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BRAZIL

The following is a summary of recent legal and economic developments in Brazil.

I. LEGISLATIVE AND ADMINISTRATIVE RULINGS

Reindexation of the Economy

On February 22, 1987, almost three months after enacting extensive deindexing legislation, the President signed Decree-law No. 2.322, which determines that contracts may be adjusted according to the indices of the National Treasury Bond (OTN). Since the February 28, 1986, monetary reform, only contracts for periods of twelve months or more could be adjusted and, even then, only after the twelfth month. The measures established by Decree-law No. 2.322, and which put a formal end to the Cruzado Plan deindexation rules, became an absolute necessity as inflation reached the monthly rate of fifteen percent and the economy virtually stopped due to the impossibility of adjusting contractual relations.

The President signed Decree-law No. 2.323 on February 26, 1987, which provides for the monetary updating of tax obligations from their payment dates. The updating will be made in accordance with the variation index of the OTN. Decree-law No. 2.323 also provides rules for the determination of corporate income tax on OTN's, the monetary adjustment of penalties under tax laws, and the rules applicable to taxes due and not paid.

The President also enacted Executive Decree No. 94.042, on February 18, 1987, setting forth the rules applicable to the monetary adjustment of contracts entered into with the federal administration. Accordingly, adjustments can be made from January 1, 1987. Contracts without adjustment clauses may be amended to provide for monetary updating in accordance with the OTN index.

Private Exploitation of Federal Highways

On February 4, 1987, the President signed Executive Decree No. 94.002, granting the Minister of Transportation the power to authorize the National Highway Department (DNER) to contract for the construction and maintenance of federal highways and pub-

lic road works with private companies. The contract awarding such construction must fulfill certain requirements which include, permanent voting capital and management control of the enterprise by a Brazilian company whose controlling shareholders must be Brazilian individuals. The corporate purpose of any such company must be limited to the construction and maintenance of highways. Companies not fulfilling the above requirements, including foreign companies, may be admitted to the bidding process provided they are in consortium with a Brazilian company. A consortium under Brazilian law resembles a joint venture in which companies associate by contract to undertake a specific project.

The concession contract shall establish the bases and criteria for toll fees to be charged so as to allow for a fair return on the capital invested and a correct economic balance of the contractual relations provided for in the concession. The invested capital shall be remunerated by the toll fees. Article 5 provides that the guarantee of the DNER and the availability of a state financial institution may be granted to ensure minimum toll revenues.

Cooperation Agreement with Belgium

On December 5, 1986, Congress approved a Scientific, Technological and Industrial Cooperation Agreement with the Government of the Kingdom of Belgium. Consequently, on February 10, 1987, the President signed Executive Decree No. 94.010 ordering the observance of the Agreement's provisions. The Agreement provides for mutual cooperation in the scientific, technological and industrial areas through the exchange of knowledge, information and documentation, and through visits and delegations of specialists or any other form of cooperation determined by mutual agreement of the two countries. The agreement also provides for the mutual granting of administrative customs and tax benefits for imports of materials to be used in projects under the Agreement.

Agreement on Economic Cooperation with Argentina

On July 29, 1986, the Presidents of Brazil and Argentina signed an agreement for Brazilian-Argentine Integration and twelve other protocols dealing with capital goods, wheat, food supply, trade expansion, binational companies, financial matters, investment funds, energy, biotechnology, economic studies, reciprocal information and assistance in case of nuclear accidents and

emergencies and aeronautical cooperation. The Act was followed by the establishment of work groups to study and propose new customs rules and procedures to facilitate trade between the two countries. In a further development, an Agreement on Economic Cooperation between both countries has now been signed. The Agreement was enacted by Executive Decree No. 94.017, on February 11, 1987. Its provisions deal with the production, trade and technological development of capital goods, and provide for the duty-free importation of certain products to be considered as domestic products of both countries, as well as the elimination of all non-trade barriers for any such imports. Article 4 establishes a trade volume equivalent to U.S. \$4 billion for the next four years. The agreement also provides for a surplus limitation to avoid excessive trade deficits by any of the signatories and a list of products which may benefit from its provisions.

Manaus Free Trade Zone

On February 13, 1987, the President enacted Executive Decree No. 94.025 providing for an overall import limit for the Manaus Free Trade Zone of U.S. \$610 million in 1987. Excluded from this limit are imports of wheat and oil subject to special controls, goods imported for the manufacture of products to be exported, as well as up to thirty percent of the foreign trade surplus of any company operating on a draw-back basis. The Manaus Free Trade Zone is an area of free import-export with special tax exemptions, established in 1957 to create an industrial, commercial and agricultural center in the Amazon region.

New Cruzado Plan

The "Bresser Plan" is a full price, rent and wage freeze, which replaces the sliding scale for wage adjustments. The freeze extends for a maximum of ninety days, at which time authorized prices will prevail until prices are able to float with the market.

