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## Brazil

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## EDITORS' NOTE

*"Legal Memoranda" is a regular section of the Review devoted to reports from corresponding law firms throughout the hemisphere. The reports are compiled, by the Review, but their accuracy is represented by the corresponding law firms, to which all inquiries should be directed.*

*We appreciate the contributions of our corresponding law firms, and invite other law firms interested in participating in this section to contact us.*

## LEGAL MEMORANDA

### BRAZIL

*The following is a review of recent legislative and administrative developments in Brazil, submitted by a correspondent law firm.*

#### I. LEGISLATIVE AND ADMINISTRATIVE RULINGS

##### *Collective Rights Under the New Constitution*

The constitutional protection of collective rights, also known as general interests, are those interests in which society at large shares and which are not necessarily based on well-defined legal relationships. The provisions protecting these rights in the Constitution are scattered and informal, and relate to the safeguarding of the collective needs relating to the quality of life. These collective rights are common to all inhabitants of a certain region, to the consumers of a given product, to those living under the same socio-economic conditions, or to an entire group that is affected by public or private enterprise.

These common interests transcend the sphere of individual rights, and therefore necessarily demand that the collective good be placed over that of the individual. Within the common good

there are various aspirations, leading to true new rights under Brazilian law, such as the right to a clean environment, the right to be fully informed, the right to the development and preservation of Brazilian culture and historic heritage, and consumers' rights.

The former constitution established, although not in great detail, certain provisions that dealt with the protection of these various interests, and directly or indirectly provided for protection of children's and adolescents' rights, maternity assistance, education for the handicapped, education, the sciences, literature and the arts, culture, the economic and social order, medical and social security assistance, and other rights, as well.

In addition to preserving these, the new constitution provides for the right to an ecologically-balanced environment and deals extensively with a series of obligations of the state authorities to protect and maintain the environment. The new constitution also provides for the enactment of a code of consumer protection within 120 days after promulgation (Provisional Dispositions, Article 52). The new constitution further allows associations and unions to file class actions to protect general, collective rights, or to seek injunctions and relief in cases in which the lack of a law regulating a constitutional right becomes a barrier to the correct exercise of such right.

The broad and liberal provisions of the new constitution are likely to be defined only on a case-by-case basis. The effective results of its liberal principles therefore will be construed by courts throughout the coming years.

### *Summer Plan*

On January 15, 1989 the federal administration announced several measures to further its plan to halt inflation and create a new Brazilian currency.

Consequently, on March 9, 1989, the Senate enacted Law No. 7738, which provides rules on salaries, contract readjustment clauses, and financial market as follows:

(a) Hourly Wage — Article I provides that daily and hourly wages be calculated with all decimals intact. Only after the total amount is determined should the amount be rounded up to two decimals.

(b) Contract Readjustment Clauses — Only contracts for peri-

ods in excess of ninety days may contain a price readjustment clause. This clause is to be based on national, sectorial or regional cost or price indices, or on indices reflecting a variation in production costs or the prices of materials used. No such index may be linked to earnings of state debt instruments or fluctuations in foreign currency prices unless materials used in the production are foreign in origin. Finally, no such escalator clause may apply for periods of less than thirty days. These rules, however, do not apply to the financial and capital market contracts.

(c) Commercial Leases — Article 5 determines that the price freeze established on January 15 is applicable to commercial and nonresidential leases, except for those whose value has been changed by a court decision. This provision temporarily settles various disputes on the commercial lease rules not yet regulated. Residential leases, on the other hand, were readjusted through January and then frozen.

Law No. 7738 also sets forth rules on housing financing and payment of federal taxes.

*The New Minimum Wage — A Conflict Between Congress and the Executive*

The minimum wage in Brazil is now approximately US\$40 per month. The new constitution empowered Congress to establish the minimum wage by law. Congress, in late November 1988 voted a 100% increase as of January 1, 1989. Subsequent to January, the Cz\$65,000.00 minimum wage was increased by 5% over and above the monthly inflation rate.

Early in December 1988, however, the Executive vetoed the 100% increase, and established the minimum wage for January 1989 at Cz\$54,374.00, a 60% increase over the previous one. The veto came amidst claims from federal administration officials and from businessmen that the 100% raise would lead to hyperinflation and to an even greater federal deficit.

The matter became, together with the 1989 budget, the first showdown between Congress and the President since the enactment of the new constitution.

