

DECISIONS BY THE SUPERIOR TRIBUNAL OF JUSTICE CREATE IMPORTANT PRECEDENTS FOR BANKS

Recent decisions by the Superior Tribunal of Justice (Superior Tribunal de Justiça – STJ), Brazil’s highest court in non-constitutional matters, may finally put an end to the thousands of actions for revision of contracts between banks and their customers. In the five decisions, the Second Section of the STJ resolved 40,000 actions brought by accountholders and consumers against financial institutions, or more than 10% of the 360,000 appeals awaiting judgment by the Court. The STJ’s judgments will clear up the backlog of pending cases and provide guidance that will ensure more uniform decisions by the lower courts in proceedings involving banking law. The decisions were made possible by the new Law 11.673, more commonly known as the Law of Repetitive Proceedings, which amended article 543 of the former Code of Civil Procedure when the Law came into force in August of 2008.



Camila Goldberg, sócia da área de
Mercados Financeiro e de Capitais

For attorney Camila Goldberg, a partner in BM&A’s financial and capital markets area, the most important decision was the one in which the STJ determined that the Court cannot establish a ceiling on interest charged by banks. According to Goldberg, although the former Restatement of Precedents issued by the Superior Federal Tribunal (the Superior Tribunal Federal – STF, Brazil’s highest court), Súmula 596, established that financial institutions are not subject to the 12% per year limit on interest imposed by the Usury Law of 1933, the lower courts did not always follow the STF’s interpretation of the law when faced with allegations that the interest rates imposed by banks were abusive. “Now the STJ has made it clear that the stipulation of interest at rates higher than 12% a year is not, in and of itself, an indication of abuse, and the courts will revise interest rates only in exceptional circumstances,” she affirms.

Aside from the question of interest rates, the STJ’s decisions also deal with late-payment interest, default, reporting of debtors to credit bureaus and ex officio revision by the courts of contractual provisions. Of the five issues, four were decided in the banks’ favor, with only the judgment on late-payment interest going against the banks. On this matter, the STJ found that in contracts with banks that are not governed by specific legislation, late-payment interest cannot be higher than 1% per month. Goldberg emphasizes that in delimiting the scope of its decisions, the STJ stated that the decisions applied only to contracts for bank loans subject to the Consumer Defense Code (Código de Defesa do Consumidor – CDC).

Minister Nancy Andrighi, president of the second section of the STJ and the reporting justice in the case, affirms that the judgments settle almost all the issues involved in actions for revision of bank contracts now before the courts. According to the Minister, however, it is difficult to put a complete end to this type of action, since new disputes can arise in the future, depending on innovations in the banking market.

For Camila Goldberg, the decisions are an important advance in banking law. “These decisions will not only reduce the number of actions pending in the STJ, which is the primary objective of the Law of Repetitive Proceedings, but will also increase legal security within the National Financial System,” she predicts. According to Goldberg, this can only be beneficial, not only for the banks – which prevailed in four of the five decisions – but also for the banks’ clients: with these important issues settled, the banks may even reduce their spread, since default and difficult enforcement of debts have a significant influence on the rates charged by banks.

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CVM DECIDES TAG-ALONG RIGHTS DO NOT APPLY IN MERGER TRANSACTIONS

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Recently, on two separate occasions Brazil's Securities Commission, the Comissão de Valores Mobiliários – CVM, decided that article 254-A of the Corporations Law (Lei das Sociedades Anônimas – LSA) did not apply in mergers, even where the transaction resulted in a change of control of a publicly-traded company. The first decision was issued by the Commission in plenary session in June of this year, in the case involving an association between Petrobras and Unipar which resulted in a change in control of Suzano Petroquímica. This decision then served as a basis for a second decision issued by the Registry of Public Offerings (Superintendência de Registro de Valores Mobiliários – SRE) in October of 2008 on the Datasul/Tovts, Tenda/Gafisa and Company/Brascan transactions. The CVM's decisions are particularly important because they are the first in Brazil to deal specifically with the question of tag-along rights in mergers.

In all four cases, the requirement to make a public tender offer for shares was found not to apply because the change in control occurred by reason of a merger within the context of an effective consolidation of assets. In the CVM's view, mergers (including stock swap transactions that result in one company becoming a wholly-owned subsidiary of the other, which are known as "stock mergers" in Brazil), even if they result in a change of control, do not constitute a sale of control and therefore do not trigger the public tender offer provisions of the LSA.

