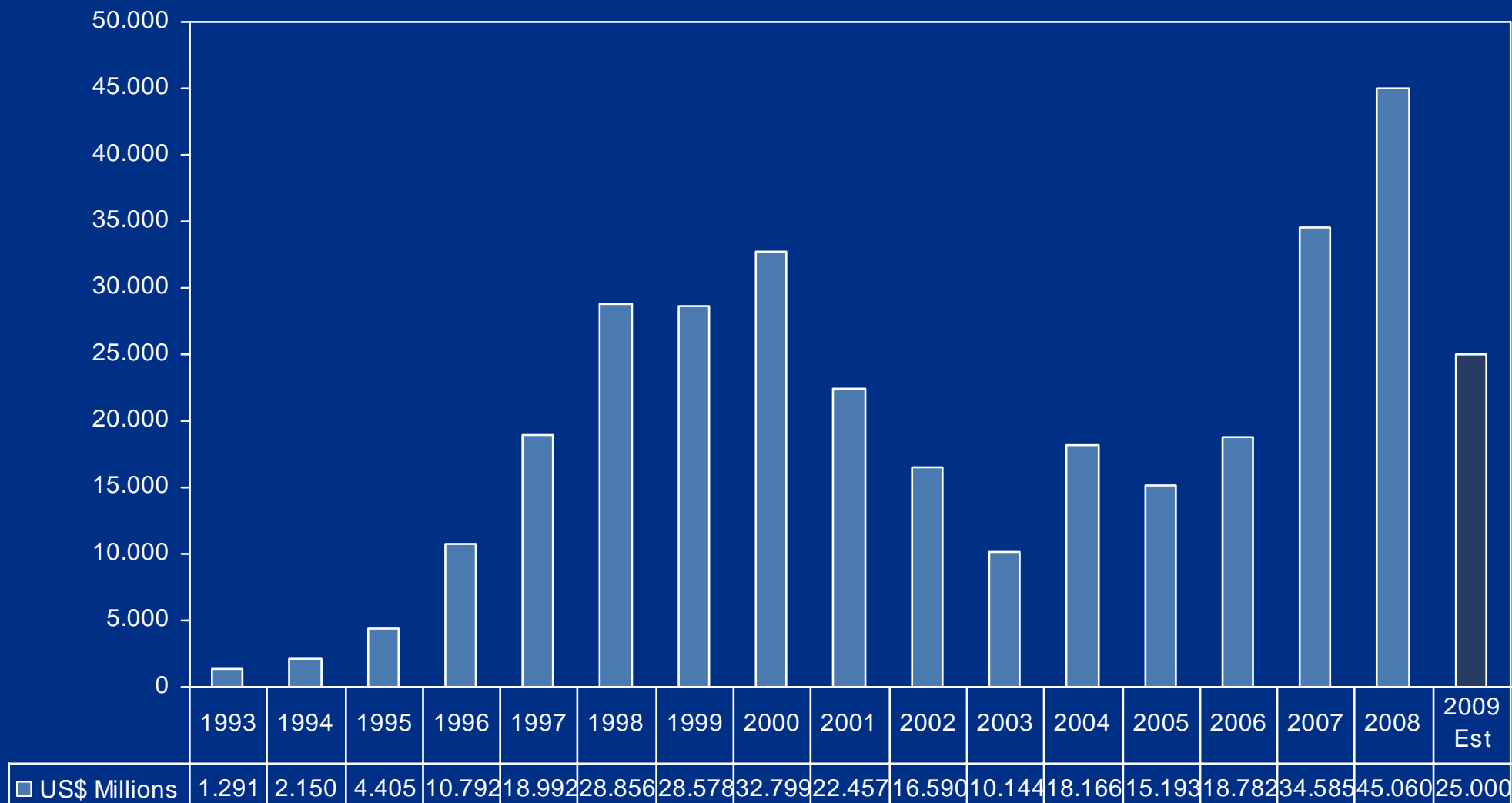
* Estimate; ** Forecast

GDP Ranking 2008

GDP (PPP) - 2008			GDP per capita (PPP) - 2008		
Ranking	Country	USD Billion	Ranking	Country	USD
1	United States	14,264,600	1	Qatar	85,868
2	China	7,916,429	2	Luxembourg	82,306
3	Japan	4,354,368	3	Norway	53,451
4	India	3,288,345	4	Singapore	51,142
5	Germany	2,910,490	5	Brunei	50,117
6	Russia	2,260,907	6	United States	46,859
7	UK	2,230,549	7	Switzerland	42,783
8	France	2,130,383	77	Brazil	10,326
9	Brazil	1,981,207	100	China	5,963
10	Italy	1,814,557	129	India	2,762

