



# A Guide to Brazilian Oil & Gas Taxation

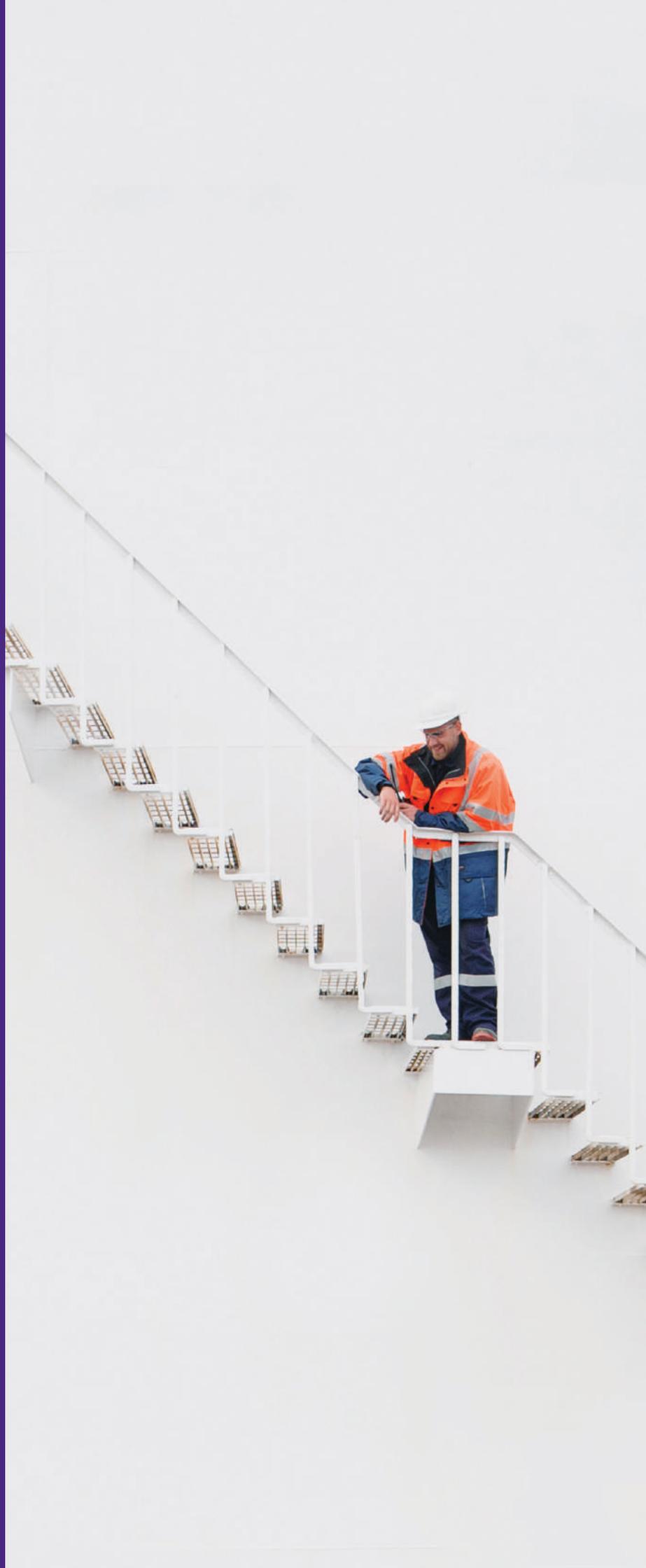
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# Welcome Introduction

As one of the main 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 957 million barrels in 2017, according to the Brazilian Agency for Petroleum, Natural Gas and Biofuels (ANP). A good example of this important advance was the signature bonus in the last ANP Bid Rounds for Pre-Salt areas, totalizing R\$ 9.3 billion. This highly productive areas had been contributing to oil production, which has grown 4%, if compared to 2016.

Such new discoveries, especially in the pre-salt area located off the coast, are considered as the largest discoveries in the world 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 unconventional and pre-salt areas. In 2017 occurred the 14th gas and oil exploitation bidding round, which marks the resumption of the sector in Brazil, with the biggest signature bonus ever – approx. US\$ 1.07 billion.

In the context of barrel prices drop, it has been noticed an increasing volume of M&A activity, and the resumption is also showed by as an unprecedented presence of newcomers starting operating in different levels of the supply chain. The projections show that the bidding rounds in 2019 may result in US\$ 80 million of new investments, during the contracts.

After dark times of barrel prices below \$40, industry showed its resilience, combining leaner operations with efficiency, and deep water exploration, as Brazilian majority of areas, survived, decreasing the lifting cost, especially in pre-salt areas. Despite that, Brazilian market face challenges as economic recession and the main rating agencies reducing Brazil's investment grade; huge political instability with the impeachment of Brazilian president in 2016; and the biggest oil and gas company, 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. 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 had proven its high productivity and its technology could be consider consolidated. Besides that, onshore opportunities as the permanent offer of areas of ANP, a calendar for Bid Rounds, and initiatives as Gas to Grow and REPETRO extension are a clear signal of boost this important industry for Brazil economy.

# 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 and only “Libra” had been developing, with commercial discovery announced in November 2017. 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 no longer 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.