In mergers, the shareholders, including the controlling shareholder, of the merging company are diluted by reason of the shares issued in exchange for shares in the merged company. In the Suzano and Tenda cases, the dilution was so great because of the values of the companies involved that it brought about a change in control. In other words, the merging companies were smaller than the merged companies.

In the Datasul and Company transactions, shares in these companies were first exchanged for shares in subsidiaries of Tovts and Brascan, and the subsidiaries were then merged into their controlling companies, unifying the shareholder base. In these cases, the merged companies were smaller, and the mergers resulted in a change in control of Datasul and Company.

In all the transactions, the change in control was not only an effect of the merger but also one of its objectives, and was certainly negotiated by the parties. This, however, does not necessarily make the mergers sales of control for the purposes of the public tender offer provisions of the LSA.

One fundamental difference in the Suzano case is that unlike the other transactions, the merger occurred at the level of the controlling shareholder of a publicly-traded company, which required a particularly detailed analysis of the merger in the specific circumstances of the case. When a publicly-traded company is directly involved in a merger, all its shareholders,

both controlling and minority, are equally affected, in proportion to their holdings in the company.

In the Suzano decision, a majority of the Commission agreed with the opinion written by Commissioner Marcos Pinto. In his view, the LSA's provision for public tender offers on sale of control must be interpreted literally in order to ensure legal security, given the various and uncertain conceptions of the legislator's objectives in imposing the requirement to make a public tender offer.

The Commission reversed the SRE's decision in the case, which was based on the CVM's power under article 29 §5 of CVM Instruction 361/02 to require a public tender offer "whenever it determines that an onerous alienation of control of a publicly-traded company has occurred", a provision which focus more on the result of the transaction than the means of achieving it. In the SRE's view, the transaction between Petrobras and Unipar constituted a transfer of control of Suzano, with payment in kind, even though it was carried out in the form of a merger. In his minority opinion, Commissioner Sergio Weguelin agreed with the SRE, finding that the merger amounted to an indirect transfer of control, based on the Commission's decision in the Pão de Açúcar supermarket case.

In the end, however, the literal terms of the LSA prevailed, which define "sale of control" (alienação de controle) for the purposes of article 254-A in a circular fashion: the direct or indirect transfer of shares, subscription rights or other securities or rights that results in a sale of control. Thus, according to the CVM, the fact that a new controlling shareholder arises as a consequence of a merger transaction, without any effective assignment of any security or right, does not constitute a sale of control within the meaning of the legislation and accordingly does not trigger the requirement to make a public tender offer.

From a theoretical point of view, mergers were classified as transactions from which control originates, which now include both situations in there is no previous controlling shareholder, as in the case of the recent purchase of ABN Amro, and situations in which the former controlling shareholder ceases to hold control without transferring or receiving any asset or advantage. The CVM also found that it would be exceeding its powers if it required a public tender offer when the legislation did not impose such a requirement in corporate transactions governed by specific provisions of the LSA, as in the case of mergers and stock mergers.

Aware of the risks that the CVM's decisions can create, both the Commission and the SRE warned that the concrete circumstances of each transaction must be examined in order to determine whether the parties' decision to enter into a merger was made for the purposes of avoiding the legal requirement to make a public tender offer. In such a case, a public tender offer would be required.

REAL ESTATE INVESTMENT FUNDS: A POWERFUL FUND-RAISING TOOL

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The financial crisis seems to have produced the push that was needed to revise Brazil's regulations on Real Estate Investment Funds (Fundos de Investimento Imobiliário – FIIs). On October 31, 2008, the CVM issued CVM Instruction 472, revoking CVM Instruction 205 and simplifying the process for creating and registering FIIs and distributing fund units. The process is now substantially the same as for other funds regulated by the CVM. The new regulations go even further, however, and make FIIs a modern and powerful tool for raising funds.