The Minister of Finance announced that Brazil will present a plan to control the government deficit and inflation to representatives of the International Monetary Fund (IMF). The macroeconomic plan, if approved, could facilitate negotiations with international financial institutions. Below are some of the measures announced on June 12, 1987:

(i) Wage Adjustments - Decree-Law No. 2.335, as amended, established a Price Reference Unit (URP) which corresponds to the average variation in the Consumer Price Index (IPC) during the previous quarter. The URP will be used to update the monetary value of wages and prices during each month of the subsequent quarter;

(ii) Deflation of Contractual Obligations - Financial obligations incurred between January 1 and June 15, 1987, having built-in monetary correction systems or no monetary correction clauses will be deflated in accordance with an exchange rate schedule prepared by the Ministry of Finance;

(iii) Monetary and Fiscal Budgets - Executive Decree No. 94.442 established that the budget proposal for 1988 shall include any and all disbursements by the federal government. The measure consolidates the monetary and fiscal budgets of the federal government and also bars the granting of financing by the federal government at a cost lower than the return on the National Treasury Bond (OTN). The raising of funds by the Central Bank of Brazil is also barred for purposes of financing the federal deficit, and the issuance of federal debt instruments to the financing requirements of the federal deficit in the budget approved by Congress is limited. This measure is the first limitation ever imposed on the financing of government deficit through issuance of debt instruments either by the National Treasury or by the Central Bank of Brazil;

(iv) Federal Debt - Decree No. 94.443 gives the Minister of Finance authority over the placement and redemption of federal debt instruments;

(v) Credit for Economic Growth - Decree No. 94.444 transfers the funds and credit programs related to economic growth from the Central Bank to the Ministry of Finance, as of January 2, 1988. Accordingly, new credit programs that cover items such as financing for farmers and small businesses shall be exclusively contracted by Banco de Brasil S.A., the commercial bank controlled by the federal government;

(vi) Budget Control - Decree No. 94.446 creates a Financial Coordination Committee within the Ministry of Finance, which shall be in charge of drafting and executing the fiscal and federal agency budgets and making such programs conform to the policies set up for the control of the federal deficit. The Committee will

centralize powers as to any item in the federal budget to be submitted to Congress.

Constitution of Special Reserve by Financial Institutions

Decree-Law No. 2.332 provides for balance sheets to be drawn up before June 30, 1987. The National Monetary Council (CMN) may require financial institutions and other companies authorized to operate by the Central Bank of Brazil to constitute a special reserve to safeguard their capitalization levels or operating capacity after absorption of accrued losses prior to any participation.

This measure is an attempt to permit small businesses to refinance their debts. During the first months of the Cruzado Plan, interest rates were as low as one percent per month; with the return of twenty percent monthly inflation rates, interest rates skyrocketed to around 1,000% per year, causing thousands of small companies to fold. The reserve is designed to avoid a wave of losses in the financial market when debts are not paid by businesses facing a substantial reduction in the overall demand for goods and services.

Technology Transfer

The President of the National Institute of Industrial Property (INPI) issued Normative Act No. 86, on April 14, 1987. The new Act releases companies that contract for foreign technology from consultation with the INPI to justify the import of technology which may already exist in the Brazilian market. The Act requires that upon completion of the form for INPI approval, the user classify the technology (trademark licenses excepted) to be contracted according to the International Patent Classification, so as to permit INPI to consult the patent bank if necessary.

New Airline in Brazil

The President signed Executive Decree No. 94.298, on April 30, 1987, granting Canadian Pacific Air Lines Limited, with head offices in Vancouver, Canada, authorization to operate in Brazil as a regular air transportation company.

Composition of National Monetary Council

The President signed Executive Decree No. 94.303 which increases the composition of the National Monetary Council by one member representing the working classes. That member shall be appointed by the President for a term of office of one to five years, with the possibility of re-appointment.

Compulsory Loan on Automobiles

The President signed Decree-Law No. 2.329, of May 20, 1987, which reduces the compulsory loan payable on purchases of automobiles manufactured as of January 1, 1987 from thirty percent to fifteen percent. The sale decree-law exempts purchases of automobiles manufactured before 1986 from the compulsory loan.

Disposition of Public Lands

On April 22, 1987, the President of the National Institute for Rural Settlement and Agrarian Reform (INCRA) issued Ordinance No. 327, marking the criteria and conditions for the disposal of federal public lands. Any individual interested in acquiring public lands will have to comply with the following conditions:

- (i) not be the owner of any rural real property;
- (ii) work the occupied property, directly and personally, for more than one year;
- (iii) reside on the property, or close to it, so that the other conditions can be met;
- (iv) have agriculture or cattle raising as the main activity of the property.

Agrarian reform has become an important issue for the present administration since its plan for the distribution of public lands and certain private properties taken by eminent domain. Ordinance No. 327 also provides for limitations on the size of the properties to be acquired by each family and the procedures for determining the price of the properties to be acquired.

Committee on Foreign Debt

On April 6, 1987, the President signed Executive Decree No. 94.192, creating a committee for the negotiation of the Brazilian

foreign debt. The members of the committee are the Minister of Finance, an ambassador extraordinaire for foreign debt affairs, the President of the Central Bank of Brazil, the Under Secretary for Economic and Commercial matters of the Ministry of Foreign Affairs, the Vice President of International Means and Operations of Banco do Brasil S.A., the Director of Foreign Affairs of the Central Bank of Brazil, the Director of Foreign Debt of the Central Bank, and certain other second echelon federal administration officials. The Decree also provides that the ambassador extraordinaire shall be in charge of conducting the international negotiations under the supervision of the Minister of Finance. The creation of the committee was considered by the press as a further step towards giving the foreign debt political treatment instead of the technical approach used in past years.