Periodically, ANP promotes bidding rounds, and also disclose the calendar for the next 3 years 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.

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 a huge 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, National Energy Policy Council (CNPE) stipulate a minimum percentage of local content in the public bidding rounds. 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 the blocks environment: 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. Recently, the percentage has decreased again to be more adherent to market and investors demand.

Although more flexible now, it is important that all investors 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 water area containing 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. 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. Good to mention that in the last years the ANP changed the regulation and Petrobras is no longer required to be the operator with 30% stake in the pre-salt oil and gas fields.



# 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 that world prices have been changing. This development is also due to companies that are striving to its position 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 areas 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. Important to mention that our Audit practice is market leader in auditing upstream companies in Brasil and also KPMG is the market leader for auditing oil and gas listed company in Brasil.

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.

# How to invest in Brazil

Careful planning is paramount for companies and funds aiming to take advantage of Brazil's recovering economy.

## Setting up the business

Brazilian law may not require a non-resident to have a formal presence in Brazil to do certain types of business.

Still, foreign investors may establish a formal business by way of a branch (filial), a subsidiary (subsidiária) or through third parties (distribution and sales representation agreement).

When it comes to the O&G industry, the decision to have a formal presence in Brazil depends on the type of activity to be performed. For instance, while service providers may provide cross-border support to Brazilian clients, companies engaged in E&P activities establish a local subsidiary even if acting as non-operators. Companies engaged in the core midstream and downstream business also perform its activities through a local subsidiary.

## Branches

Branches generally are subject to Brazilian law and courts with regards to its business and transactions carried out in Brazil.

Apart from the incorporation process, there is virtually no difference between

subsidiaries and branches from tax perspectives.

## Subsidiaries

Foreign investors tend to incorporate a subsidiary rather than a branch to the extent that: (i) 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 sometimes much less time consuming when compared to establishing a branch.

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

Subsidiaries must adopt one of the types of legal entity provided in Brazilian law.

## Limitadas (Limited Liability Companies)

The articles of incorporation of a Limitada follow the form of a partnership contract, generally requiring two quota holders

A Limitada is an entity separated from its quota holders. Nonresident quota holders must grant a power of attorney to a representative in Brazil who will receive notices and act on behalf of the quota holders during its 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 quota holder's participation.

## SAs (Corporations)

Law 6,404 from 1976 governs the organization and operation of SAs. SAs were designed to foster the development of the Brazilian capital market and Corporate Governance.

The SAs may be either public or privately held. Corporate capital is divided into shares, which can be ordinary or preferred (granting special rights to specific classes of shareholders). The shareholder's responsibility is limited to the value of shares held.



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

Fundo de Investimento em Participações or “FIP” is a type of investment fund (not a legal entity) designed to foster the Private Equity industry where a pool of resident or nonresident investors may gather its resources to acquire shares, debentures, subscription bonuses and other securities convertible into shares issued by corporations (SAs) or quotas of Limited Liability Companies (Limitadas).

FIP may grant some advantages to its investors, such as: (i) income and gains earned within the fund are not subject to tax; and (ii) Distributions to foreign investors are not subject to tax either provided 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)**

Consortiums are a type of unincorporated entity where two or more parties sign a joint venture agreement to engage in a specific project, for a predetermined period of time.

The consortium is regulated by sections 278 and 279 of Brazilian Corporate Law (Law 6,404 from 1976) 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 Consortium agreement must define the company’s responsibility for the Consortium operations. There are rules of joint withholding tax responsibility when the consortium fails to collect the withholding taxes levied on services contracted by the consortium.

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)**

A joint venture or consortium agreement is commonly accompanied by Joint Operating Agreements (JOA), which aims to define rules of sharing 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.

### **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). A proper registration enables future distributions and capital repatriation.

Non-residents with investments in the Brazilian financial and capital market (e.g. FIP) 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 also be subject to the 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.

### **Funding**

There are two main funding strategies available: Equity and Debt.

Equity – Equity funding by a Brazilian investor is exempt of tax. Funding carried out by a non-resident investor is levied by a Financial Tax (IOF) at a 0.38%. Exemptions may apply depending on the investment structure (ex.: FIP).

Debt – Debt funding is generally subject to IOF: (i) local debt – IOF will apply at different rates depending on the characteristics of the debt facility; and (ii) cross-border debt – IOF 6% will apply if the average term of the loan is lower than 6 months.

### **Distributions**

There are two main distribution routes provided in Brazilian law for Brazilian companies: Dividends and Interest on net equity. Other capital repatriation options may be available depending on the funding strategy adopted by investors or the investment structure (such as FIP).

### **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 low tax jurisdictions).

#### **Interest**

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

Interest linked with debt with related parties abroad (or legal entities located in low tax jurisdictions or privileged tax regimes) must comply with Brazilian thin capitalization rules (2 debt vs. 1 equity, or 0.3 vs. 1 for low tax jurisdictions and privileged tax regimes) and transfer pricing rules.

The transfer pricing parameter is determined by an index (depending on the characteristics of the debt plus a fixed margin):  
Index:

- (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 Reais; or
- (iii) 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. 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 payment of the capital gain tax due.