The most significant innovation is probably the flexibility in the types of investments FIIs can make, introduced by article 45 of CVM Instruction 472. FIIs can now invest in any kind of real rights in real estate; shares, debentures, bonuses, subscription rights and receipts, investment fund units, promissory notes and any other type of security authorized for issuance or trading by the CVM and issued by entities whose preponderant activity is one permitted for FIIs; shares in specific purpose companies in the area of real estate; units in Private Equity Funds (Fundos de Investimento em Participações- FIPs) which invest exclusively in construction or real estate; Additional Construction Rights Certificates (CEPACS – Certificados de Potencial Adicional de Construção, which are certificates issued by municipalities as a way of raising funds for urban improvement projects in exchange for a certain area that the holder can use additional construction or to modify uses of land or projects); units in other FIIs; real estate receivables or units in Receivables Investment Funds (FIDCs – Fundos de Investimento em Direitos Creditórios); and investment certificates issued by banks backed by mortgages or other security interests in real estate. The regulations also permit FIIs to invest part of their resources in investment fund units and public or private fixed-income securities, without any rigid percentage limit, as long as such securities are acquired to meet the funds' liquidity requirements.

As a result of these changes, FIIs can represent an attractive alternative investment vehicle, in some cases. For example, qualified investors which invest in special purpose companies (SPCs) can make their investment through an FII, with limitation of liability to the amount invested, rather than through a private equity fund (FIP), in which this legal limitation of liability does not exist. The difference is that FIIs are based on Law 8.668/93, which limits liability, while FIPs and other investment funds created under CVM regulations do not enjoy the same legal protection. Moreover, SPCs in which FIIs invest are not required to adopt the same standards

of corporate governance required of closely-held companies in which FIPs invest. In fact, the SPCs in which FIIs invest need not take the form of corporations (sociedades anônimas) and can be incorporated in the simpler form of a limited liability companies (sociedade limitada).

Another example is investment in real estate-backed receivables, which can now be made not only through an FIDC but also through an FII, giving the investor the advantage not only of limited liability in addition to the tax treatment applicable to investments in FIIs, which can be more favourable because of tax exemptions enjoyed by FIIs in comparison to FIDCs. The possibilities are many, and must be analyzed on a case-by-case basis.

Other innovations under CVM Instruction 472 relate to FIIs directed exclusively to qualified investors. For these funds, it is possible to obtain a waiver of the prospectus, publication and evaluation requirements, and the regulations provide for the possibility of paying in units of the fund by transfer of securities (art. 55). Another change worth mentioning is the regulations' express provision for reorganization of FIIs, including merger and split.

Although CVM Instruction 472 does not go so far as to authorize an FII to engage directly in the enterprise in which the fund invested, it does allow the administrator of the fund "regardless of whether [the administrator] engages specialized third parties, to exercise effective control over the development of the project" (art. 45 §1). The regulations do not permit the creation of encumbrances against real estate held by the fund (art. 35 (X)), but do expressly state that this restriction does not prevent the acquisition of encumbered properties (art. 35 §1). FII administrators continue to be prohibited from granting or taking loans (art. 35 (III)), but it is possible for FIIs to make advances for construction projects, including the purchase of land, construction work and market launch of the project (art. 45 §2).

In short, FIIs now have great potential and open a range of investment alternatives, particularly for qualified investors. In fact, it is likely that investments initially made through other vehicles will migrate to FIIs. Existing funds can be transformed into FIIs, on the favourable vote of unitholders representing at least one-half of the fund's issued units at a General Meeting of Unitholders (art. 64).

As a final note, CVM Instruction 472 requires existing FIIs to adapt their rules to the new regulations within a period of six months (art. 66).

THE CONTROVERSY OVER BANK FINANCING CERTIFICATES

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One of the most hotly-disputed legal issues in 2008 was whether Bank Financing Certificates are simple debt instruments or whether they are also securities. Bank Financing Certificates, or CCBs (Cédulas de Crédito Bancário) are issued by borrowers in favour of the lending bank, and represent a promise to pay in money, similar to a promissory note. CCBs not only facilitate recovery of loans in default, since the bank can enforce them directly through expedited execution proceedings rather than an ordinary action, but they can also be traded on the secondary market.

The controversy arose out of a consultation by a Brazilian financial institution to the Brazilian Securities Commission (CVM) on the question of whether a public placement of CCBs would require the CVM's prior authorization. In the past, CCBs had been placed by banks with qualified investors, but never with the public.

The question was considered by the Commission in plenary session, and the Commissioners unanimously agreed that CCBs are securities, since they fall squarely within the concept of collective investment instruments set out in art. 2 (IX) of Law 6.385/76, and that trading in CCBs will be subject to CVM rules when: (i) they are distributed through a public offering and (ii) the bank's liability for payment is expressly excluded from the instrument. This decision generated a great deal of discussion among academics and practitioners, who in large part disagreed with the Commission.