II. CAPITAL AND EQUITY

Moratorium

On February 20, 1987, the Central Bank of Brazil, acting under its authority as federal monetary and exchange regulatory agency, issued Resolution No. 1.263, stating that all foreign currency acquired by borrowers in connection with payments of interest due to foreign financial institutions shall not be remitted to the foreign creditors but shall, instead, be deposited with the Central Bank of Brazil. The measure established a moratorium on all interest payments due by Brazilian borrowers.

On the same date, the Central Bank released Circular No. 1.131, outlining the procedures and rules applicable to the opening of accounts and the placement of deposits with the Central Bank on behalf of foreign creditors. The Circular expressly exempted from the mandatory deposit those payments previously not subject to any rescheduling under the Brazilian foreign debt rescheduling agreements, such as:

- (i) publicly issued bonds, publicly issued floating rate certificates of deposit or publicly issued floating rate notes;
- (ii) privately issued bonds, obligations with foreign governments or foreign governmental agencies (including export credit agencies) or international agencies;
- (iii) transactions guaranteed or insured by foreign governments or foreign governmental agencies (including export credit

agencies) or international agencies;

(iv) financing guaranteed by ships, aircraft, or drilling equipment;

(v) transactions funded by bankers' acceptances or commercial papers; and

(vi) equalization interest arising under the Export Financing Program (FINEX).

In addition to Resolution 1.263 and Circular 1.131, the Central Bank released Joint FIRCE-DEC.AM Communiqué No. 198, dated February 19, 1987, establishing that, until February 27, 1987, any foreign currency contract entered into for the remittance of profits, dividends and repatriation of capital will be subject to prior examination by the Department of Control and Registration of Foreign Capital of the Central Bank (FIRCE). The communiqué requires that all relevant documentation be submitted for review.

Restrictions on Consumer Credit

By means of Circular No. 1.119 of January 30, 1987, the Central Bank limited the credit extended by commercial banks and thrift institutions to individuals under any form. Accordingly, commercial banks and the Federal Savings Bank (CEF) may lend only fourteen percent of their available reserves to individuals. State savings banks must limit their lending to individuals to seventy-five percent of their available reserves. The measure attempts to reduce the aggregate demand on the market as inflation returns to very high levels.

Foreign Debt Relending

On January 30, 1987, the Central Bank issued Circular No. 1.121, setting a ceiling of U.S. \$100 million for relending transactions to private borrowers, during the months of January and February, of the accounts matured during 1985 and deposited with the Central Bank.

On March 20, 1987, the Central Bank issued Circular No. 1.145, setting a ceiling of U.S. \$300 million for relending transactions to private borrowers, during the months of March and April, of accounts matured during 1985 and deposited with the Central Bank.

The Central Bank issued Circular No. 1.167 on May 7, 1987, creating a ceiling of U.S. \$100 million for May 1987, for transactions of relending to private borrowers during the month of May, of amounts matured during 1985 and deposited with the Central Bank.

Foreign Currency Transactions

Exercising its authority as the Federal Exchange Regulatory Agency, the Central Bank released Circular No. 1.138 on March 9, 1987. It regulates the granting of double authorization for financial institutions of the same group to deal in foreign exchange and in the sale and repurchase of certain liquidity instruments.

Exchange Transactions

Central Bank of Brazil issued Resolution No. 1.325 establishing that exchange transactions: (a) made for payment of installments of principal and interest on financial obligations falling due between January 1, 1985, and December 31, 1986; (b) with principal falling due between January 1 and June 30, 1987; (c) resulting from transactions with a payment term of over 360 days, registered at the Central Bank of Brazil; (d) related to agreements or other financial arrangements concluded prior to March 31, 1983; or (e) owed or guaranteed or insured by foreign governments shall be deposited in full at the Central Bank of Brazil in foreign currency accounts in the name of the respective creditors.

Centralization of Foreign Exchange

The Central Bank issued Circular No. 1.173 on May 19, 1987, which determined that deposits were not required at the Central Bank under Resolution No. 1.263 dated February 20, 1987, for the proceeds from foreign exchange sales made by authorized banks for interest payment on:

- (i) transactions made under Reciprocal Credit Conventions;
- (ii) import financing of more than 360 days from funds allocated from Project C of the Brazilian Financing Plan; and
- (iii) loans or financing granted with new money, if the respective certificates of registration are included in a list to be disclosed by the Central Bank.

Foreign Portfolio Investment

The Central Bank issued Circular Letter No. 1.620 on May 11, 1987, establishing the procedures to be adopted in connection with the registration of foreign capital invested in investment companies, foreign capital investment funds and in the so called managed portfolios. These three structures are currently the possible alternatives for foreign portfolio investment in the Brazilian capital markets and have been granted substantial tax incentives.