As from 2017, the capital gain tax applies on a bracket calculation methodology:

<b>Capital Gain Tax</b>	
<b>Parcel of the gain</b>	<b>Rate</b>
Lower than 5 million	15%
Between 5 and 10 millions	17.5%
Between 10 and 30 millions	20%
Higher than 30 millions	22.5%

Sellers located in low tax jurisdictions are subject to a flat rate of 25%.



# Tax Overview

## Introduction

Brazilian tax system is based on the principle of strict legality and other principles as defined by the Federal Constitution of 1988 and by the Federal Tax Code of 1966. There are three levels of jurisdictions and tax collection: Federal, State and Municipal Authorities.

There is a separation of jurisdictions and powers between the judiciary and the administrative boards for the judgment of tax controversies. A tax matter is usually analyzed at an administrative level before the judiciary.

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

This section applies to companies that are tax resident in Brazil. A company is resident in Brazil if incorporated under Brazilian law and domiciled in Brazilian territory. Please refer to the International Taxation section for more details on the tax system applicable to non-residents doing business in Brazil.

## Corporate taxation

### Federal corporate income taxes

Corporate income tax (IRPJ – Imposto de Renda das Pessoas Jurídicas) and the Social Contribution Tax on Profits (CSLL – Contribuição Social sobre o Lucro Líquido) are both charged as federal income tax in Brazil.

Corporate income tax (IRPJ) is charged 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) is

levied at a standard rate of 9%. The tax basis for both taxes are very similar (with few exceptions). Income tax law provides two main methodologies to compute income tax: Actual Profit and Presumed Profit Systems.

### Actual Profit system

Taxable income in this system corresponds to the company's net profit, adjusted by certain inclusions and deductions as provided by Income tax law. Deductible expenses are generally all items related to the ordinary business of a company, properly documented and which are necessary to maintain the main source of income.

Companies may accrue tax losses to be offset with future taxable income of the same company (there is no tax consolidation in Brazil). These are the main rules governing tax losses: (a) tax losses may be carried forward indefinitely (carry back is not allowed); (b) the company may offset up to 30% of annual taxable income; (c) non-operational losses may be carried forward, but they may only be utilized to offset non-operational income (e.g., capital gains); and (d) 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

Companies may elect to compute corporate taxes on a presumed net income basis, 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 calculated by applying a predetermined percentage (the presumed margin), which varies according to the activity of the taxpayer, to the Gross Revenues. The total amount of capital gains, financial revenue and other revenue are then added to this presumed profit. At last, the corresponding tax rates are then applied to the presumed profit.

For instance, for the income tax (IRPJ), 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 (CSLL), the percentages are 12% and 32%, respectively.

## IFRS harmonization and the O&G industry

In general terms, IFRS was introduced in Brazil in 2007, becoming effective in 2008. In fact Brazil does not have a specific accounting framework for the O&G industry. Consequently, companies utilize accounting standards issued in other jurisdictions.

For many years (until 1998), Petrobras (a listed company controlled by the government) was the only player allowed to hold a concession to explore and produce oil & gas locally. After almost 20 years of the opening to the market, Petrobras is still viewed as a benchmark by private companies,

governmental authorities and other players in this market.

Given the lack of a specific local GAAP for the industry, Petrobras and other private O&G companies recognize exploratory costs based on two internationally known methods: full cost and successful efforts. The application of such methodologies by players were naturally influenced by other rules of the local GAAP.

The government issued a tax law in 1966 informing that Petrobras (during a period of monopoly) was allowed to deduct exploratory expenses for income tax purposes. In addition to that, up to 2008 the income tax code played a relevant role on the local GAAP, especially in what regards to capitalization of expenses (as a deferred asset).

After the introduction of IFRS in 2008, the market was hoping that a specific GAAP would be enacted. However, a specific local accounting framework has not come into force after 10 years. In the current context, companies still use foreign accounting standards as guidance when it comes to exploratory costs.

Taxpayers faced a period of transition from 2008 to 2014 where the IFRS should be disregarded for tax purposes (in other words, the previous GAAP was the only acceptable for the computation of taxes). In 2013 the government issued Provisional Measure 627 (converted into Law 12,973 in 2014) which imposed the end of the transitional period and provides all the tax adjustments required by law for the currently locally

accepted accounting standards. New accounting standards introduced afterwards must be disregarded for tax purposes until a formal act of *Receita Federal do Brasil* is published governing the application of tax law.

Law 12,973 does not provide any specific rule for O&G activities either. A more specific set of rules for the O&G tax framework was only introduced in 2017, when the government issued Provisional Measure 795 (converted into law 13,586).

As per the current rules, it is expressly allowed to deduct all expenses incurred during the exploration and production phases.

Depletion expenses related to capitalized costs from the development phase may also be deducted for income tax purposes. In this case, the taxpayer may opt to consider an accelerated exhaustion rate (x2,5) to be determined by the unit of production (UoP) method. An exception to the development phase rules apply for machines and equipment utilized in the activity, where the taxpayer is allowed to deduct depreciation expenses (as per a specific income tax schedule of depreciation).