Source: International Monetary Fund

Foreign Investment Inflow (in US\$ Million)



Source: Boletim Focus/Central Bank



Brazil's Economy – Why is Brazil gaining relevance worldwide

Brazil's Economy – Important facts

- Brazil's economy is riding the worldwide boom in raw materials
- Brazil has gained better control of currency fluctuations and inflation
- A stronger middle class is forming in Brazil
- Brazil is in the middle of a catch-up campaign in infrastructure investments
- Brazil surpasses France as number 6 worldwide in automobile production
- Brazil will host the FIFA Soccer World Cup in 2014

Brazil's Economy – Important facts

**„Among the last
to fall into recession,
Brazil may be among the first
to grow out of it“**

Source: The Economist, June 2009



Doing Business in Brazil – Overview

Brazilian corporate law – Overview

- Main legal entities types

- *Limitada (Ltda.)* – Limited Liability Company (equivalent to the German GmbH – Gesellschaft mit beschränkter Haftung)
- *Sociedade Anônima (S.A.)* – Corporation, publicly held or privately held (equivalent to the German AG – Aktiengesellschaft)

The S.A.s are subject to more compliance and bureaucracy than the Limitadas

- Others possibilities available, e.g., consortium (private agreement between parties), joint venture partnership. These other types of companies are less common than Limitadas and S.A.s

- Branches x Subsidiary

- There is no different tax treatment applicable.
- However, the incorporation of branches are more bureaucratic and need prior approval, what makes them less common than subsidiaries

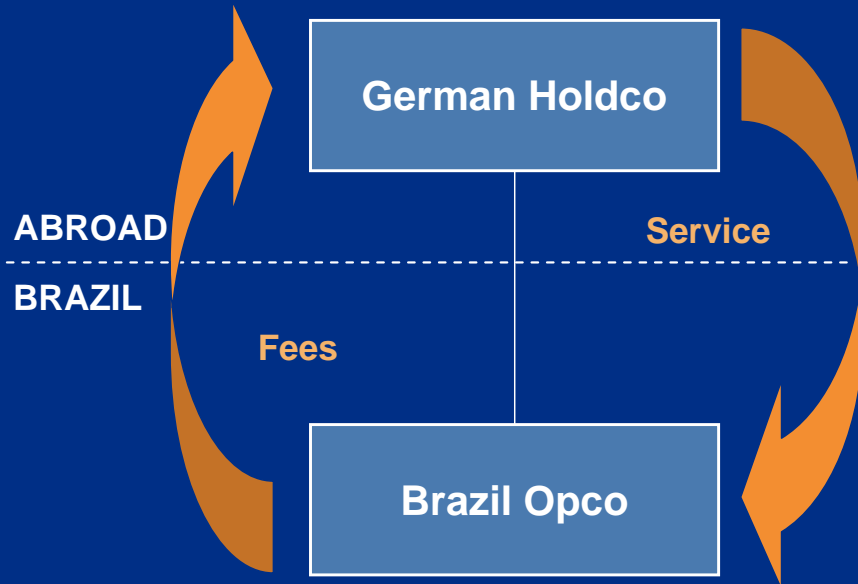
Brazilian taxes – Overview

- Corporate income taxes
 - Income tax – 25% (15% rate plus a 10% surplus)
 - Social contribution tax on profits – 9% (15% for financial institutions and insurance companies)
 - Two main tax regimes: Actual profits and presumed profits
- Other taxes
 - PIS and COFINS: cumulative regime and non-cumulative regime
 - IPI (Federal VAT)
 - ICMS (State VAT)
 - ISS (Municipal service tax)
 - IOF (Financial tax)
 - CIDE (Special Social Contribution)
 - ITCMD-ITBI (State and Municipal property taxes)

Brazilian tax issues – Cross-border operations

- Tax treaties
 - Brazil is not an OECD member
 - Double Tax Treaties network – 28 countries (Brazil-Germany DTT revoked in 2005)
 - Brazil/United States – Treaty for exchange of information
- Transfer pricing
 - Not OECD based/No best-method rule
 - Comparables and minimum/maximum fixed margins
 - Average prices and costs
- Non-resident capital gains
 - 15% or 25% and discussions regarding computation methods