*Relending*

On November 30, 1988, the Central Bank of Brazil, based on a

policy decision by the National Monetary Council, issued Resolution No. 1540 authorizing Brazil's foreign creditors, which recently lent Brazil US\$4.5 billion under the new foreign debt rescheduling agreements, to relend to Brazilian borrowers a portion of such funds.

The relending of these foreign currency funds is subject to a US\$1.7 billion ceiling during 1989. Contrary to the terms of the rescheduling agreements, no relending was allowed in 1988 in a last-ditch attempt to control the expansion of the monetary basis and, thus, the the monthly inflation rate. The 1989 limit is to be disbursed in twelve installments, the first six equal to US\$158.3 million each, and the last six US\$125 million each.

In 1990 the annual limit will be US\$1.55 billion. From 1990 on, the annual limit is still to be defined subject to the federal administration's monetary policy.

### *Brazilian Foreign Investment*

Any Brazilian investor interested in investing in a foreign country or simply establishing a subsidiary abroad has to acquire on the market and deliver to the Central Bank of Brazil gold certificates for the hard currency amount it wants to remit abroad. This system was adopted to maintain this country's hard currency reserves in the wake of a series of failures of Brazilian foreign investments over the last ten years.

On November 30 1988, the Central Bank issued Resolution No. 1531, exempting from such system remittances to countries with which Brazil (1) maintains reciprocal credit agreements, and (2) has positive balances under such agreements. Such remittances, however, are subject to a US\$5 million ceiling per economic group.

Simultaneously, the Central Bank of Brazil issued Resolution No. 1534, authorizing remittances in forms other than the gold deposit system in the event the Brazilian company investing abroad receives new foreign investment in the same amount it plans to invest overseas. In this case, the foreign investment in Brazil is to remain in the country for as long as the Brazilian investment remains abroad.

### *Import of Electronic Products*

For the second year in a row, the federal administration has

eliminated the U.S. dollar limit on the import of electronic products. The elimination of this year's ceiling, proposed by the Ministries of Planning and Finance Justification No. 003 of February 28, 1989, is based on the federal policy of deregulating foreign trade, and attempts to "favorably contribute to the modernization of the activities that depend on informatics equipment". Last year's US\$800 million limit was also eliminated, and imports soared to US\$1 billion.

### *Debt-Equity Conversion*

On November 30 1988, the Central Bank issued Resolution No. 1530, prohibiting the participation of entities located overseas and controlled by Brazilian federal, state, or municipal entities as investors in debt-equity conversions. This measure attempts to control the debt-equity process within the public administration in one further effort to curb public spending.

### *New Law on Illegal Immigrants*

On December 2, 1988, the Senate passed Law No. 7685, which the president subsequently approved, regulating the provisional registration of illegal foreigners in Brazil.

Article 1 of Law No. 7685 allows any foreigner who illegally entered the country prior to July 1, 1988 to apply for registration at the nearest immigration office. Such registration guarantees the foreigner a stay of up to two years and the same rights as if he/she had a temporary visa under the Foreigners' Law. Such rights include:

- (i) exercise of a remunerated activity;
- (ii) enrollment in schools; and
- (iii) freedom to come and go within the Brazilian territory.

The two-year stay may be extended if there is evidence of:

- (i) the exercise of a profession or employment relationship, or if there are properties sufficient for maintenance;
- (ii) good behavior;
- (iii) no tax debts or criminal records exist; and
- (iv) the foreigner is in good health.

The temporary visa may be replaced by a permanent resident

visa by approval of a request made within the 90 day period prior to expiration of the two-year stay.

### *Taxation of Financial Income*

For the third time since January 15, 1989, the federal administration changed the tax rates applicable to financial income. According to Provisional Measure No. 42, issued on March 16, 1989, the withholding income tax rate for transactions for less than ninety days is eight percent and five percent for transactions for more than ninety days.

These rates are applicable to all transactions with fixed-rate securities earned by individuals and mutual funds, as well as to any financing transactions realized on the stock, commodities and future exchanges. The above rates, however, are not applicable to:

(i) short-term funds, subject to a twelve percent withholding income tax rate;

(ii) day-trade transactions, subject to a forty percent withholding income tax; and

(iii) savings accounts, subject to taxation in accordance with Law No. 7738.