The concept of a collective investment instrument used by the CVM was inspired by decisions of the United States Supreme Court on the definition of a security. Analysis of this concept reveals five essential elements of a security: (1) the intention to make an investment; (2) an investment formalized through an instrument or contract; (3) collective investment; (4) the expectation of profit; and (5) gains produced by the efforts of the entrepreneur or third parties, with the right to share in the profits of the common enterprise.

Applying these elements to CCBs, it can be seen that not all are present, despite the CVM's position. The fifth element does not apply in the case of CCBs, since the certificates are issued simply to represent a debt, not to carry out a common enterprise.

As the legal commentators point out, as a rule the issuing CCBs does not reflect a transaction in which the investor, in exchange for the certificate, delivers funds to be used in developing or carrying on the issuer's business. On the contrary, in the case of CCBs the disbursement of funds by the bank precedes the issuing of the certificate, which is intended merely to represent the debt, in order to facilitate collection and circulation of the instrument.

Unlike an investor in the equities market, the holder of a CCB does not assume the risk of the issuer's business: the interest stipulated in the certificate is owed whether the issuer's business succeeds or not.

Thus, payment of the CCB depends on the financial capacity to honor its obligations, but the yield on the CCB does not depend on the efforts of any other party, since interest is payable on the capital amount of the loan and is not linked to any underlying business activity. Formally speaking, therefore, CCBs do not fall within the concept of a security under Brazilian law and it would follow that CCBs are not subject to the CVM's jurisdiction.

Still, an isolated examination of the text of the applicable legislation and regulations is not enough to determine the real scope and meaning of the law. Practical issues will also influence the definition of security within the regulatory system. Here again, however, the legal literature points to structural differences that prevent CCBs from being securities, in three different aspects: with respect to the issuer, the assignor and the assignees of the certificates.

With respect to the issuer, it cannot be supposed that a bank in whose favor a CCB was issued could force the original issuer to submit to registration with the CVM in connection with a public offering.

As to the assignor (the banks), a structural distortion also exists, since treating a CCB as a security would produce an unacceptable situation in which an offeror sells a "security" through a public offering on the stock market, but assumes no responsibility or liability for the "security" it offers.

Turning to the assignees (the investors), a public offering of a CCB would put them in the position of co-owners of the certificate, but in the general co-ownership within the meaning of the Civil Code, not the special co-ownership such as exists for investment funds, and therefore without the protection of regulations that protect the investing public.

In short, CCBs are thus formally and structurally incompatible with the concept of a security and should not be subject to the CVM's jurisdiction.

In practice, however, that the CVM has taken the position that CCBs are securities if they are distributed through a public offering and the bank's liability for payment under the certificates is expressly excluded, and that the CVM has jurisdiction in such cases. In fact, the CVM recently submitted for public comment draft regulations on public offerings of securities with limited sales efforts, which will be used principally to govern offerings of CCBs.

SHARE BUY-BACKS AND RECIPROCAL HOLDINGS

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As a rule, in Brazil companies are prohibited from trading in their own shares (art. 30 of Law 6404/76). The prohibition, which originates in the principle that the capital of a company should not be reduced, is not absolute, however. Among other exceptions, the legislation provides that companies may acquire their own shares to be kept in treasury for sale at a later date or for cancellation (art. 30 §1 of Law 6404/76).

Accordingly, as long as companies use available profits or reserves, and their capital does not decrease as a result of the acquisition, companies can buy shares they have issued and maintain them in treasury for later sale or cancellation. The question that this article addresses is whether a publicly-traded company which does not have available profits or reserves can acquire its own shares through a controlled company that does have the necessary funds.

Acquisition of shares by a controlled company results in reciprocal shareholdings, with each company holding shares in the other. The same principles that prohibit a company from trading in its own shares also, as a rule, prohibit reciprocal shareholdings (art. 244 of Law 6404/76). However, the Law also provides that this prohibition does not include the cases in which companies are permitted to acquire their own shares (art. 244 §1). In other words, in order to determine whether a controlled company can acquire shares issued by its controlling shareholder, one must examine the cases in which the controlled company can acquire its own shares.

The prohibition against trading in a company's own shares is based on the principle that the company's capital should remained unchanged, and seeks to prevent the company from carrying out an indirect reduction in its capital, paying out the amount of the reduction to the shareholders and weakening the security the company's capital represents for its creditors without complying with the provisions intended to protect creditors.