Cross-border services and assistance



- Multiple taxes

- WHT15% or 25%
- ISS2% - 5%
- CIDE10%
- PIS/COFINS.....9.25%
- IOF.....0.38%

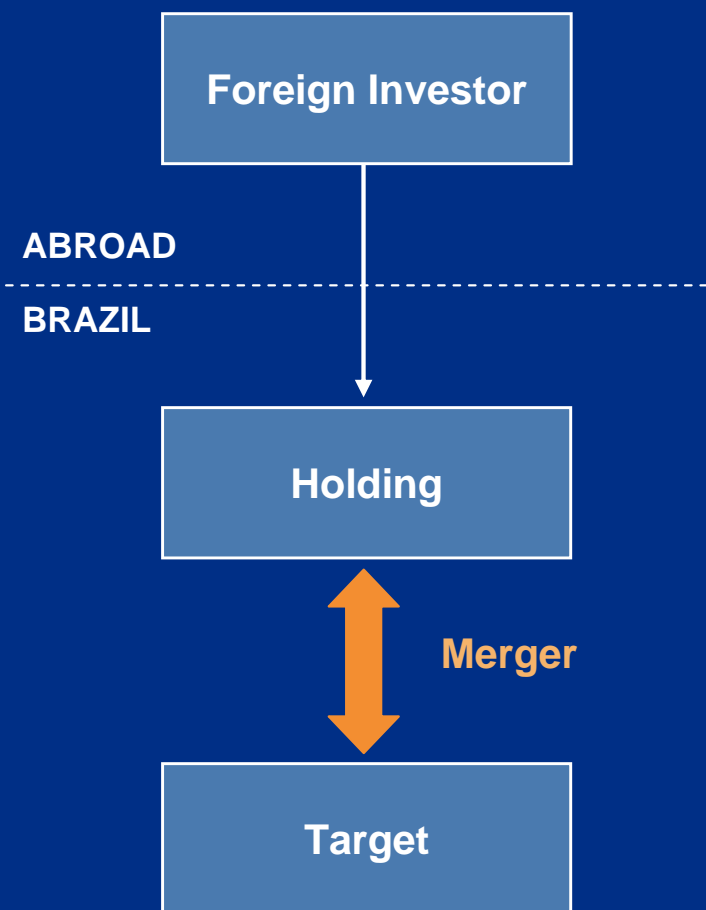
- Deductibility

- Service with transfer of technology/know-how – usually 5% of the net revenues
- Service with NO transfer of technology/know-how – transfer pricing rules