Until 2017, companies did not have a clear rule in tax law providing on whether or not companies could deduct such expenses (or when). During this period of uncertainty income tax rules not designed to the O&G industry were utilized by taxpayers by way of analogy as an attempt to cover gaps of the tax law.

## Tax Audits

In general tax audits are performed by tax inspectors on a random selection as the scope and frequency of auditing does not follow a specific pattern in general. Taxpayers that meet one of the conditions bellows are subject to a more stringent audit process so-called close monitoring (*acompanhamento diferenciado e especial*):

- Gross revenues higher than R\$ 200 MM
- Tax Debts (including payroll taxes) higher than R\$ 25 MM
- Payroll Salaries higher than R\$ 65 MM

The right of the tax authorities to assess taxpayers (statute of limitation for tax purposes) generally 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 unsuccessful, the taxpayer may still appeal to the judicial court.

## PIS/Cofins (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, import of goods and services are also subject to PIS and COFINS at combined rates of 11.75% (goods) or 9.25% (services).

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 in order to concentrate the calculation and payment of social contributions in one specific taxpayer of the whole commercial chain.

### **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.

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). As from January 2013, imported goods that have not been subject to a pre-defined minimum industrialization process in Brazil will be subject to an ICMS rate of 4% on transactions involving two different states. 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 basis 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 risen 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 that may grant tax reductions of ICMS on the industrialization and commercialization of equipment, 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 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. The constitutionality of the law if being questioned at the Supreme Court (Action 5481) 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 provision of certain activities (services). The activities subject to the ISS are listed in federal law (Lei Complementar 116/03).

The tax basis 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.

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

ISS also applies on the import of services. Services provided to non-residents may not be subject to ISS if the stringent set of requirements is met.

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.

### **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.

### **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 in certain situations.

A special CIDE is also applied to the Oil & Gas industry (CIDE Combustíveis) upon 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 basis 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 securities 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:

Local credit facility: IOF is charged at a daily rate of 0.0041% plus a flat rate of 0.38%. The rate is subject to a limit of 1.88% when the loan has a predefined principal.

Foreign Exchange operations: The inflow or outflow of foreign capital imply on a currency exchange transaction and depending on the nature of the transaction a different tax rate shall apply. For instance: (a) Equity investment: 0.38%; (b) Dividends and interest on equity remitted abroad: 0%; (c) Foreign Loans: 6% (if less than six months) or 0% otherwise.

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:

Long distance transportation (cross-country transportation);	25%
Cabotage freight (transportation between Brazilian ports)	10%
River and lake transportation involving liquid bulk cargoes in the north and northeast regions of Brazil	40%

However, the AFRMM may 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**

Brazilian government charges specific taxes from companies engaged in the E&P of O&G fields. Find below a brief description of the Governmental Takes, 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**

Due by field concessionaires on a monthly basis for the exploration and production of Oil & Gas. Tax rates vary from 5% to 10% and are applied on sales revenue (ANP price reference may be considered for this purpose).

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

**Special Participation**

Due by field concessionaires on a quarterly basis 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 reference price 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 a range between 0.5% and 1% of the oil and gas production revenues at the ANP's discretion (a 1% fixed rate applies to production share contracts).

**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. Different R&D rules applied to the last bids for Production Share contracts and Open Acreage, where the obligation varied from 0.5% to 1% of the gross sales.

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.

### 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 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. 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.

This fee is being questioned by taxpayer at the Supreme Court (Action 5480).

### 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).

# 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

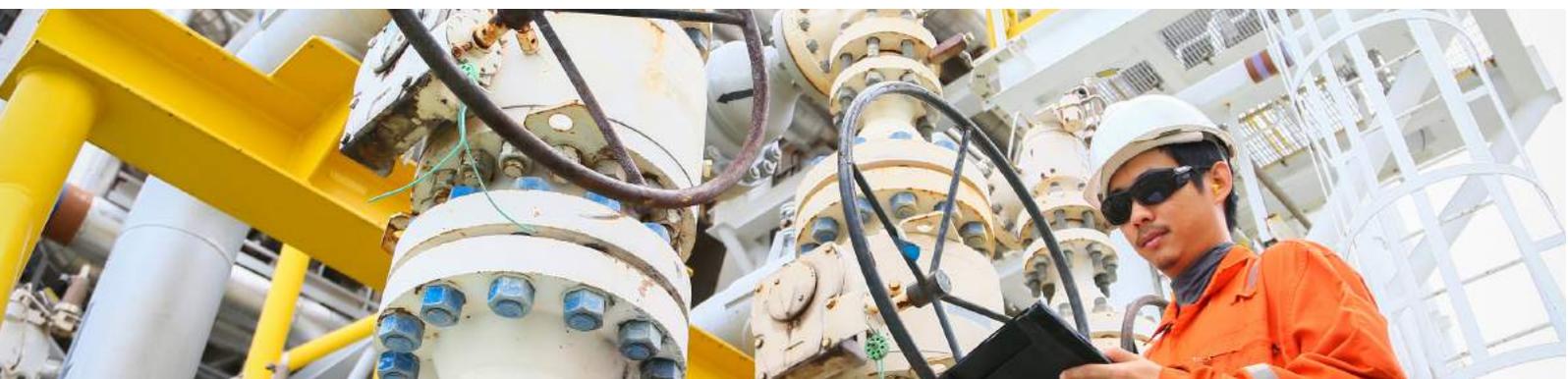
radioactive materials, and weapons, among others.