A company's acquisition of its own shares is regulated by CVM Instruction 10/80, which also applies to acquisition of a publicly-traded company's shares by a related or controlled company (arts. 2 and 22). The Instruction establishes procedures that must be adopted by publicly-traded companies when they trade in their own shares, which are intended primarily to prevent the creation of artificial trading conditions and reduction of the company's capital, and to ensure that the transaction is disclosed to the public.

Article 2 of CVM Instruction 10/80 prohibits the direct or indirect acquisition of shares by the issuing company when it would (i) result in a reduction of capital; (ii) require the use of funds in amounts greater than the profits or reserves shown on

the last balance sheet; (iii) create, directly or indirectly, by action or omission, artificial conditions of demand, offer or price of the shares or involve unfair practices; (iv) involve shares not yet paid in or shares belonging to the controlling shareholder; or (v) take place during a public tender offer for the shares.

However, if these restrictions are respected, publicly-traded companies can acquire their own shares, with the approval of their Board of Directors and after due disclosure to the market.

The legal literature on the subject warns of the problems related to the acquisition of a company's shares by its controlled company. While the authorities agree that such a transaction is perfectly possible where the legal requirements are met, they all recommend that precautions be taken to ensure that the controlled company's acquisition of its controller's shares does not result in allegations that the transaction is a mere sham.

Ideally, the controlled company should have its own operational activity and the funds used to acquire the controller's shares should be profits from the controlled company's operations or legitimately created reserves.

In Administrative Proceeding RJ-2007-11413, the CVM in plenary session held that a controlled company cannot acquire shares issued by its controlling shareholder when the controlled company does not have accumulated profits or reserves to carry out the acquisition. The CVM concluded, therefore, that if a controlled company does have sufficient accumulated profits or reserves, it can proceed with the acquisition.

In light of the CVM's decision, in Brazil controlled companies are permitted to acquire shares issued by their controlling shareholders, provided they have sufficient accumulated profits or legitimately created reserves to do so, and they comply with the requirements under applicable legislation and regulations, particularly art. 30 §1 and art. 244 of Law 6404/76 and CVM Instruction 10/80.

In conclusion, a word of warning: an acquisition of shares that results in a reciprocal shareholding contrary to art. 244 of Law 6404/76 not only constitutes a serious violation of CVM Instruction 10/80, but also exposes the management of the company to civil and criminal liability (art. 244 §6).

Faced with the significant decrease in the price of shares traded on the stock market, a number of companies have announced their intention to buy back their own shares, in order to take advantage of the low price of the stock, or to signal to the market management's confidence that the stock will recover.

INCONSISTENCY IN THE APPLICATION OF THE RECENT REFORMS TO THE CODE OF CIVIL PROCEDURE

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Recently, a number of changes were made in the Code of Civil Procedure's provisions on interlocutory appeals (*agravo de instrumento*), performance of judgments, expedited execution proceedings (*execução de título extrajudicial*) and the use of digital technology in legal proceedings (Laws 11.187, 11.232, 11.382 and 11.419). The Brazilian courts, however, have been inconsistent in applying the new legislation, generating a certain level of uncertainty in the legal community, and not enough time has yet passed to consolidate the judiciary's understanding of the law.

Law 11.187, which establishes that appeals on interlocutory decisions will be retained until an appeal on the merits, if any, is heard, has had little effect on attorneys' habitual practice of filing interlocutory appeals. Under Law 11.187, the use of the interlocutory appeal is restricted, as a rule, to cases of manifest urgency. Nonetheless, generally speaking the appeal courts have continued to process interlocutory appeals, even when the appellant fails to demonstrate the urgency of the case.

Law 11.232/2005 introduced a new provision to the Code of Civil Procedure, article 475-J, which is intended to encourage speedy compliance with money and liquidated judgments by imposing a fine of 10% if the judgment debtor does not pay within 15 days. More than two years after the Law came into force, there is still no agreement among the appeal courts as to when the 15-day time period begins to run. In fact, the courts' decisions have produced four different interpretations: the 15 days start to run (a) from the date the judgment becomes final; (b) from date notice to pay, addressed to the debtor's attorney, is published in the *Judicial Gazette*; (c) from the date the debtor is personally served with notice to pay (this is now the consolidated position of the Rio de Janeiro appeal court); and (d) from the date on which the judgment creditor files execution proceedings, in which the creditor is required to submit a calculation statement showing the current value of the judgment debt.

