

## TAX NEWSLETTER

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Provisional Measure ("*Medida Provisória*") No. 472, of December 15, 2009, published in the Brazilian Official Gazette on December 16, 2009, introduced important modifications to Brazilian tax law. The most important modifications are addressed herein. These modifications entered into force and became effective as from December 16, 2009, except as otherwise stated below.

### 1. SPECIAL TAX REGIMES AND TAX BENEFITS

The following special tax regimes providing for tax advantages were created:

- REPENEC – Special Regime for Incentives to the Development of Oil Industry Infrastructure in the North, Northeast and Middle-West Regions of Brazil (Articles 1 to 5);
- RECOMPE – Special Regime for the Acquisition of Computers for Educational Use, within the PROUCA – Program of One Computer per Student (Articles 6 to 14); and
- RETAERO – Special Regime for Tax Incentives to the Brazilian Aeronautical Industry (Articles 30 to 34).

In general, these special regimes provide for the suspension of the Social Contributions on Gross Revenues (PIS and COFINS), of the Social Contributions on Imports of Goods and Services (PIS on Imports and COFINS on Imports), of the Federal Excise Tax (IPI), and of the Import Duty, as the case may be, in the case of sales carried out in the Brazilian domestic market, or in the import of raw material, intermediary products, merchandise and equipment in general, as well as in the rendering of services, provided that certain requirements are met.

In addition to the creation of the aforementioned regimes, Provisional Measure No. 472/09 also:

- Modified the rules related to the enjoyment of benefits of exemption/reduction of the IPI with respect to the increase in performance and competitiveness in the field of information technology and automation, dealt with under Laws No. 8,248/91 and No. 8,387/91, in connection with the Basic Productive Process – PPB (Articles 15 and 16);
- Postponed to December 31, 2014 the term of effectiveness of the Digital Inclusion Program, reducing the rates of the PIS and COFINS levied on gross revenues deriving from retail sales of computers (Article 17); and

- Modified the reach of the benefits related to the Program Supporting the Technological Development of the Semiconductor Industry – PAIS and the Special Regime for Incentives to the Development of Infrastructure – REIDI.

## 2. IRRF, CIDE, PIS ON IMPORTS, AND COFINS ON IMPORTS ON IMPORTS OF SPECIFIC SERVICES – ZERO PERCENT RATE AND NON-LEVY

The payment, credit, delivery, employment or remittance of funds, by an individual or legal entity that is a resident of or domiciled in Brazil, to a recipient that is a resident of or domiciled outside Brazil, as compensation for the provision of certain services by the latter to the former provided for under the Agreement on Sanitation and Phytosanitation Measures and the Agreement on Technical Barriers to Trade, both of the World Trade Organization – WTO, now benefit from:

- Reduction to zero percent of the rate of the Withholding Income Tax (IRRF) and of the Social Contribution of Intervention in the Economic Domain (CIDE) (Article 18); and
- Non-levy of the PIS on Imports and COFINS on Imports (Article 19).

These tax benefits shall not apply if the party providing the service:

- Is a resident of or domiciled in a tax favorable country or location (as defined under Article 24 of Law No. 9.430/96); or
- Benefits from a privileged tax regime (as defined under Article 24-A of Law No. 9,430/96).

## 3. SECURITIZATION COMPANIES–MANDATORY ELECTION OF THE "ACTUAL PROFIT METHOD" ("*LUCRO REAL*")

Certain legal entities domiciled in Brazil are required to calculate and pay the Corporate Income Tax (IRPJ) and the Social Contribution on Net Profits (CSLL), an IRPJ surtax, pursuant to the "actual profit method" ("*lucro real*"). This requirement may result from the amount of gross revenues of the legal entity, from the type of activity carried out by this entity, or from other circumstances related to this entity. Provisional Measure No. 472/09, in its Article 22, added to the list of legal entities that are required to adopt the "actual profit method" the entities which explore the activity of securitization of real estate, financial and agro-business credits.

## 4. THIN CAPITALIZATION RULES

In Brazil, no legal provision requiring minimum proportions between debt and equity of legal entities (so-called "thin capitalization rules") existed. With the enacting of Provisional Measure No. 472/09, Brazilian legal entities are now required to comply with rules that have the nature of "thin capitalization", with respect to the deduction, from the taxable bases of the IRPJ and CSLL, of the interest related to loans obtained from (Articles 24 and 25):

- Related parties that are resident of or domiciled outside Brazil, according to the definition provided for under Brazilian tax law for the purpose of transfer pricing (Article 23 of Law No. 9,430/96); or
- An individual or legal entity that is a resident of or domiciled in a tax favorable country or location (Article 24 of Law No. 9,430/96) or that is under a favorable tax regime (Article 24-A of Law No. 9,430/96).

In the first situation, the interest can only be regarded as deductible from the taxable bases of the IRPJ and CSLL when, considering the moment the interest is accrued, such interest relates to the amount of debt which does not exceed the following two limits, to be applied together:

- Two times the value of the equity interest held by the respective related company in the net worth of the Brazilian legal entity, considering each debt separately; and

- The total value of equity interests held by all related companies in the net worth of the Brazilian legal company, considering the sum of the debt transactions.

Not all individuals and legal entities that are a resident of or domiciled outside Brazil and that are considered to be related to the Brazilian legal entity, according to Article 23 of Law No. 9,430/96, hold equity interest in the Brazilian legal entity. For example, the definition of related companies for these purposes includes a branch, affiliate, a company controlled by the Brazilian company, a consortium member, a company under common control with the Brazilian company, among others. Provisional Measure No. 472/09 has not defined, in such situations, how the debt limitation must be calculated.

