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LEGAL MEMORANDUM

The first part of this memorandum is a brief summary of legal rulings and decisions recently enacted by the Brazilian government. The second part analyzes a recent development in the Brazilian law concerning the application of double-taxation treaties to the remittance of interest on financed importation of goods.

I. LEGISLATIVE AND ADMINISTRATIVE RULINGS

New Limits on Purchase of Foreign Currency and on Individual Remittances Abroad

The Central Bank issued Resolution No. 760/82 establishing major new restrictions on the sale of foreign currency to defray the personal expenses of persons living in Brazil and travelling abroad. The measure was taken to curb speculation. The limit of US \$ 2,000.00 is maintained but only US\$ 100.00 may be obtained in cash or travelers checks. The remainder is to be received abroad by payment order drawn in favor of the traveler. No more than US \$ 500.00 may be obtained for trips to South or Central American countries or on trips where the first stopover is in any of those countries. The full amount may be delivered in cash if the currency is that of a South or Central American country. Minors under 18 years of age may purchase only one-half the adult allotment, and no foreign currency may be sold to children under two years of age. Not less than 180 days must elapse between two consecutive purchases of foreign currency by the same person. Moreover, these "tourist dollar" sales will be taxed at 25% under the Tax on Financial Transactions (IOF). In addition, under Resolution No. 764 published on September 23, 1982 the purchase of exchange for personal monthly remittances in amounts of up to US \$ 300.00 or its equivalent in other currencies is now restricted to transfers to residents of Brazil who are abroad under educational programs covered by scholarships and certified by the Ministry of Education and Culture or who are undergoing medical treatment paid for through the social security system (INAMPS). Additional details as to the implementation of Resolution 760 are contained in Central Bank Communiqué DECAM Nos. 499/82 and 500/82 (DOU-I, September 15, 1982).

Limitations on Bank Purchase of Debentures

The Central Bank has published Circular No. 728/82, giving further instructions concerning the provisions of Resolution No. 756/82, which set a monthly limit on purchases of convertible and non-convertible debentures by commercial and investment banks. In this Circular, the Central Bank decided: (a) to permit fulfillment of commitments to subscribe debentures, where such commitments were assumed prior to August 13, 1982 and the General Meeting had already formally decided on the issue; (b) that the institutions should, within 15 days of the Circular's publication, forward to the Department of Banking Supervision or to the Capital Markets Department (depending on whether the interested bank is a commercial or investment bank), a chart showing the status of investments in debentures as of August 12, 1982, including any subscription commitments which could be honored as above; (c) to remind banks which have excess holdings under the Resolution 756 rules, including surpluses due to subscriptions referred to in (a) above, that they may not make further purchases of debentures while the excess holdings persist; that is, while debentures account for more than 5% or 15% (depending on whether the bank is a commercial or investment bank) of the institution's total investments that are subject to credit expansion limits (DOU-I, September 2, 1982).

Limits on Stock Exchange Holdings

The Securities Commission—CVM has set operating limits for investors and brokers on Brazil's stock exchanges. Under Instruction No. 25/82, no investor in the futures and options markets on a given exchange may hold positions which together represent more than 25 million shares or correspond to more than 2% of a particular type or class of share in the capital of a publicly-held company. The minimum holding requirement remains unchanged (DOU-I, October 14, 1982).

Succession of Companies under Income Tax Law

The Coordinator of the Tax System has issued Normative Opinion No. 20/82 explaining what is meant by succession between companies for the purposes of Article 54 "a" of Decree-Law No. 5.844/43 (Art. 149 of the 1980 Income Tax Regulations—RIR/80). Succession is deemed to have occurred when the universe consist-

ing of a commercial establishment or good will is acquired and the purchaser acquires the firm's assets and liabilities. An owner of an individual company may transfer the net equity of the company in order to pay up capital subscribed in an existing company or in one which is to be set up. That company will then be the successor in tax obligations. Succession may also operate by transfer, to an individual company, of the net worth of a company. A legal entity which becomes extinct by virtue of its net worth having been absorbed can have its enrollment in the General Taxpayers' Register (CGC) cancelled by a simple "Request for Cancellation" as provided for in item 2 of Secretary of the Federal Revenue Normative Ruling (IN SRF) No. 42/82 (DOU-I, September 8, 1982).