Limitation on Bank Spread

On April 23, 1987, the Central Bank announced that from that day on, bank spreads would be subject to certain limitations depending on the type of institution and transaction involved. The measure, taken to offset pressure from Congress against the high interest rates charged by financial institutions, limits the spread of the major commercial banks and of institutions connected with the Federal Savings Bank (CEF) to four percent annually, while setting a limit of five percent for the spread charged by small commercial banks and other institutions. Both limits are exclusive of full indexation to the inflation rate. The regulations of such limitation are contained in Resolution No. 1.302, dated April 23, 1987, issued by the Central Bank of Brazil.

On the sale date, the Central Bank released Resolution No. 1.308, providing for a special credit facility for small businesses, which are now facing difficulties in meeting bank debt payments on credit obtained during 1986, when inflation was as low as one percent monthly. The resolution established favorable financial conditions on such credit facilities available to companies whose gross income does not exceed 437,500 National Treasury Bonds.

Standards for Financial Statements

The Securities Commission released Deliberation No. 44, dated February 11, 1987. It requires mandatory compliance by independent accountants with the rules specified in Technical Communiqués Nos. 01 and 02, issued by the Brazilian Accounting Association (IBRACON), when issuing auditing opinions or financial statements of publicly-held companies, brokerage houses and securities dealerships.

Investment Funds

Since the creation of the Securities Commission (CVM) in December 1976, that agency has shared with the Central Bank the role of monitoring and regulating the Brazilian capital and equity markets. The division of jurisdiction between both agencies resulted from Law No. 6.385, dated December 7, 1976, which provided that CVM would be in charge of regulating publicly-held companies and the securities issued by them, leaving to the Central Bank the regulation of other liquidity instrument markets and of financial institutions.

A change in this approach occurred in March 1987 when the National Monetary Council (CMN) decided that CVM would be responsible for regulating certain equity investment funds. The following CMN decisions were released:

(i) Resolution No. 1.280 of March 20, 1987, gave CVM authority to regulate investment funds, with the exception of limits on prices and commissions, and consolidated the regulations applicable to such funds; and

(ii) Resolution No. 1.289, also of March 20, 1987, consolidated all the rules applicable to foreign portfolio investment on the Brazilian capital markets.

(iii) The Central Bank also released Resolution No. 1.286 of March 20, 1987, regulating fixed-income investment funds, which remain subject to full Central Bank regulation.

The measure increases the CVM role on the market and signals a possible future restriction of the Central Bank's regulatory powers in the area. Moreover, even though the regulations contained in Resolution No. 1.280 provide for detailed investment policies to be followed by funds, the applicability of such provisions was suspended for 180 days. The suspension seeks to allow the recovery of the major Brazilian stock exchanges that have plunged deeply since last August.

Penalty for Breach of Registration with the Securities Commission

The Securities Commission (CVM) released to the market on March 30, 1987, its Resolution No. 47, determining that any company that fails to keep its registration updated with the Commission shall have to pay a penalty equivalent to ten National Trea-

sury Bonds per day. The penalty is exclusive of other penalties to which corporate managers may be subject under Law No. 6.385, and a decision to impose it on a given company may be appealed to the Board of the Commission.

Other Central Bank Resolutions

(a) On February 26, 1987, the Central Bank released Resolution No. 1.265 providing that until June, 1987, the value of the National Treasury Bonds would be updated monthly by the variation of the consumer price index or by the rate of return of Central Bank Bills (LBC), whichever was greater. From July onwards, the OTN value would be updated monthly in accordance with the rate of return of the LBC. The same indexation rules apply to the balances on savings accounts, in the Unemployment Guarantee Fund (FGTS) and in the PIS/PASEP Participation Fund;

(b) Resolution No. 1.334 requires entities authorized to operate by the Central Bank to constitute a special reserve, designed to increase operating capacity and capitalization level;

(c) Resolution No. 1.335 authorizes a special refinancing facility for commercial, investment and development banks, credit, financing and investment companies, and the Federal Savings Bank, designed to receive working capital financing transactions for small businesses;

(d) Resolution No. 1.338 allows the face value of the National Treasury Bond (OTN) to be updated by the income produced by the Central Bank Bills (LBC) from the prior month. The OTN face value shall now be updated monthly according to the variation in the Consumer Price Index (IPC);

(e) Circular No. 1.186 permits acceptance of foreign currency deposits resulting from liquidation of investments and the sale of shareholdings registered with the Central Bank and related to foreign capital by banks authorized to deal in foreign exchange;

(f) Resolution No. 1.339 establishes 1,200,000 OTN's as the minimum limit for paid-in capital and net worth for the operation of investment banks;

(g) Resolution No. 1.342 published the deflation factors to be used in accordance with Article 13 of Decree-Law No. 2.335;

(h) Circular No. 1.189 provided that the deflation factors, as established by the National Monetary Council (CMN), should be

applied by cumulative multiplication;

(i) Circular No. 1.163, dated April 29, 1987, creates special foreign currency credit facilities in favor of banks authorized to deal in foreign exchange. The limits for these credit facilities will be established in U.S. dollars and attributed to each bank according to its performance on the export exchange market, subject to review by the Central Bank at any time;

(j) Circular No. 1.164, dated April 29, 1987, provides that banks may establish a spread based on the weighted average of the rates for raising funds, excluding only transactions of repassing interbank deposit certificates;

(k) In DCAM Communique No. 1.003, of May 7, 1987, the Central Bank permitted the remittance of interest abroad on pre-paid financing taken directly by Brazilian exporters from foreign import companies, and extended from 180 to 360 days the period for prepayment before actual shipment of the goods.