The appeal courts also diverge as to whether the 10% fine provided for in article 475-J applies to provisional execution of judgment, with decisions both for and against application of the fine.

There is also inconsistency on the question of whether the judgment debtor can be ordered to pay the

judgment creditor's attorneys' fees in the execution phase. Some appeal courts take the position that attorney's fees are owed when the debtor fails to pay the judgment debt, compelling the judgment creditor to bring execution proceedings to collect. Other courts hold that even when the judgment debtor unsuccessfully contests enforcement of the debt in execution proceedings, the judgment creditor is not entitled to an award of attorney's fees.

Another controversial point on payment of money judgments and liquidated awards is whether the judgment debtor must deposit security into court in the full amount of the judgment in order to contest execution. In one decision, the appeal court of São Paulo held that the debtor can contest execution of the judgment, even though security in the full amount of the debt has not been deposited, while the appeal court of Minas Gerais has found that any contestation can only be heard after the full amount has been deposited. There are still other decisions holding that the debtor can be cited in execution proceedings only after sufficient security for the judgment has been deposited.

As for the changes to expedited enforcement proceedings introduced by Law 11.382, they too have generated contradictory decisions. In São Paulo, for instance, some decisions have held that under the new Law the defendant may no longer contest execution on the basis of preliminary questions going to the validity of the instrument on which the proceeding is based or the enforceability of the debt itself, while other decisions have allowed debtors to make preliminary arguments in cases of manifest nullity of the execution proceeding. In procedural terms, the advantage of these preliminary arguments, or "*exceções de pré-executividade*", is that the defendant is not required to deposit security into court for the amount under collection, in contrast with the ordinary means of contesting an execution proceeding, which is the objection to execution or "*embargos à execução*".

The use of electronic documents in judicial proceedings, introduced by Law 11.419, is also being unevenly implemented by the courts. Some courts are already using electronic filing, while others have done no more than begun publishing the *Judicial Gazette* electronically. This is yet another example of the lack of uniformity in the Brazilian courts, particularly where the application of the recent procedural reforms are concerned.

FOREIGN INVESTMENT IN LIMITED COMPANIES: IS GOVERNMENT AUTHORIZATION REQUIRED?

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BM&A opens new tax and intellectual property consulting firms

Barbosa, Müssnich & Aragão's new consulting firms BM&A Propriedade Intelectual, specialized in Intellectual Property, and BM&A Consultoria Tributária, specialized in Tax, opened in November 2008.

BM&A Tax will give clients a broader range of services in developing their tax projects and tax planning.

BM&A PI – Intellectual Property unites the intellectual property practices of Barbosa, Müssnich & Aragão and Carminatti Schulz. The partners of Carminatti Schulz, Antonella Carminatti, Claudia Schulz and Ana Cristina Müller, will be responsible for the new firm.

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The press has reported recent first instance court decisions which held that foreign companies that intend to acquire interests in Brazilian limited companies (sociedades limitadas) must have government authorization.

The recent decisions dealt with the question of foreign holdings in limited companies in an incidental manner, in the context of proceedings on other matters, such as applications for bankruptcy and actions to hold shareholders liable for labor obligations, and cannot be seen as a consolidated interpretation of article 1134 of the Code. Still, the question is not new, and in fact was discussed in an article in BM&A Review no. 4 in 2004. The origin of the issue is article 1134 of the Civil Code: "A foreign company, regardless of its purpose, may not operate in the country without the authorization of the Executive Branch, even through subordinate establishments, although it may, except in those cases expressly provided for by law, be a shareholder of a Brazilian corporation."

The text of article 1134 reproduces article 64 of Decree-Law 2527/1940 almost exactly, without any attempt to adapt the provision to the modern context, and therefore requires a certain amount of effort on the part of the interpreter in order to avoid absurd conclusions. The article has two distinct parts. The first prohibits foreign companies from operating directly in Brazil without government authorization. The second part clarifies that such authorization is not required for foreign companies to hold shares in Brazilian corporations.

In the context of Decree-Law 2627/1940, which dealt exclusively with corporations (sociedades anônimas), it was clear that the provision referred only to that form of business organization. Imported into the Civil Code, the clarification made in the second part of the text has led some to the conclusion that foreign companies can invest without government authorization only in Brazilian corporations, or, put another way, that government authorization is required for foreign companies to invest in Brazilian limited companies.