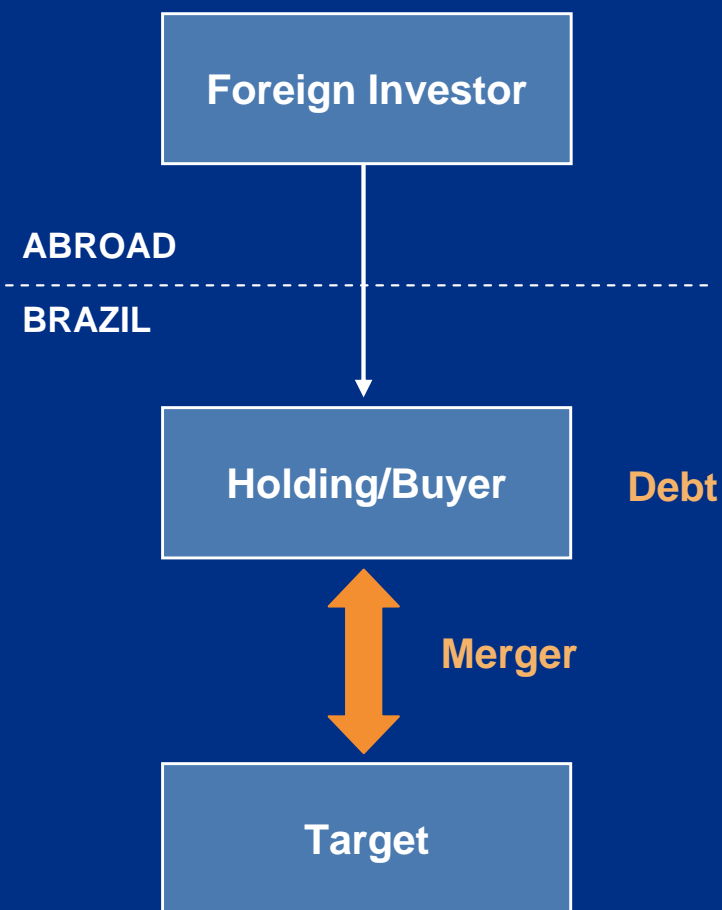
Tax Structuring

Tax structuring in Brazil – Goodwill



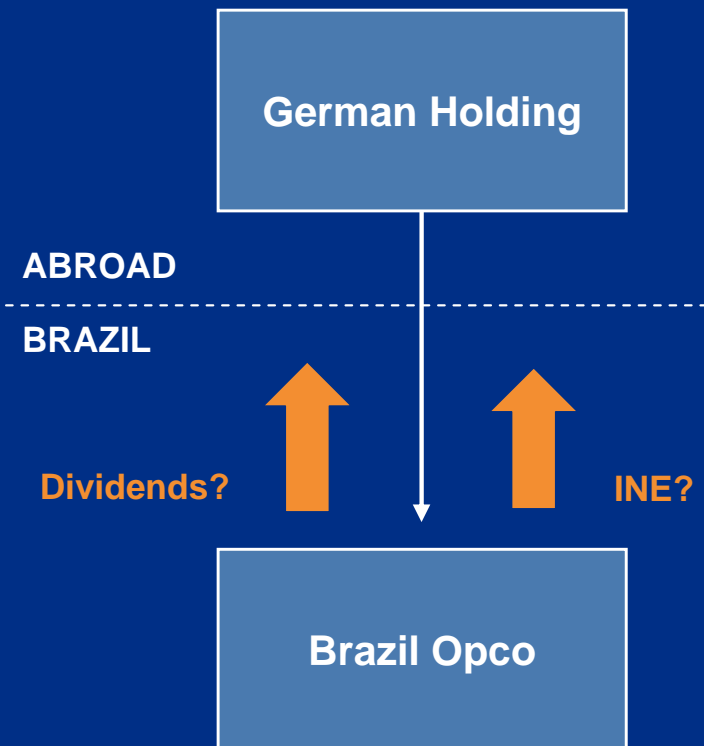
- Share deal transaction
 - Goodwill: the difference between acquisition price and net equity book value
 - Possible tax benefit: 34% deduction (minimum five-year period of amortization)
 - Compliance with certain requirements apply (appraisal report, downstream/upstream merger, etc.)
 - Important: Brazil is moving towards IFRS and changes on the tax law could take place

Tax structuring in Brazil – Debt x Equity



- Debt *versus* Equity
 - No thin cap rules
 - 15% or 25% WHT on interest
 - 0% WHT on dividends (provided profits generated after January, 1996). IOF could be charged
 - Interest tax deductible at 34%
 - FX exposure

Tax structuring in Brazil – Interest on Net Equity (INE)



- Profit repatriation

- Concept: Tax deductible interest expense at 34% computed on the net equity, calculated upon a long-term interest rate (TJLP) on the Brazilian entity's adjusted net equity
- Requirements: 15% WHT (or 25% for low-tax jurisdictions) and limitation (the higher amount between 50% of retained earnings or 50% of current profits)
- Compliance with Brazilian Central Bank rules (restrictions if there are accumulated accounting losses)



Tax Updates

New accounting practice

- Law 11,638/07 and Accounting Practice Committee (“CPC”)
- New concepts and broad application
 - Essence over form
 - Risk and benefit analysis over legal property
 - Rules guided by principles
 - Cash Flow and Added Value Statements are mandatory
- Law 11,941/09
 - Transitory Tax Regime (“RTT”) - to regulate the tax implications for 2008 and 2009
 - Tax neutrality for 2008 and 2009. From 2010 on new tax rules shall be issued

Public System of Digital Bookkeeping – SPED

- The Public System of Digital Bookkeeping (SPED) consists of a new electronic system to monitor and facilitate the fulfillment of tax obligations
- As users of SPED, Tax Authorities (Federal, States, Central Bank, CVM, etc.) will have full access to all taxpayers' accounting and tax information in a very organized and updated manner
- Comprises three main subprojects:
 - Accounting SPED (2009, 9.000 companies; 2010, 170.000 companies)
 - Tax SPED (2009, approximately 80.000 companies chosen by each State; 2010, all companies)
 - Electronic Tax Invoice (2008 or 2009, for some companies, depending on the economical activity)

Special Tax Regimes

- Brazil has several different special tax regimes that may lower overall tax burden (examples):

Special tax regime	Beneficiary	Purpose	Main tax benefits
R&D	Industries in general but also service providers	Fostering research and development and technology advances	Additional tax deduction, reduction of IPI, accelerated amortization and depreciation, etc.
REPES	Software developers	Development of IT service platform for exports	PIS and COFINS exemption on acquired goods and IT services
RECAP	Export companies	Acquisition of fixed assets by exporters	PIS and COFINS exemption on acquired capital goods

Special Tax Regimes, continued

Special tax regime	Beneficiary	Purpose	Main tax benefits
REIDI	Legal entities with approved infrastructure project	Development and implementation of projects in the infrastructure sector	Exemption of PIS and COFINS upon the local and foreign acquisitions
REPETRO	Oil and gas companies	Research, exploration, development, and economic exploitation of oil and gas	Exemption from some of the taxes on import and export transactions of certain goods
SUDENE-SUDAM	Companies located in the Northeast and North regions	Boost economic activities in such regions	75 percent reduction of the corporate income tax

