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BRAZIL

The following memoranda summarize recent legislative and administrative rulings in Brazil.

1. New Foreign Investment Rulings

Amending Foreign Capital Rules to Stimulate Greater Investment

Foreign investments in Brazil are regulated by Law No. 4131 of September 3, 1962, as amended. According to this law, investments made by foreigners in Brazil must be registered with the Central Bank of Brazil in order to allow repatriation of capital, as well as remittance of profits and dividends abroad.

The withholding income tax on foreign investments is levied at the standard rate of 25%, but remittances in excess of an average of 12% per annum of registered capital over a three-year period are subject to an additional withholding tax assessed on a sliding scale (up to 60%). The purpose of the withholding surtax is to stimulate reinvestments.

However, the rules set forth by Law No. 4131, as well as certain procedures adopted by the Central Bank of Brazil and other governmental agencies, are very strict, making Brazil less attractive to foreign investors than other developing countries. With this scenario in mind, the Brazilian Government is amending foreign capital rules and applicable procedures to stimulate greater foreign investment. In late 1991 and early 1992, three important measures were issued in this regard:

(i) Law No. 8383 of December 30, 1991

Besides regulating the payment of taxes due the federal government, this law extinguished the withholding surtax as from the three-year period ending on December 31, 1991; it reduced the withholding income tax on foreign investments from 25% to 15% as of January 1, 1993; and it allowed the amounts remitted abroad in payment of technical or scientific assistance and royalties to be deducted as business expenses, even if the company receiving the payments controls the remitting company. (DOU-I, December 31, 1991).

(ii) Decree No. 365 of December 16, 1991

Regulating the registration of reinvestments of profits with the Central Bank of Brazil, Decree No. 365 establishes that as of January 1, 1992, the foreign currency amount corresponding to the reinvestment will be determined by the average exchange rate of the day the reinvestment is made, and no longer by averaging the exchange rates between the profit distribution and reinvestment dates. (DOU-I, December 17, 1991).

(iii) Resolution No. 1894, issued by the Central Bank of Brazil on January 9, 1992.

Resolution No. 1894 amended Resolutions Nos. 1810 of March 27, 1991, and 1850 of July 31, 1991, which regulate debt/equity conversions under the Brazilian Denationalization Program. According to Resolution No. 1894, debt/equity conversions under the Denationalization Program are now subject to the following:

> (a) the amounts to be converted are subject to an initial discount of 25%; and
> (b) the amounts resulting from the debt conversion must remain in Brazil for at least six years.

According to the former regulations, debt/equity conversions under the Denationalization Program were subject to the following:

(a) initial discount of 25% on the amounts to be converted;

(b) funds had to remain invested in Brazil for at least twelve years;

(c) the participation in a privatized company acquired through debt/equity conversion could not be sold for two years, unless the funds resulting from the sale were reinvested in another privatized company;

(d) during this two-year period, a foreign investor would not be allowed to remit capital gains or investment returns abroad for any other investments; and

(e) if the foreign investor received capital gains or returns from its other Brazilian investments within six months prior to the application for debt/equity conversion, the Central Bank of Brazil would only register the investment if the investor returned the amounts to Brazil. (DOU-I, January 13, 1992).

Circular Letter No. 2266: Registration of Foreign Investments

On March 13, 1992, the Central Bank of Brazil issued Circular Letter No. 2266, regulating the registration of foreign investments by way of capitalization of profits and reserves and the remittance of profits abroad as from January 1, 1992. These guidelines are the result of several meetings held between representatives of the Central Bank of Brazil and foreign investors, and constitute a significant step towards making Brazil more attractive to foreign investors.

We mention below certain items of this circular letter that warrant special attention:

Of the profits elgible for remittance, the Central Bank of Brazil still does not permit the foreign investor to remit a greater share than the domestic investor. The Central Bank considers that for purposes of remittance abroad, equal treatment must be given to Brazilian and foreign investors. In this regard, Letter Circular No. 2266 reiterates Communique No. 158 issued by the Foreign Capital Department of the Central Bank of Brazil (FIRCE) on June 24, 1985.

According to articles 2, 3 and 5, profits for capitalization will from now on receive treatment equivalent to profits destined for remittance. This treatment is far more favorable to the foreign investor than formerly. In the past, profits that were eligible for remittance could be monetarily updated and sent abroad using the exchange rate prevailing at the remittance date. At the same time, profits designated for capitalization were not monetarily corrected, but converted at the average rate for the period between the balance sheet closing and the actual capitalization.

The capitalization or payment of interim dividends is provided for in article 4. When the capitalized or paid interim dividend is less than the final profit for the year, the Central Bank may either: (i) reduce the reinvestment amount in foreign currency; or (ii) request that it be returned to Brazil.

Article 7 invokes an old Central Bank rule that prohibits direct capitalization of both revaluation and contingency reserves and realizable profits. In FIRCE's view, these amounts should be entered in the accrued results account before being capitalized; otherwise they will not be eligible for foreign currency registration.

Finally, in article 13, the Central Bank states that it will pe-

nalize any fraud connected with foreign investment. (DOU-I, March 17, 1992).

2. Export Processing Zones

Export Processing Zones (EPZs) are free-trade areas, isolated from the rest of the country by trade and exchange barriers. Decree No. 2452 of July 29, 1988 created EPZs to attract foreign industries through tax and exchange incentives. When President Collor took office on March 15, 1990, there were twelve EPZs authorized by law, but there were in fact no EPZs operating in Brazil.