Termination of Price Freeze

On February 5, 1987, the Price Commission (CIP) passed Resolution No. 199, which stated that the products and services listed in Resolution No. 166 of April 2, 1985 are now subject to the system of price controls, under which price adjustments can only occur with the express prior authorization of CIP or its General Secretariat. Products and services not included in the above-mentioned Resolution No. 166 are subject to a price follow-up system, under which companies must inform CIP of their actual price changes. Resolution No. 199 puts an end to the price freeze created by the February 28, 1986 monetary reform. Even though certain products and services are still under strict control, most prices are now allowed to float according to market trends.

Price Adjustments

The Price Commission (CIP) issued Resolution No. 218 on May 12, 1987, which establishes a minimum interval of thirty days for price and tariff adjustment of any industrial products or services, except with the express authorization of CIP. Such adjustments shall be limited to the monthly cost variation, provided that it does not exceed eighty percent of the Consumer Price Index (IPC) for the previous month. The measure, presented amidst sug-

gestions of a new price freeze and skyrocketing prices, attempts to avoid a further increase in the twenty percent monthly inflation rate.

The Special Secretary for Supplies and Prices then issued Ordinance No. 20, dated May 20, 1987, which provides that products contained in the list attached to CIP Resolution No. 215 of April 24, 1987, may have their prices adjusted automatically by the respective cost variation, provided that the prices do not exceed eighty percent of the most recently published INPC index. These price adjustments are subject to a minimum interval of thirty days as defined in Article 1 of CIP Resolution No. 218 of May 12, 1987.

Rules on the Financial Guarantee of the Republic

Acting under the authority of Decree-Law No. 1.312 and Law No. 7.492, the Ministry of Finance issued Ordinance No. 18, dated February 2, 1987, conditioning the guarantee by the National Treasury of foreign credits obtained under any kind of transaction, including export-import financing, upon the existence of a clause providing for the automatic termination of the guarantee if any fee or charge not expressly authorized by the Central Bank is for any reason charged or paid in Brazilian or foreign currency.

Devaluation of the Cruzado

On his second day in office, the new Minister of Finance announced an 8.49% devaluation of the cruzado, the first substantial devaluation of the new Brazilian currency since its creation on February 28, 1986. The measure, expected by the market for a long time, signals a substantial change in the policies of the federal administration, which, until a few weeks ago, refused to consider a devaluation of the cruzado. The purpose of the 8.49% devaluation was to boost Brazilian exports, as foreign trade revenues have been plunging since November of last year from the usual U.S. \$1 billion monthly to an average of a little below U.S. \$200 million. The measure was announced on April 30, 1987, by the Central Bank of Brazil, the federal monetary authority which usually works under close monitoring of the Ministry of Finance.

Venture Capital Companies

The federal administration, by means of Article 17 of Decree-

Law No. 2.287, established certain incentives for venture capital. Accordingly, dividends, cash distributions, profits or any other distributions attributed to venture capital companies, as well as any gains or profits earned in the disposal or liquidation of their equity holdings, were not to be included in the venture capital companies' taxable income. Moreover, small and medium-sized companies were not to include any distribution to venture capital companies in their taxable income. Distributions by venture capital companies to their shareholders, though, were to be subject to a twenty-three percent income tax rate.

Venture capital companies are defined in Article 19 of Decree-Law No. 2.287 as companies whose only corporate purpose is to hold equity investments in small and medium-sized companies complying with certain requirements established by the National Monetary Council (CMN).

The CMN further regulated the provisions of Decree-Law No. 2.287 through Resolution No. 1.184 to provide for an increase in the net worth of the companies in which venture capital companies can invest their funds. Accordingly, a company receiving venture capital funds cannot have a net worth in excess of 500,000 National Treasury Bonds (OTN's), and the group to which such companies belong cannot have a total net worth of more than 1,000,000 OTN's.

III. TAXATION

Taxation of Financial Income Earned by Foreigners

By means of Declaratory Act No. 20 of March 20, 1987, the Coordinator of the Tax System, a division of the Federal Revenue Office, announced that from the date of enactment of Decree-Law No. 2.308 on December 19, 1986, the determination of the taxable income for purposes of withholding income tax applicable to income, capital gains and short-term income from investments on the financial markets by parties who are residents or domiciled abroad, shall be made in accordance with the rules that apply to those who are residents or domiciled in Brazil. This tax varies according to the term and type of income. It can be reduced somewhat if there is a treaty for the avoidance of double taxation between the country of residence of the foreign party and Brazil.

Taxation of Capital Gains in the Financial Markets

On April 7, 1987, the Coordinator of the Tax System of the Federal Revenue Office issued Declaratory Normative Act No. 33, regarding the calculation of the taxable income for purposes of the withholding income tax applicable to capital gains realized in transactions with National Treasury Bonds (OTN's). If the OTN's are redeemable with full correction in accordance with the dollar-cruzado exchange rate, the previously taxed income, including the excess of the full exchange rate correction over the monetary correction, net of income tax, shall be excluded from the purchase, transfer or liquidation amount.