Company Merger—Effect on Tax Incentives

The absorption of a company which enjoys tax incentives in the form of an exemption on production of goods which are in the national economic interest does not act to abolish the tax benefit as long as the goods continue to be employed for the intended purposes (1st Chamber of the 3rd Taxpayers' Council, in Decision No. 21.827).

Bill would Prohibit Use of Decree-law to Create or Raise Taxes

A bill introduced in Congress by Senator Itamar Franco would prohibit the use of the Decree-law mechanism to establish a new tax or raise an existing one (Decree-laws are handed down by the Executive Branch and are afterwards submitted to Congress for approval. On very few occasions has Congress refused this approval). Bill No. 158/82 would reword Article 97 of the National Tax Code to provide that the following may only be accomplished through ordinary law: institution or abolition of taxes; increase or reduction of taxes; definition of the circumstance which generates the main tax liability; setting of the tax rate and its basis of calculation; imposition of penalties for actions or omissions contrary to tax law provisions or for certain other infractions. The introduction of this bill was inspired by the dispute over the manner in which the Fund for Social Investment (FINSOCIAL) was created by Decree-Law No. 1940 of May 25, 1982 (DCN, August 31, 1982).

New Restrictions on Imports

In a further effort to restrain the flow of foreign exchange out

of Brazil, the Foreign Trade Department of Banco do Brasil S.A. (CACEX) has temporarily suspended the importation of hundreds of products. The list, which appears in Communiqué No. 26/82, includes machinery, equipment, components and raw materials used by the chemical, petrochemical and pharmaceutical industries (DOU-I, September 28, 1982).

Ruling on Disguised Distribution of Profits

According to Normative Opinion No. 21/82 of the Coordinator of the Tax System—CST, a disguised distribution of profits will be presumed to have occurred when a company asset is sold to a controlling shareholder for a price that is known to be considerably under the market value. The transaction will be considered as having been entered into with a controlling shareholder when the purchaser has a significant or substantial participation in the profits of the seller company to a degree which would justify the presumption of preferential treatment (DOU-I, October 1, 1982).

Declaration of a Resident Foreigner's Income

A foreigner resident in Brazil must include on his income tax return all salaries and benefits received from the domestic company for which he works and from the foreign company with which he is associated (2nd Chamber of the 1st Taxpayers' Council, Decision No. 102-18.588).

New Ministerial Post Created to Coordinate Land Matters

In view of the increased interest in resolving questions of land ownership, especially in Brazil's developing areas, the President of the Republic has signed Decree No. 87.649 of September 24, 1982 providing that a Special Minister for Land will coordinate the activities of the National Institute for Rural Settlement and Agrarian Reform (INCRA) except for those relating to the rural association and rural cooperative movement and to rural electrification. The latter functions will continue to be supervised by the Ministry of Agriculture. INCRA will be responsible for carrying out the decisions of the Special Minister (DOU-I, September 27, 1982).

Subsequently, the President signed Decree No. 87.700 of October 12, 1982 which contains the regulations for the National Land Distribution Policy Program, defining the authority of the newly-created Ministry as well as Decree-Law No. 1963 of October 14,

1982 concerning the funds allocated to this program and the financing of housing for rural workers (DOU-I, October 15, 1982).

Status of Corporation Director under Labor Law

A director of a “sociedade anônima” who has been elected by a General Meeting of the shareholders is not to be considered an “employee” under labor law even if, because of his duties, he is accountable to the General Meeting (Decision No. 523 of the 2nd Panel of the Superior Labor Court).

Federal Guarantee now Available on Commercial Leasing by Government-Controlled Companies

The President of the Republic has signed Decree-Law No. 1960 of September 23, 1982 authorizing the Executive Branch to either contract or guarantee on behalf of the Federal Government and in the form of a surety, the payment of installments owed by companies and other entities that are directly controlled by the Federal Government or by one of the States, in connection with commercial leasing agreements, with option to buy, signed with companies or entities located outside Brazil (DOU-I, September 24, 1982).