The new rules allow corporate entities to avoid withholding income tax, provided such entities prove in writing that they are subject to taxation on their taxable profit and the following conditions are met:

(a) income generated by:

(i) term deposits or nontransferable registered financial instruments;

(ii) book-entry financial instruments;

(iii) book-entry registered debentures, kept in custody by an institution authorized by the Securities Commission;

(iv) financial instruments maintained and traded only in registered form and in one of the systems for custody and liquidation (SELIC and CETIP) authorized by the Central Bank of Brazil;

(b) the transaction is redeemed by means of a credit in an account kept with a financial institution or by means of crossed, registered check for deposit only; and

(c) upon transfer or liquidation, the trading receipt which evidences the transaction is presented.

The above benefits of only being taxed on their year-end statements do not apply to day-trade income and income earned from short-term funds. However, the benefit does apply to income earned from investments in fixed-income funds (whose minimum lock-up period is thirty days).

Provisional Measure No. 42 also determines that savings accounts shall earn in May the same income paid by the Financial Treasury Bond (LFT) plus the usual 0.5% monthly interest. No rules have been established for savings account earnings for the remainder of the year.

### *Reduction in Tax Incentives*

By means of Provisional Measure No. 21, dated December 6, 1988, the Executive proposed an extensive reduction in the tax incentives available to corporations. It is hoped that the reduction, the first of its kind since tax incentives became a popular economic policy instrument in the late 1960s, will bring down to zero the federal deficit proposed in the 1989 budget. The 1988 deficit was nearly four percent of the Brazilian gross national product.

Under the new Brazilian Constitution, provisional measures are subject to congressional review within thirty days of their issuance. If they are not approved, they are held to be void from their enactment.

### *Mergers of Financial Institutions*

On March 9, 1989, the Central Bank of Brazil issued Circular No. 1456 regulating the accounting rules applicable to mergers and spin-offs of financial institutions. Article 2 requires that both financial companies in a merger, or the one being spun off, draw up balance sheets to be audited by independent auditors, providing for:

- (i) inventory and general adjustment of all assets and liabilities, taking into account any difference;
- (ii) a *pro rata temporis* adjustment up to the date of the merger or spin-off of all active and passive transactions as well as of other income and expenses;



- (iii) monetary correction of fixed assets and net worth;
- (iv) accounting of the depreciation and amortization quotas;
- (v) provisions for possible asset devaluations; and
- (vi) net worth of relevant investments, profit-sharing and income tax provisions, if any.

Circular No. 1456 also lists the documents companies are to make available for Central Bank review in the five years following the merger or spin-off.

### *Monetary Correction of Dividends*

On November 17, 1988, the Securities Commission released to the public its Opinion No. 16, providing for general rules to be followed by corporations. Even though such opinions are not enforceable rules, which may also be issued by the Commission, they are viewed as safe-harbor rules for market participants.

In view of the high Brazilian inflation rates, twenty-nine percent monthly in 1988, Opinion No. 17 recommends that, in the event dividends on preferred shares are to be paid based on a percentage of the nominal share value (par value) or of the capital, such basis (the par value or the capital) shall first be monetarily corrected from the date of issuance until the date of actual payment of the dividend.

### *Public Offerings of Securities*

On December 3, 1988, the Securities Commission issued Normative Instruction No. 88 regulating certain secondary offerings of securities by Brazilian publicly-held companies, their shareholders and creditors.

Accordingly, prior registration with the Securities Commission is now mandatory when there is a sale, a sale commitment, an offer to sell, or acceptance of a sale request for:

(i) common or preferred shares in a publicly-held company representing more than five percent of the outstanding shares of the same type or class, when offered by the issuer, its founders or persons equated thereto;

(ii) shares or debentures issued by closed corporations held in treasury, or owned by the controlling shareholders, or persons equated thereto, that are distributed to the public subsequent to

the corporation's registration with the Securities Commission, to be traded on stock exchanges or on the over-the-counter market.

(iii) debentures issued by publicly-held companies through private placings when offered by whomever intends to distribute them publicly;

(iv) any number of shares when methods used in negotiations represent a sales effort greater than normal for the secondary market;

(v) subscription rights and options originating from public offerings owned by the controlling shareholders or persons equated to the issuer in an amount greater than five percent of the issue, provided the offering corresponds to at least five percent of the outstanding shares of the same type or class; and

(vi) options in such volume that their exercise may result in subscription for shares corresponding to more than five of the outstanding shares of the same type or class, when offered by the issuer, its founders or persons equated thereto.