Special Partnership Taxation

Special partnerships have been used for tax planning purposes in Brazil for several years. By means of Decree-Law No. 2.303 of December 21, 1986, the federal administration tried to reduce the use of special partnerships for tax purposes by providing that they will be subject to normal corporate taxation. The Secretary of the Federal Revenue Office has now released Normative Instruction No. 49, dated April 15, 1987, regulating the taxation procedures by establishing that the partnership shall maintain its own separate books and records and its results shall be determined for each fiscal period in accordance with the tax rules applicable to other corporate entities. The regulation also determines that the ostensible partner (the one who makes routine management decisions) shall be responsible for such determination of results. The rule also provides that the profits of the special partnership shall under no circumstances be incorporated in the profits of any of its partners, and shall be subject to withholding income tax as if they were dividends. Investments in special partnerships shall be accounted for in the fixed assets account of corporate partners and are subject to the evaluation criteria established by tax and commercial legislation.

IV. JUDICIAL DECISIONS

Supreme Court Decision on Breach of Price Freeze

Early last year, during the so-called Cruzado Plan, the manager and the owners of a retail outlet were accused of breach of the

price freeze. A petition for *habeas corpus* was filed to avoid their identification as criminals at the local police department. A police investigation was initiated to determine liability for a crime against the public economy. The case was just a sample of thousands of similar criminal charges pressed against businesses throughout the country during the price freeze. The defendants denied the breach of the price freeze and alleged that the State Public Attorney did not have jurisdiction since the National Supplies Agency was in charge of monitoring the application of the price freeze rules. The petition for *habeas corpus* was denied by the State Court of Appeals, and an appeal was filed with the Supreme Court.

Upon hearing the arguments on the appeal, the Second Panel of the Supreme Court held that a price freeze was only a deterrent measure and that breach of such a freeze only triggers administrative sanctions. Only a breach of an official price list can be considered a criminal act under applicable law. According to the Court, when a public authority freezes prices, it merely restrains further price increases. Notwithstanding the fact that Article 35 of Decree-Law 2.284 had held the price freeze equivalent to an official price listing, there was no way to identify the point at which a transgression occurred. Therefore, no criminal act was committed by the defendants. The Decision of the State Court of Appeals was overruled by the Supreme Court. *Antonio L.R. de Oliveira et al. v. Court of Appeals of the State of Parana* R.H.C. 64.802-9, slip op. (Supreme Court, February 17, 1987) (Sec. Panel), *rev'd*.

Registration of Trademarks

The following are not eligible for registration as a trademark: the name of a literary, artistic or scientific work, theater play, movie film, official sports competition or game or the like, if it can be transmitted by means of communication, or a printed artistic design, except to distinguish gross products or services with the express consent of the respective owner or author. The protection afforded to intellectual works also extends to their title (Decision of the 5th Panel of the Federal Court of Appeals on Appeal in Writ of Mandamus No. 112.053, published in DJU on February 26, 1987).

Operating Expenses

The expenses incurred in the base period in which the company begins operating cannot be treated as pre-operating expenses for purposes of deferral to subsequent fiscal years, even if such expenses refer to months prior to the date of first operation (Decision of the 1st Chamber of the 1st Taxpayers Council on Judgment No. 101-77 036, published in DOU-I of March 12, 1987).

Foreign Trademarks

If a foreign trademark is not protected in Brazil, it can be appropriated and registered by third parties who then obtain the right to exclusive use of the trademark. This rule does not apply in the case of a well-known trademark (Decision of the 2nd Panel of the Federal Court of Appeals on Appeal No. 114.930-2, DJU, March 27, 1987).

Council of Appeals of the National Financial System

The Brazilian Securities Commission, acting under its authority as regulatory agency for the stock market, held the officers of a corporation liable for breach of requirements to be satisfied with the Commission. The defendants filed an appeal with the Council of Appeals of the National Financial System (CRSFN). The CRSFN was created by executive decree to decide final appeals of administrative decisions related to the applicability of penalties under Law No. 4.595 (the Brazilian Banking and Capital Markets Law), Law No. 4.131 (which regulates foreign capital investment and lending in Brazil), Law No. 6.385, (the Securities Commission Law), as well as certain other legislative acts. The appeal was denied by the CRSFN and the defendants filed a hierarchical appeal with the National Monetary Council (CMN).

The case was decided by the Minister of Finance wherein he affirmed the opinion of the Office of the Attorney General of the National Treasury. The opinion, dated December 23, 1986, held that:

(i) the Constitution grants the President of the Republic the powers to issue executive decrees regulating laws and to provide for the structure, jurisdiction and operation of agencies within the federal administration such as the CRSFN and the CMN, whose

structure and jurisdiction may be altered by executive decree;

(ii) the CMN cannot legally be subordinated to any ministry, because under a general principle of administrative law, ministries relate among each other by coordination and each one of them is only subordinated to the Presidency of the Republic;

(iii) the vote of the Securities Commission representative is legal and valid as the vote of the representatives of financial and capital markets entities, the criterion being one of origin, not of agents or delegates;

(iv) the deciding vote of the president of the CRSFN in the case of a deadlock is valid, considering that there is an even number of members and that decisions are taken by a majority vote, rendering as *res judicata* this appealable administrative decision; and

(v) the Minister of Finance cannot re-examine a decision by the CRSFN without breaching a presidential order.