## 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) 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 import of 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.

### 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

demanding 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 currently comprised by 4 member countries: Argentina, Brazil, Paraguay and Uruguay (Venezuela is currently suspended).

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 certain 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 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 & REPETRO-SPED

### REPETRO

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 import 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 admission regime under Repetro expires in December 2020.

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 products and equipment currently utilized by the O&G companies in the exploration or production activities.

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.

### REPETRO-SPED

Brazil's federal government extended REPETRO until 2040 (Decree No. 9,128 and Law No. 13,586) under a new name (REPETRO-SPED). Announced by the National Council of Energy Policy in 2016, the extension became effective on August 18, 2017 and applies to imports of goods on a temporary or on a definitive basis and to domestic purchases of goods to be used in E&P activities.

Law No. 13,586 (conversion of Provisional Measure No. 795 of 2017) extended the scope of old REPETRO's tax suspension to other transactions. The suspended payment of federal taxes will also cover imports (on a permanent basis) and purchases of goods from local suppliers. This new suspension will be applied to transactions carried out by December



31, 2040. The payment of federal taxes levied on the importation and production of goods used in E&P activities will be suspended if taxpayers meet certain conditions.

The tax suspension regime for the Definitive Import system may not be used for vessels used for coasting navigation and inland navigation on domestic routes, nor is it applicable to port support and maritime support navigation (support vessels).

Instruction No. 1,781 issued on January 2, 2018 regulates REPETRO-SPED establishing the main conditions that must be met by taxpayers to be granted tax suspension: qualified beneficiaries, goods within the scope of the suspension (including two Annexes with lists of eligible goods), limitations and other rules governing the application of the tax suspension regime.

Regarding ICMS, ICMS Covenant 3 from 2018 (published on January 17, 2018) provides that States may (i) suspend the ICMS due on the import of goods under the temporary admission regime and acquisition of inputs under REPETRO-SPED; and (ii) charge ICMS at a rate of 3% on the acquisition of finished goods under REPETRO-SPED (Definitive Import and Local Acquisition systems). It is worth to mention that the ICMS law provides that taxpayers must waive of past lawsuits and pay ICMS supposedly due from operations carried out in the past under the old REPETRO regime.

The tax benefits provided by ICMS Covenant 3/2018 were regulated by the States of Rio de Janeiro, São Paulo and Espírito Santo until the issuance of this guide.

#### *Who is eligible?*

Regarding eligibility, the following may benefit from the REPETRO or REPETRO-SPED: (i) the owner of concession or production share

contract to carry out the activities of research or exploration of oil or natural gas reserves; and (ii) 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.

#### **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.

#### **REPLAT**

REPLAT (Normative Instruction 513) is a Special Customs Industrial Warehouse Regime established to make the shipbuilding and oil industries more dynamic by granting tax incentives, such as the suspension and exemption of federal and state taxes charged on inputs used for manufacturing or converting naval assets (platforms and drill-ships, for example) to explore oil and gas fields.

Under the regime, the companies commissioned to build or convert vessels and platforms, as well as the goods listed by Regulatory Instruction IN 1410 issued in 2013, can import or acquire, raw materials, parts and pieces to produce the final goods (Ships, Oil Platforms and support vessels) to be exported, and federal taxes are suspended, in the following situations: (a) on the asset (Ship or platform) itself that is being manufactured or converted; (b) on a shipyard; (c) on industrial facilities used for manufacturing the goods required for exploring the oil and gas fields; and (d) on port facilities described by the Regulatory Instruction that regulates REPLAT. The regime allows the qualified company to enjoy the following benefits:

- Suspension or reduction of the taxes charged on imports or purchases made in the local markets of parts, pieces and components (II, IPI, PIS, COFINS and ICMS – subject to the local law);
- Tax exemption on exports;
- Receipt of merchandise under the regime, with or without foreign exchange hedging;
- Customs Warehouse Regime for Imports applied on the exported assets that does not physically leaves Brazil and is delivered, by order of the foreign purchaser, to the legal entity commissioned to build or convert the ship/platform or the platform modules qualified to operate the regime.

The Federal Revenue Service sets the following requirements for a company to qualify to operate under the REPLAT:

- The applying company must be commissioned by an oil company, located abroad, to build or convert a platform for exploring and drilling for oil and gas, or sea modules or structures in Brazil;
- Special permanence authorization issued by the Navy;
- Exploration Concession Agreement issued by regulatory agencies (ANP - Brazilian Oil Agency);
- Meet the requirements set for providing federal tax debt clearance certificates;
- Have an Automated Control System for receiving, keeping and shipping raw materials, parts and components, as well as recognizing and calculating tax liabilities which are due, terminated or whose payment has been suspended. The Control System must be integrated with the company's corporate systems in Brazil, and with free and permanent access of the Federal Revenue Service.