Special Tax Regimes, continued

Special tax regime	Beneficiary	Purpose	Main tax benefits
PPB	Computer, electronic and telecom equipments	Development and implementation of projects in the infrastructure sector	Reductions on IPI and ICMS
Manaus Duty-Free Zone	Companies located in Manaus	Research, exploration, development, and economic exploitation of oil and gas	Income tax reduction and other taxes exemption, reduction and deferral
PROVEÍCULO	Automobile manufacturers in the state of Sao Paulo	Boost investments in the automotive sector in the state of Sao Paulo	More possibilities to offset accumulated ICMS credits, ICMS deferral in some specific cases

Special Customs Systems

- Brazil has also several different special customs systems (examples):

Special customs system	Main benefits
Drawback	Exemption from import tax, IPI, PIS and COFINS on imports of raw materials to be used in the manufacturing process of products to be exported, provided there is a minimum level of local manufacturing. ICMS benefits may be also available.
Temporary admission	Allows the import of goods staying in the country on a temporary basis (e.g. lease or rental transactions) with a total or partial exemption from taxes levied on imports.

Special Customs Systems, continued

Special customs system	Main benefits
Bonded warehouse and DAC	<p>The Brazilian company 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.</p> <p>In case of exports, products are presumed exported but physically remain in a bonded warehouse in Brazil. The beneficiaries are the companies allowed by the tax authorities to operate under this regime.</p>
Export Processing Zone (EPZ)	<p>Planned industrial areas in which established companies have their operations exempt from some federal taxes and contributions, mainly Import Tax and IPI.</p>

Special Customs Systems, continued

Special customs system	Main benefits
Presumed export	Goods are sold to a non-resident, 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 foreseen in law.
Tariffex	Exemption or reduction of the import tax on the import of equipment in cases where there is no similar equipment in the country. This benefit is granted after the importer submits a request and obtains approval from the authorities.
RECOF and RECOM	Certain specific products may be imported (and sometimes acquired in the local market) without taxes (import tax, IPI, PIS and COFINS), if they will be 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 some electronics).

Special Installment Program – Law 11,941/09

- The Brazilian government has been periodically enacting federal tax amnesty and installment programs.
- The new tax installment program, established by Law 11,941/09, allows companies that:
 - have federal outstanding tax debt matured until 30 November 2008; or
 - opted for a previous special tax amnesty program; or
 - used tax credits with regard to specific non-taxable federal VAT (IPI) transactions (recent court decisions disallowed the offsetting of such credits)... to pay these debts:
 - In up to 15 years;
 - With reduced penalties and interest, depending on the schedule
 - Offsetting penalties and interest against accumulated tax losses
- The application has to be completed through the Internet until November 30



Priorities for the years ahead – What is on the “tax agenda”?

Tax Reform

- **Main objectives**

- Simplify the tax system
- Eliminate distortions to boost investments
- Finalize the “fiscal war” among the 27 Brazilian states (“race to the bottom”)
- Improve regional development policy

Tax Reform, continued

- Federal Taxes
 - Creation of the Federal IVA eliminating PIS, COFINS, CIDE and other federal taxes
 - Implementation of excise tax substituting the IPI
 - Unification of Corporate Income tax (extinction of CSLL)
- Indirect taxes
 - Creation of State IVA substituting the ICMS
 - Unification of the 27 state ICMS laws into a single federal law
 - Unification the IVA rates throughout the country
 - Municipal Service Tax (ISS) continue to exist

Other Possible Bills of Law

- Dividends
 - Taxation on dividends payments to nonresidents at different rates (e.g. 15%)
 - Proposals are under analysis in the House of Representatives since 1999
 - Present situation: under analysis by the commissions
- Tax transaction
 - The initial proposal refers to nine forms of negotiation of tax debts, such as transaction in administrative or legal phase, judicial transaction in case of bankruptcy, preventive transaction, etc
 - Certain requirements should be met, such as amount involved and compliance with terms and conditions determined in the negotiation
 - Present situation: under analysis in the House of Representatives

Other Possible Bills of Law, continued

- CSS (Financial tax)
 - Charged at 0.1% on all financial transactions performed in the country. Tax revenues should finance health programs only
 - The CSS is a similar tax to the CPMF, charged in the past at 0.38%
 - Present situation: under analysis in the House of Representatives with a lot of political debate



Q&A Session



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