Tax Considerations

For tax purposes, goods are deemed to be lost if they are missing upon entry into the Brazilian territory, whereupon the party considered liable by the customs authority shall indemnify the National Treasury for the taxes that were consequently not paid. The maritime agent performing his specific duties is deemed to be liable for the taxes and is not a carrier for the purposes of Decree-law No. 27/66. Any tax exemption enjoyed by the imported goods cannot be extended to the carrier if it is liable for the tax obligation resulting from loss. In cases of loss of imported goods, the currency conversion rate is the rate prevailing on the date on which the loss of the goods is discovered (Decision of the 5th Panel of the Federal Court of Appeals on Civil Appeal No. 93.006, DJU of February 12, 1987).

Income Tax — Expropriation

Indemnity for expropriation is not subject to income tax. The phrase "including by expropriation" in article 31 of Decree-law No. 1.598/77 was found to be unconstitutional (Decision of the 4th Panel of the Federal Court of Appeals on Civil Appeal No. 105.972, DJU of February 5, 1987).

The indemnity received by a legal entity as a result of amicable or judicial expropriation is not subject to income tax (Remittitur of Record No. 110.376 of the 6th Panel of the Federal Court of Appeals, published in DJU on April 23, 1987).

Artificial Day-Trade Transactions

The benefit of non-applicability of income tax under Article 40, paragraph 5(a) of the 1980 Income Tax Regulations does not apply to transactions carried out on the options market of the Stock Exchanges when they result in artificial, pre-established profits and losses. Income declared as non-taxable because it does not result from transactions of such kind, in the absence of evidence of the actual origin of such income, is classified in schedule H of the income tax return according to article 39 of the 1980 Income Tax Regulations (Decision No. 106-1.169 of the 6th Chamber of the 1st Taxpayers Council).

Supplementary Income Tax

Companies calculating total net profits and dividends actually remitted abroad, subject to the supplementary income tax which applies whenever average remittances over a three-year period exceed twelve percent of registered capital plus reinvestments, may compute in the investment amount their capital increases pending registration at the Central Bank of Brazil and specified in a liability commitment (Second Instance Judgment No. 103-07.934 of the 3rd Chamber of the 1st Taxpayers' Council).

Income Tax Return of Persons Resident Abroad

Income tax returns unduly filed on behalf of an individual domiciled abroad by an attorney not specifically authorized to do so, and contested by the principal before any fiscal action, cannot be used as evidence of the withholding of income tax from the income declared and contested by the principal (Decision No. 102-22.753 of the 2nd Chamber of the 1st Taxpayers Council).

Remuneration of Officers

In Brazilian "limitada" companies and partnerships, the administration is the responsibility of the corporate or individual

managing quota-holders or managing partners. If corporate, the administration must necessarily be delegated under article 13 of Decree No. 3.708/19. Even if such delegation is made without complying with corporate law, what is most relevant in determining the limit of deductible remuneration, is to define who exercised the management. Above such limits, the remuneration is not deductible by the company (Decision No. 101-77.132 of the 1st Chamber of the 1st Taxpayers Council).

V. MISCELLANEOUS

Export Policy

Trying to overcome the shortage of foreign credit to finance import transactions, created by the moratorium on debt interest payments determined last February, the federal administration has announced a series of measures affecting a substantial change in the federal policies valid during the last decades.

By means of Executive Decree No. 94.170, dated April 1, 1987, the federal administration has allowed domestic companies to import certain goods listed by the Foreign Trade Department (CACEX) without exchange cover. Until now, all goods imported into Brazil had to be paid for with foreign exchange obtained from authorized institutions. It remains to be decided how payment for goods imported without exchange cover will be made. CACEX will determine which products can be imported without cover. The new rules are valid until December 1987.

On March 30, 1987, the President executed Decree-law No. 2.324, which provides for exemption from import duty and from the tax on manufactured products. The exemption is limited to ten percent of any increase in the exports of the respective manufacturer in the preceding year, and covers imports of machinery, equipment (whether industrial or research), parts and intermediary products, and is valid until December 31, 1991.

Exports through Customs Warehouse

On April 2, 1987, in an attempt to expedite export procedures, the Minister of Finance issued Ordinance No. 60, providing for a customs warehouse system for export goods and regulating delivery under customs bond. According to Ordinance No. 60, only goods sold abroad under the delivery of a customs bond system may be

accepted pursuant to the new export system for deposit with an authorized depository entity. The ordinance also established basic provisions and rules applicable to DUB (delivered under customs bond) contracts.

Letters of Credit for Imports

In Declaratory Act No. 35/87, the Coordinator of the Tax System declared that the return on guarantee deposits made by importers at banks authorized to deal in foreign exchange, for the opening of letters of credit for imports, shall be subject to withholding income tax as follows:

(i) as a gain on a short-term transaction, if the period between the date of deposit and the date of redemption is equal to or less than the period established by the National Monetary Council(CMN) for such transactions; or

(ii) as a capital gain, if such period is greater than that established by the CMN for short-term transactions.