Responsibility for Excess Storage Costs—Customs Clearance

In the event that a delay in customs clearance of goods can be attributed to the Government, the fees for storage in excess of the normal period should be borne by the Government rather than by the private party (5th Panel of the Federal Appeals Court, in Civil Appeal No. 45.512).

Right of Attorney to Obtain Certificates

An attorney’s right to obtain a certificate from public administrative offices is conditioned upon his needing that certificate to defend the rights of a client, the demonstration of an interest which he is legally responsible for pursuing, and proof that he holds a power-of-attorney (3rd Civil Chamber, Superior Court of São Paulo, in ruling on Appeal No. 6.784-1).

New Regulations on Maritime Shipping

Decree No. 87.648 of September 24, 1982 has been signed by

the President of Brazil, approving a new body of Regulations for Maritime Traffic containing general principles governing ocean, river, and lake shipping as well as navigation safety and security in Brazilian waters. Labor, Customs, tax, sanitary and maritime police law apply to such activities, along with pertinent domestic and international rules aimed at rapid, safe, economic, and efficient transportation (DOU-I, September 27, 1982).

Tax Incentives for Export

The Foreign Trade Department of Banco do Brasil S.A. (CACEX) has established the rules under which interested parties are to qualify for, use, and calculate the export tax credit afforded by Article 1 of Decree-Law No. 491/69 and for the reimbursement of the Tax on Manufactured Products (IPI) provided for in part 1 of Article 1 of Decree-Law No. 1894/81. These rules are contained in CACEX Communiqué No. 32/82 (DOU-I, October 22, 1982).

II. THE APPLICATION OF DOUBLE-TAXATION TREATIES TO THE REMITTANCE OF INTEREST ON FINANCED IMPORTATION OF GOODS

1.—Interest payments that are remitted abroad as due on the purchase of goods on credit payable in installments are subject to the withholding of income tax under Article 556 of the Income Tax Regulations (as approved by Decree No. 85.450 of December, 1980) — the RIR. In such transactions the party which remits the interest payments is considered as being the taxpayer.

2.—The sums paid by way of interest owed under the circumstances delineated in the previous paragraph will not undergo the gross-up performed at the time of remittance, as provided in Article 577 of the RIR for purposes of determining the basis of calculation of the withholding tax, even if the purchaser of the goods has specifically assumed the burden of paying the tax.

3.—For some time it was believed that, in transactions with residents of countries with which Brazil has signed a Treaty to Avoid Double Taxation, the income tax rates called for in such treaties ought to be applied. However, in a case involving the Treaty to Avoid Double Taxation signed with Japan, where the Brazilian debtor had assumed the burden of the withholding tax, the Federal Court of Appeals ruled that the rate provided for in the Treaty would not be considered when the Brazilian party was liable for the tax (Civil Appeal No. 48724-RJ). The issue deter-

mined on that occasion was the inapplicability of the Treaty for determination of the tax rate due on remittances of interest due to a "cash loan," however, this does not prevent doubts from arising as to the applicability of the treaties in other transactions where the Brazilian taxpayer bears the burden of the withholding income tax.

4.—In order to resolve those doubts, the Secretary of Federal Revenue, through Normative Ruling, SRF No. 070 of October 15, 1982 has resolved that income tax is to be withheld on interest paid to residents of countries with which Brazil has a Treaty to Avoid Double Taxation, when such interest is paid in connection with the financing of purchases of goods at the rate called for in the Treaty. Therefore the 25% rate mandated in domestic legislation will be disregarded. Nor will there be any need to gross-up the sum remitted in order to arrive at the basis of the calculation of the tax, even if the purchaser has assumed the tax liability.

5.—Brazil maintains a Treaty to Avoid Double Taxation with the following countries:

Austria	Germany	Norway
Belgium	Italy	Portugal
Denmark	Japan	Spain
Finland	Luxembourg	Sweden
France		

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