Commitments made by the beneficiary to remain under the regime:

- Use the goods within the deadline and solely for the purposes and in the conditions established for granting the regime;
- Assume tax liabilities to the Federal Revenue Service.
- Identify the goods used, produced and exported under REPLAT.
- Conduct an audit to evaluate what has been achieved under the regime.

### Other Special Custom Regimes

**Drawback** is Special Customs Regime controlled through Concession Act, allowing the beneficiary company to import or acquire in the local market raw materials, parts and components used to generate higher added value goods on which taxes are suspended. These goods should be exported or used in a sales transaction equivalent to an export. When exporting the finished good, the company turns the tax suspension into a tax exemption.

**RECOF (Normative Instruction 1,291)** consists of a Special Customs Regime of Industrial Warehouse under automated control of Customs Board which allows the beneficiary company to import or to acquire in the local market, raw materials, parts and components destined to industrial application, on which taxes are suspended. Part of these goods must be applied on industrial processes, and it can be subsequently shipped both to domestic and foreign markets. When exporting the finished good, the company terminates the payment of taxes.

**RECOF-SPED** (Special Customs Regime of Industrial Warehouse under control of the Public System of Digital Bookkeeping) is a special regime that simplifies and expands the possibilities already offered by RECOF, allowing the beneficiary to import or to acquire in

the local market, raw materials, parts and components on which taxes are suspended. Part of these goods must be applied on industrial processes, and it subsequently can be shipped both to domestic and foreign markets. When exporting the finished good, the company exempts the payment of taxes.

**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.

**Bonded warehouse** (Entrepasto 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.

**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.

**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.

### Authorized Economic Operator (OEA)

**Authorized Economic Operator (OEA)** aims at certifying companies whose logistics chains pose low levels of operational risks and comply with standards of excellence set forth by customs legislation. The OEA Program seeks to encourage voluntary adherence so that by 2019 all export and import declarations are filed by companies classified as OEA. The purpose of the Program is to integrate several participants in the trade logistics chain, such as exporters, importers, transportation and cargo agents, depositories of goods and products under customs control, port and airport operators and customs brokers. The companies and participants identified as possible OEAs can enjoy benefits such as: (a) The Brazilian Federal Revenue Services customs clearance units release OEAs from fulfilling formal requirements for qualifying for special customs regimes or already applied in areas already covered by certification proceedings; (b) The OEA company may opt to enjoy the benefits and advantages of Mutual Recognition Agreements that the Brazilian Federal Revenue Service may sign with other customs authorities; (c) Selection of channels for checking export and import customs clearances by OEAs; (d) The Export and Import Declarations filed by OEAs, are processed on a priority basis; and (e) For sea shipments, the OEA importer may register the Import Declaration before the cargo arrives at the customs territory and apply the immediate parametrized selection.

**Special Deposit** is a special custom regime permits tax suspension for the storage of spare parts for vehicles, machines, equipment, devices and others, according to the Brazilian rules and provided that the imported

goods are without currency exchange coverage. 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.

### **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.

#### **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, equipment 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.

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. Brazilian tax law does not provide a clear concept of permanent establishment 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. Tax sparing clauses are also found in 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, Russia, Slovakia, South Africa, South Korea, Spain, Sweden, Trinidad and Tobago, Turkey, Ukraine and Venezuela.

Treaty with Paraguay have been executed but are pending final approval from the National Congress. Treaty with Germany is suspended since 2006.

## Withholding tax rates

Withholding tax (WHT) is charged on most cross-border transactions (except for payment of goods) with a Brazilian source of payment.

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 are 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): (a) Dividends (if related to post-January 1996 profits) – 0%; (b) Interest and commission on export financing – 0%; (c) Interest and commission on export notes – 0%; (d) Export commissions – 0%; (e) Interest on certain government bonds – 0%; (f) International hedging – 0%; (g) Air and sea rentals, charters, demurrage, container and freight payments to foreign companies – 0%.

## WHT Exemption on Charter contracts

There is a WHT exemption generally applied to payments made to a

non-resident in respect to charter agreements. As from 2015 (Law No. 13,043 of 2014), limits were established for the application of this WHT exemption in cases where the charter contract is executed simultaneously with a service contract and where the Charterer and the Service Provider were considered related parties for the purposes of the original wording of Law No. 13,043.

The Government introduced several amendments to the WHT exemption rule for charter contracts and created an amnesty program for payments due before 2015. The rules introduced by Law No. 13,586 were regulated by Instruction No. 1,778 of January 2, 2018. Current limits imposed to the WHT exemption on charter payments (as of 2018):

- 70% for vessels with floating systems of production or storage and offloading (75% according to Regulatory Instruction No. 1,778);
- 65% for vessels with rig systems for drilling, completion and maintenance of wells;
- 50% for other types of vessels; and
- 60% for maritime vessels used in the transportation, transfer, storage and regasification of LNG.

Vessels used for maritime support navigation are not subject to the above limits

### 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% (currently lower than 17% as per Ordinance 488/14), and (ii) jurisdictions whose national legislation allows confidentiality as to ownership of shares or the corporate organization of legal entities. This definition was brought 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).