In the second situation, i.e., loans obtained by a Brazilian legal entity with an individual or legal entity that is a resident of or domiciled in a tax favorable country or location, or that is under a tax favorable regime, the interest can only be regarded as deductible from the taxable bases of the IRPJ and CSLL when, considering the moment the interest is accrued, such interest relates to the amount of debt that does not exceed 30% of the net worth of the Brazilian legal entity, considering:

- Each debt separately; and
- The sum of debt transactions.

"Debt", for the purposes above, comprises all of the forms and terms of financing, regardless of the registration of the respective agreement with the Brazilian Central Bank, as well as the transactions in which the related company or the company that is a resident of or domiciled in a tax favorable country or location, or that is under a favorable tax regime, does not act as creditor, but, instead, as co-signor, guarantor, attorney-in-law, or intervening party.

Transfer pricing rules existing under Brazilian tax law remain applicable, together with the new limitations for the deduction of interest addressed above.

#### 5. REMITTANCES TO INDIVIDUALS OR LEGAL ENTITIES IN TAX FAVORABLE COUNTRIES OR LOCATIONS OR IN FAVORABLE TAX REGIMES – CONDITIONS TO DEDUCTION

Pursuant to Article 26 of Provisional Measure No. 472/09, the amounts of any kind that are paid, credited, delivered, employed or remitted, directly or indirectly, by legal entities domiciled in Brazil to individuals or legal entities that are resident of or domiciled outside Brazil and submitted to the treatment of a tax favorable country or location (Article 24 of Law No. 9,430/96), or that are under a favorable tax regime (Article 24-A of Law No. 9,430/96), shall be regarded, as a rule, to be non-deductible from the taxable bases of the IRPJ and CSLL of the Brazilian legal entity, except if the following conditions are cumulatively met:

- Identification of the actual beneficiary of the entity domiciled outside Brazil, considering, as such, the individual or legal entity that has not been created with the sole or main purpose of tax savings and that earns the amounts on its own behalf, and not as an agent, trustee, or attorney-in-fact on behalf of a third party;
- Proof of the operational capacity of the individual or legal entity that is a resident of or domiciled outside Brazil and that carries out the transactions; and
- Documentation proving that the price was paid and that the respective goods or rights were received, or that the respective services were used.

#### 6. EXPATRIATION OF BRAZILIAN INDIVIDUALS – CONCEPT OF TAX RESIDENCY

An individual who is a resident of or domiciled in Brazil and who transfers his or her residency to a tax favorable country or location (Article 24 of Law No. 9,430/96) or to a favorable tax regime (Article 24-A of Law No. 9,430/96) shall remain a resident of Brazil for tax purposes until (Article 28):

- He or she proves that he or she is an actual resident of the non-Brazilian jurisdiction (i) by proving that he or she has remained in that jurisdiction for more than 183 consecutive or non-consecutive days within a period of up to 12 months; or (ii) by proving that his or her family resides in that jurisdiction and that the majority of his or her assets is physically located in the "listed territory".
- He or she demonstrates that, because of the laws of the non-Brazilian jurisdiction, he or she is subject to the tax on income considering the taxation of the total income derived from work and from capital, by presenting the documents related to the actual payment of the tax on such items of income.

Provisional Measure No. 472/09 does not define "listed territory".

#### 7. COINSURANCE PREMIUM – PIS ON IMPORTS AND COFINS ON IMPORTS

Article 29 of Provisional Measure No. 472/09 increased the taxable bases of the PIS on Imports and of the COFINS on Imports from 8% to 15% of the respective amount paid, credited, delivered, employed or remitted. The combined rate of 9.25% remains in force. Such increase in the taxable bases of the PIS on Imports and COFINS on Imports shall become effective as of April 1, 2010.

#### 8. TRANSFER PRICING – PROFIT MARGIN IN THE PRL METHOD

According to Article 18 of Law No. 9,430/96, with the wording provided by Article 2 of Law No. 9,959/00, for the purpose of proving transfer pricing, the parameter price in import transactions was measured, in the case of adoption of the "Resale Price Minus Profit" – PRL method, by the arithmetic average of the resale price of the goods or rights minus:

- The unconditional discounts;
- The taxes and contributions levied on the sales;
- The brokerage fees and other fees paid;
- A 60% profit margin, calculated on the resale price after the deduction of the amounts described above and the value-added in Brazil, in the case of imported goods used in the production of other goods;
- A 20% profit margin, calculated on the resale price, in the remaining situations.

In turn, Provisional Measure No. 472/09, by means of its Article 61, Item II, revoked Article 2 of Law No. 9,959/00, that was the law providing for the two profit margins described above (of 20% and 60%).

As a result of this revocation, in principle, there is no longer a legal provision dealing with the profit margins which must be used for the purpose of calculating the PRL method. This, in practice, no longer enables the use of this PRL method for transfer pricing purposes.

It is possible that such revocation results from a mistake. It is also possible that another legal provision is created to deal with this situation. Until the date of this newsletter, however, such situation had still not been clarified.

#### 9. PENALTIES – INDIVIDUAL INCOME TAX

With the modifications made to Article 44 of Law No. 9,430/96 by Provisional Measure No. 472/09, the following are now subject to a 75% penalty:

- The amount of the Individual Income Tax (IRPF) to be refunded to an individual taxpayer that had been informed as such by the taxpayer in his or her Annual Income Tax Return, and that is not refunded due to the identification of an infraction to Brazilian tax law; and

- The amount of deduction and offset that are considered not to be due to an individual taxpayer, and which had been informed in this individual's Annual Income Tax Return.

This newsletter aims at commenting on the main changes recently occurred on the Tax Legislation. For further enlightenments, our professionals are at your disposal.

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