Economic Cooperation between Brazil and Argentina

On December 10, 1986, the governments of Brazil and Argentina signed reports issued by the Commission for execution of the Program of Integration and Economic Cooperation between both countries, containing decisions and regulations applicable to the Protocols signed in July last year when an Economic Cooperation Program was established.

Arbitration

The Ministry of Justice released for public comments a draft bill of law regulating arbitration procedures in Brazil. The draft bill substantially innovates two main aspects of arbitration as regulated by current law. Article 5 establishes that the stipulation of arbitration as a dispute solution proceeding may give rise to specific performance. This basically means that if a contractual clause provides for arbitration to resolve any dispute arising under the respective contract, no court of law will have jurisdiction over any such dispute. Under current Brazilian law, a contractual arbitration clause does not bar any of the parties from bringing legal action on any dispute nor does it bind the parties to resolve the dis-

pute only through arbitration. Article 32 of the draft bill provides for a second innovation, as it determines that any arbitration award issued abroad, duly certified at a Brazilian consulate and accompanied by a sworn translation, will qualify for enforcement in Brazil through summary proceedings.

Reenrollment of Foreigners

On November 7, 1986, the Minister of Justice issued Ordinance No. 559 establishing a sole form of identity card for foreigners having a temporary or permanent visa or enjoying asylum in Brazil. Under the terms of Ordinance No. 559, all foreigners were required to re-enroll at the Federal Police Department within ninety days beginning January 2, 1987.

Copyright Regulations

The National Copyright Council (CNDA) issued Resolution No. 47 on February 25, 1987, regulating the procedures for registration of intellectual property, as such term is defined in Law No. 5.998 of December 14, 1973. Under article 17 of Law No. 5.988, intellectual property is any book, brochure, letter, speech, theater play, choreography, music, film, photograph, design, picture, illustration, project, draft, applied art work, adaptation, translation or other transformation of an original work, as well as collections, compilations, encyclopedias, and certain other works within this category, which may constitute intellectual property based on their criteria of selection and organization. Resolution No. 47 establishes the documentation and procedures for the registration of such property with the respective agencies listed in Law No. 5.988.

On the same date, CNDA also issued Resolution No. 50, setting the rules that apply to the registration of recordings produced in Brazil, for the purposes of collecting and distributing the revenue from copyrights arising from the public use of such intellectual property. Resolution No. 50 determines that the Central Collection and Distribution Office shall identify and register all recordings in accordance with technical information provided for in the resolution. Recording producers shall fill out and submit an application for registration of each recording.

Industrial Policy

The Ministry of Industry and Commerce released for public comment, through Ordinance No. 12, dated February 5, 1987, a proposal on the guidelines to be observed by the federal administration in establishing future industrial policies for the national economy. The industrial sector was divided into six segments for purposes of analysis: chemical and intermediary goods, non-metal, metallurgical and intermediary metal goods, durable consumer goods, automation and capital goods, construction, cement and ceramics, and non-durable consumer goods. The paper, which outlines the objectives and strategies to be observed by the federal administration, provides for an analysis of the agents involved in the sector — private, state and foreign companies. It describes the dynamic role of foreign companies and emphasizes their technological and international marketing contributions. Its last part investigates each sector's current situation, perspectives and objectives, finally providing for an outline of the issues to be addressed by future industrial policies.

North-South Railroad

On April 29, 1987, the Ministry of Transport published in the Official Gazette, Justification No. 12, dated April 23, 1987, which presents to the President the reasons for the construction of the North-South Railroad. The North-South project involves the construction, operation and maintenance of a railroad, by a state company, which will connect Brasília with São Luis, capital of the State of Maranhao, on the North coast. A major portion has already been built and connects the area known as the "Carajas Project," a large mining and metallurgical center, with São Luis. According to Justification No. 12, the project will allow the transport of agricultural products produced in an area of approximately 600 thousand square kilometers. The railroad will be operated in the future by private companies.

The North-South Railroad has been criticized by the press as a waste of public funds. The \$2.4 billion price tag is considered too high when compared with the fact that the country has suspended interest payments on its foreign debts with private institutions and is suffering increases in the federal public deficit. Criticism of the project grew after a São Paulo newspaper published the results of the bidding for the construction of the railroad several days before

the construction companies' bids were to be opened in a public ceremony. The newspaper denounced the whole bidding process as fraudulent. As a result of the news, all bids were annulled and four different committees were established to investigate the allegations of fraud.

The National Development Fund (FND), the federal agency responsible for the granting of funds for the project, stated that none of the conditions precedent for the release of funds had been fulfilled, including an economic feasibility study of the railroad. Funds held by FND are derived from new taxes imposed on July 23, 1986, to restrain the skyrocketing demand for goods and services. The federal government has strongly defended the construction of the railroad, and is backed by the governors of the states where it is to pass.

Anti-Dumping

The Customs Policy Council (CPA) released to the market an outline of a petition to be presented by domestic industries whose markets and products are threatened by dumping practices. The outline, which covers all anti-dumping provisions of the General Agreement on Trade and Tariffs (GATT), will be presented to CPA for the establishment of an investigation procedure.

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