In 2008 the definition of low-tax jurisdiction was expanded by Law 11,727 in order to include “a country or a place where legislation does not allow the access to the information related to 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, Curacao, Cyprus, Djibouti, Dominica, Eastern Samoa, French Polynesia, Guernsey (Channel Island), Gibraltar, Granada, Hong Kong, Isle of Man, Ireland, Jersey (Channel Island), Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macau, , Maldives, Marshall Islands, Mauritius Islands, Montserrat, Monaco, Nauru,, Niue Isle, Norfolk Island, Oman, Panama, Pitcairn Island, Queshm Island, Saint Cristobal and Nevis, Saint Helena Island, Saint Pierre and Miquelon, Saint Vincent and the Grenadines, San Marino, San Martin, Santa Lucia, Sark (Channel Island), Seychelles, Solomon Island, Swaziland, Tonga, Tristan da Cunha Island, Turks and Caicos Islands, United Arab Emirates, and Vanuatu.

#### 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”. 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% (updated by Ordinance 488/2014); 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; and 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% (updated by Ordinance 488/2014); and IV – does not allow the access to information related to the corporate structure, ownership of goods or rights, or to the economic transactions performed.”

Normative Instruction 1,037 from 2010 provides a list of situations regarded “privileged tax regimes” for Brazilian tax purposes:

- Uruguay (only with respect to “Sociedad Anonima Financiera de Inversion – Safis” until December 31, 2010).
- Holding Companies in Denmark, which do not perform a substantial economic activity.
- Holding companies in Netherlands, which do not perform a substantial economic activity
- Iceland (only with respect to International Trading Companies – ITCs).
- 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)<sup>1</sup>
- Malta (only with respect to International Trading Company (ITC) and International Holding Company (IHC)).
- 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).
- Holding Companies in Austria, which do not perform a substantial economic activity.

<sup>1</sup> 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.

- Costa Rica (only with respect to “Free Trade Zones – RZF”)
- Portugal (only with respect to “International Trade Center in Madeira – CINM”)
- Singapore, with respect to several regimes with differentiated tax rates, such as: (a) Concessionary rate of tax for Finance and Treasury Centre; (b) Concessionary rate of tax for income derived from managing approved venture company; (c) Concessionary rate of tax for international growth company; and (d) Concessionary rate of tax for several regimes related to maritime transport; etc.

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, (c) the deductibility of expenses on cross-border payments; (d) Brazilian CFC rules; and (e) Tax Exemption on Charter Payments.

### 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:

- 40% with respect to sectors involved in pharmaceutical and pharmaceutical products; tobacco products; optical equipment and instruments; photographic and cinematographic equipment; machinery, apparatus, and equipment for dental, medical, and hospital use; oil and natural gas extraction; oil-derivative products;
- 30% with respect to sectors involved in chemicals; glass and glass products; pulp, paper, and paper product and metallurgy; or
- 20% for other sectors.

- 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%.

**Quotation price on imports method (PCI - Método do Preço sob Cotação na Importação)** applies for inbound transactions involving commodities and is based on the average daily price of goods or rights as recognized on an international futures and commodities exchange, adjusted by the average premium.

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):** uses a 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)**

uses a 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 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)**

considers a 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.

**Quotation price on exports method (PCEX - Método do Preço sob Cotação na Exportação)**

applies for outbound transactions involving commodities and is based on the average daily price of goods or rights as recognized on an international futures and commodity exchange, adjusted by average premium.

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, the deduction of interest expenses shall observe certain limitations as provided below:

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).

The proportion of the interest expense (in respect to the calculation above) that exceeds the limits imposed by thin cap rules shall not be deductible for income tax purposes. 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 as it is charged to the entity that pays the royalties and, therefore, in principle it does not generate a foreign tax credit for the recipient abroad.

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 and the type of service involved.

Transfer pricing rules must be observed if the fees are to be paid to related parties (or to tax havens/ privileged tax regimes) as well as 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.

#### **SISCOSERV**

As from September 2012, transactions carried out by

Brazilian entities with non-residents involving services and/or intangible assets shall be informed by way of SISCOSERV system.

For operations carried out as from 2014, the information must be filed up to the last business day of the following month from the first day of the operation. Transactions performed abroad through branches and controlled entities shall be informed as of 2014, until the last working day of June, in relation to operations performed in the previous calendar year.

#### **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.

**Foreign Tax Credit**

In case 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. 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.

# 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.

Merger and acquisition transactions commence with preliminary negotiations between the parties on purchase terms and conditions, representations and warranties, and non-compete 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, especially 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, especially 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 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**

Law 12,973 (regulated by Normative Instruction 1,700) introduced changes in tax legislation in order to harmonize it with international accounting standards (Law 6,404 modified by Law 10,638 from 2007). One of the most important changes refers to the acquisition of shares and the possibility of

recognition and tax deduction of premium paid in these operations.

The premium refers to the potential positive difference between the purchase price and the company’s net assets. As per the current tax law, the acquirer (a Brazilian company) is required to allocate the cost of acquisition among these items (following this order): Net Equity, Fair Value of Assets and Goodwill. Law 12,973 changed some concepts assumed by taxpayers over the years and the main one refers to the necessary report in way to show the allocation above of the price paid in the acquisition of equity interests.