Immediately after his inauguration, President Collor tried to quash all EPZs by Provisional Measure No. 158 of March 15, 1990, but Congress did not approve this provisional measure. On April 7, 1990, Senator Nelson Carneiro, President of the Federal Senate, acting on behalf of Congress, sanctioned Law No. 8015 which increased the number of EPZs from twelve to fourteen.

On April 12, 1990, however, Congress sanctioned Law No. 8032, whereby the creation, implementation, and approval of industrial projects in EPZs would be suspended for 180 days, during which time Congress was to evaluate the benefits of EPZs. Since then, little has been said about EPZs in Brazil.

Recently, the Executive Branch presented Congress with a legislative bill modifying Decree No. 2452. This bill was approved as Law No. 8396 of January 2, 1992. The issuance of Law No. 8396 has brought the EPZ issue back to centerstage.

According to Decree No. 2452, amended by Law No. 8396, the purpose of the EPZ is to enhance the Brazilian balance of payments, promote the diffusion of technology and economic growth, and reduce regional and economic imbalances. EPZs are to be located in less-developed areas and will be created at the request of individual states or municipalities, either of which can submit a proposal to the National EPZ Council. Under such proposal, the state or municipality will assume all costs, as well as demonstrate that it has funds sufficient to defray the required expenditures. The federal administration is expressly prohibited from directly or indirectly assuming any such costs.

According to Law No. 8396, a company interested in establishing itself in an EPZ must also present a proposal that must not entail the transfer of already-established Brazilian industrial facili-

ties. A company installed in an EPZ will be exempt from the following taxes and duties, and such exemption will be guaranteed for 20 years, unless more favorable treatment is made available:

(i) import duty;
(ii) Tax on Manufactured Products;
(iii) contribution to the Social Development Fund;
(iv) freight surcharge for the conservation of the Merchant Marine;
(v) Tax on Credit, Exchange, Insurance and Securities Transactions; and
(vi) income tax on remittances and payments abroad.

These companies will be subject to income tax on EPZ profits. No license is necessary to import goods for their manufacturing activities or to export from the EPZ, except when sanitary, environmental protection, and national security regulations are involved. There will be no control on foreign exchange transactions to and from a company installed in an EPZ. Any sale from the country to an EPZ will be treated as an export.

According to Law No. 8396, the EPZ concession expires twelve months after the date of issue if no infrastructure construction has begun during this one-year period. In the specified case of 14 concessions already existing, this term is 24 months. (DOU-I, January 6, 1992).

3. Incentives for Cultural Activities

Law No. 8313 of December 23, 1991 created the Brazilian Cultural Support Program. Under this program, donations and sponsorships offered through or for the account of cultural projects approved by the Department of Culture — part of the Brazilian President's Office — can be deducted from the amount of income tax due, though the deduction is subject to limits set by the Executive Branch.

Also on December 23, 1991, President Collor issued Decree No. 372, which established the ceiling of Cr$ 48,158,000,000.00 on total deductions from the income tax due on donations and/or sponsorships of 1992 cultural projects. Decree No. 372 further establishes that such deductions will be limited to 1% of the income tax due if the donor or sponsor is a company, or 3% of the income tax due if the donor or sponsor is an individual. (DOU-I, December 24, 1991).

Article 10 of Law No. 8313 authorized the Securities Commission (CVM) to regulate the constitution of investment funds for the purpose of investments in cultural projects. Such funds, known as Cultural and Artistic Investment Funds (FICART) are afforded favorable tax treatment; they are exempt from both the Tax on Financial Transactions (IOF) and income tax. Profits received from such funds by investors, however, are subject to income tax at the rate of 25% in the case of Brazilian citizens; in the case of foreign investors, the income tax is also levied at 25%, but can be reduced by double taxation treaties.

Pursuant to article 10 of Law No. 8313, on March 17, 1992 CVM issued Rule No. 186 that regulates the creation and functioning of FICART funds. According to Rule No. 186, the FICART can be an open-end or closed-end fund, depending on whether the fund will allow redemption of quotas or not. Quotas of the closed-end fund can be traded on the stock exchanges or through the over-the-counter market. The FICART funds will be managed exclusively by banks, brokers, or securities dealerships duly authorized by CVM. (DOU-I, March 24, 1992).

4. Aliens

The legal status of foreigners in Brazil is regulated by Law No. 6815 of August 19, 1980, as amended, which establishes that aliens performing any professional activity in Brazil must have either a temporary or a permanent visa.

Permanent visas are granted to those who intend to live permanently in Brazil, while temporary visas are granted to those coming to the country with a specific purpose (as in the case of business trips, scientific missions, and study programs). The maximum term of validity for temporary visas is four years.

In order to obtain a temporary or permanent visa, a number of conditions must be met by the applicant. In the case of permanent visas, besides providing the documentation mentioned by Law No. 6815, the interested party must meet special requirements established by the Brazilian Immigration Council, the government body charged with regulating immigration policy.

On March 18, 1992, the Brazilian Immigration Council issued Resolution No. 23 that provides for the granting of permanent visas to foreigners who are willing invest the equivalent of at least US$200,000 in activities expected to contribute to Brazil's eco-

nomic development and to employ at least ten Brazilians. Besides the initial investment, the would-be investor must also bring to Brazil at least US$50,000 for personal and family sustenance.

The terms of the visas granted vary depending on the amounts invested: (i) two years, if the investment is less than US$400,000; and (ii) four years, if the investment exceeds US$400,000. In order to renew the visa, the investor must prove the investment is in good standing 90 days prior to the expiration date. (DOU-I, April 9, 1992).

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