However, a provision that expressly permits foreign companies to invest in corporations without government authorization does not mean that government authorization is required for investment in other types of companies. In effect, the requirement for government authorization relates only to direct operations in Brazil by foreign companies, and the purpose of the rule is – and always was – to prevent foreign companies from operating in Brazil without any means for the Brazilian government to inspect and regulate them. A legal entity incorporated in another country cannot create branches, agencies or establishments in Brazil (all of which are forms of direct operation) without due authorization, granted in the exercise of Brazil's national sovereignty. On the other hand, the simple holding of an equity interest in a Brazilian company (a form of indirect operation) does not offend national sovereignty. In fact, the making of the investment is subject to a series of controls (such as publication of the incorporating instruments of the investing company, its registration in Brazil's federal register of taxpayers, the CNPJ, and registration of the investment with the Brazilian Central Bank). And, of course, the Brazilian company in which the investment is made is subject to the jurisdiction of Brazilian authorities.

This reasoning is reflected in the fact that the National Business Registration Department (the Departamento Nacional do Registro do Comércio – DNRC) does not require submission of government authorization in order to file the corporate instruments and acts of limited companies which have foreign investors. None of the States' Boards of Trade, which are directly responsible for ensuring the legality of corporate acts, impose such a requirement. And the Federal Constitution itself, after Constitutional Amendment no. 6 of August 15, 1996, makes no mention of any difference in the treatment given to Brazilian companies which have only national shareholders and those which have foreign investors.

For these reasons, the best interpretation of article 1134 of the Civil Code is that foreign companies do not require government authorization to invest in Brazilian limited companies, and it is likely that this interpretation will prevail when the question reaches the superior courts.

FEDERAL TREASURY PUBLISHES NEW INTERPRETATION ON TRANSFER PRICING RULES

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On September 24, 2008, the Brazilian Federal Treasury (Ministério da Fazenda) issued regulations on the fixing of percentages and profit margins for determining transfer prices under Ministerial Order (Portaria) 222. Under the regulations, transfer prices are fixed by application to the Brazilian Federal Revenue Service, in a procedure very similar to the advance pricing method (APA) provided for under United States tax legislation. The application results in an administrative proceeding to determine transfer prices, and is not merely a request for the Revenue Service's interpretation of transfer pricing rules.

Transfer pricing, which was introduced into Brazilian law in 1997 by Law 9430, is intended to correct distortions in the valuing of international transactions between related parties. In the case of imports, if the price of the imported goods is higher than the amount determined under one of the pricing methods established in the legislation, the difference will be included in the calculation of taxable profit. In export transactions, if the price of the exported goods is less than the amount determined under one of the pricing methods, the Revenue Service can adjust the amount of the exporter's revenue from the transaction. In practice, transfer pricing rules prevent the manipulation of revenues and expenses by over-invoicing imported products and under-invoicing export products.

The fact is, however, that the methods established in the legislation are often not sufficient to determine if the taxpayer has complied with the transfer pricing rules, due to lack of information on competitors' prices or the composition of the product's cost. In these cases, where the taxpayer is exposed to the imposition of deemed prices for tax purposes and consequent adjustments in their taxable income, Law 9.430 provides that the Federal Treasury can alter the percentages established in articles 18 and 19 of the Law for fixing transfer prices.

Ministerial Order 222 now establishes the procedure taxpayers must follow to apply for a change in the percentages fixed by law. Basically, the process begins with an application to the Brazilian Federal Revenue, made either by an organization which represents an entire economic sector or profession on a national scale or by the taxpayer itself. The application must state the tax classification of the products involved under the Mercosur Common Nomenclature (NCM), and demonstrate the technical criteria, consistency and uniformity of the samples used in the research and studies to support the application. The Ministerial Order also establishes certain parameters for transfer pricing applications, in view of the peculiarities of each transfer pricing method.

The procedure established under Ministerial Order 222 is quite similar to Advance Pricing Agreements provided for under United States law. The main difference between Ministerial Order 222 and APAs relates to their scope. APAs are used not only to fix transfer pricing margins for the purposes of internal tax legislation, but also for the purposes of international agreements to avoid double taxation entered into between the United States and other countries. In contrast, the scope of applications under Ministerial Order 222 is limited to national legislation, and does not extend to double taxation agreements between Brazil and other jurisdictions.

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