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 Premium tax benefit is one of the most common subjects in tax audits. Situations questioned by tax authorities in the past now need even more attention and a

good preparation against the new requirements introduced by the Law.

#### **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 reasons and economic 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.



# Labor Law & Individual Taxation

On November 2017, Law No 13,467/2017 formally amended Decree-law No. 5,452/43, known as Consolidation of Labor Laws (CLT).

The changes impacts in different areas of the Consolidated Labor Laws (CLT), including the conflictual situation between the employers and workers, that now has more flexibility to negotiate and agree terms referring to remuneration, holidays, working hours, etc.

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 human resources 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 to 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 CLT is limited to 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. However, Law 13,467 admitted that parties agree, under an individual or collective agreement to a 12-hour working day followed by 36 hours of rest.

### **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 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.

Law 13,467 introduced the possibility of termination of an employment contract through a common agreement between the employee and the employer. In this case, the employee will be entitled to receive half of the amount of the prior notice, but will not receive unemployment insurance and 20% of the FGTS fine instead of 40%.

### **Litigation**

Labor Law provides free access to the Judiciary. For the plaintiff to benefit from free legal services, insufficiency of resources to pay for procedural costs must be proven. Also, judges and presidents of labor courts can decide, to grant free legal services to those who receive a salary equal to or less than 40% of the maximum limit of the benefits of the General Social Security System.

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.

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 employment contract.

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

Employers may not reduce salaries except under extraordinary circumstances.

### Fringe Benefits

Benefits such as transportation, meal payments, travel allowances and premiums are not included in the employee's remuneration, therefore in principle they are not accounted for in the collection of labor and social security charges.

### 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 in unhealthy conditions, 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\$

954. 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 allowed relates to the employment of individuals with physical handicaps.

Law 13.467 changes different rules under which an employee can claim equal pay. Not only must the activities between the compared employees be the same, but it must also have been performed within the same business site. Furthermore, the compared employees cannot have a difference of more than 2 years in the same position and the difference between lengths of service for the same employer cannot exceed 4 years.

Companies that have a career track plan may have differences in salary levels in accordance with seniority and merit.

### 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 can 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

Law 13,467 provides that Collective Agreements can prevail over the law when they provide in some matters, including profit sharing.

### Prior Notice on Dismissal

The employer or the employee wishing to terminate an employment relationship should give a thirty day notice. If the company terminates the working contract without giving a prior notice or before



its end, the employee will have the right to the salaries corresponding to the term of the notice.

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 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.

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.

It is important to note that entities engaged in specific business activities may calculate the social security tax (INSS) based on the gross revenue at a rate of 2% to 4.5%, instead of 20% over the employees gross salaries.

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%.

#### **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\$ 5,645.80 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.

### 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.

### 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

Law 13,467 changed the former obligation upon Union contributions allowing the employer and employee contributions to be optional.

### 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, qualifies 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 directors and employees of a foreign company, individuals establishing a significant new investment in Brazil and to employees transferred from a foreign company to Brazil with skills not available in Brazilian labor market.

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. Work visas issued to foreigners are temporary visas (valid for up to two years) that can be extend with an authorization of residence.

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.

### Auxiliary obligation (eSocial)

Starting in 2018, eSocial is a new public system that allows the employers to transmit to the government in a unified declaration containing labor information such as wages, social security charges, payroll, employment payment rules, tax obligations and information on the FGTS.

This system will be implemented in five phases starting in the first half of 2018. In this first phase, companies with an annual income higher than

R\$ 78 million will be obliged to use the eSocial program from January 8, 2018.

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

Law 5,811/72 regulates O&G labor regime.

### **Shift Rotation Regime**

When operational continuity is indispensable, employees may be kept in their workstations under a shift rotation regime.

Two distinct workloads are eligible for this shift rotation regime: 8 hours or 12 hours. The 12 hours regime is restricted to activities of E&P in distant land areas and in sea. The employee should not remain in this shift rotation regime for more than 15 consecutive days.

During the 8 hour regime, the employer must provide the following labor right: (i) night shift extra pay, (ii) free food and transportation, (iii) 24 hour of rest for every three turns worked; and when applicable, (iv) payment in double for the suppressed rest and lunching hours.

During the 12 hour regime, the employer must provide, other than the previous labor rights mentioned above: (i) free collective accommodation (ii) 24 hour of rest for every turn worked.

### **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.

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.

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.

### **Taxation of capital gains**

On 17 March 2016, Law 13,259/2016 introduced changes to the capital gain tax applicable to Brazilian resident individuals. This change had the effect of calculating capital gain tax based on the progressive income rates from 15% to 22.5% (dependent on the quantum of the capital gain). 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**

#### **Authorization for Residence & Permanent Visa**

On November 2017, Law 13,445/2017, known as the Migration Law, formally

revoked the Brazilian Foreigner Statute Law extinguishing the permanent visa. In substitution to the permanent visa, Law 13,445 introduced an “authorization for residence” for foreigners who enter Brazil holding temporary visas.

Individuals transferred to Brazil until November 2017 on a permanent visa are subject to tax as residents from the date of arrival.

### **Temporary visa**

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

### **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.

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