Normative Instruction No. 88 also sets forth the rules governing the registration of such offers, prospectuses, and advertising materials as well as the civil liability of the offeror.

### *Constitutional Limitation on Interest Rates*

One of the most debated articles of the new Brazilian Constitution purportedly limits interest rates to a maximum of twelve percent per year. Proposed by leftist parties, it was unexpectedly approved by a conservative Constituent Assembly.

The provision, however, was inserted at the end of an article providing for the enactment of a new domestic financial market law. A doubt then arose as to whether the provision was self-executing, or whether it would require the passing of a new law.

Immediately after promulgation of the constitution, the Central Bank issued a resolution stating that the provision was not self-executing and, therefore, interest rates would be allowed to float freely. The legal basis for the rule was provided by an opinion of the Counsellor General of the Republic, a direct assistant to the President of the Republic, who had opposed the provision.

In November, the Democratic Labor Party (PDT), a left-of-center party, filed an action with the Supreme Court against the Central Bank ruling.

The Office of the Attorney General of the National Treasury has recently released Opinion No. 884, dated November 28, 1988, responding to the claims of Labor politicians. Opinion No. 884 basically holds that Article 192 contains in its main section two basic rules: one providing for the structuring of the financial system so as to promote balanced development, and serve the interests of the nation, and another providing that such regulation should be issued as a complementary law (a type of law that requires a special quorum to be passed and modified, and serves as a complement to constitutional provisions).

In accordance with Opinion No. 884, the purpose of paragraph 3 of Article 192 is to provide for the twelve percent cap on annual real interest rates as well as to categorize any breach of this cap as a contravention of usury law. However, according to Opinion No. 884, paragraph 3 is merely a parameter to be observed by legislators when voting on the new financial law system. The cap is not self-executing, and, in fact, is an incomplete rule of law, as it does not define what "real interest" is, nor how to determine the correct inflation rate, thereby making it impossible to determine a breach of its terms.

Opinion No. 884 also claims that any opposite understanding would bring to a sudden halt the federal administration's monetary policy, consumer financing, loan agreements, credit cards, bank discounting transactions, foreign currency loans and the offering of state instruments of indebtedness. It further states that the Constituent Assembly records of discussions on the floor of the Assembly and in committee, presented in the action as evidence, are not considered binding sources of law. Opinion No. 884 is to be submitted to the Supreme Court, which will hear the case sometime in 1989.

### *Income Tax Reform*

On December 22, 1988, the President of the Republic submitted Law No. 7713 containing new rules governing the taxation of income received by individuals. Congress approved almost everything the Executive proposed in the 1988 income tax. The new law simplifies the taxation of individuals, and creates only two tax rates, namely ten percent and twenty-five percent.

Congress also approved on December 5, 1988 the provisional measure proposed by the Executive that determines the daily mon-

etary correction of federal taxes as from their due date. The provisional measure became Law No. 7691, and the federal administration expects it will help reduce the federal deficit by increasing tax revenues. With a daily inflation rate of almost one percent, as a rule, tax revenues were substantially depleted by the date of payment. The monetary correction now approved will update the amount to be paid in accordance with the variation index of the National Treasury Bonds up to the due date. Thereafter, the updating will be done on a daily basis.

## II. JUDICIAL AND ADMINISTRATIVE DECISIONS

### *Exports of Manufactured Products Fiscal Incentives*

The fiscal authorities have a forty-five day period to consider and decide on requests to refund tax credits on sales made to purchasers overseas. This term cannot be extended by using the argument that there is a tax execution under way against the taxpayer (Appeal in Writ of Mandamus No. 88916 of the 6th Panel of the Federal Court of Appeals, Reporting Justice Carlos M. Velloso).

### *Professional Activities of Attorneys*

In a session held on December 20, 1988, the Federal Council of the Brazilian Bar Association (OAB) approved Act No. 66/88, defining the scope of professional activities engaged in by attorneys. According to this act, the practice of law includes, in addition to representation in any court, higher court or government agency in the land, extrajudicial procuration, as well as legal work involving consultancy, assistance and the providing of counsel. Attorneys also have the proprietary right to provide legal assistance in real estate transactions, in drafting contracts and by-laws of civil and commercial companies, as well as with the preparation of defenses before any courts and government agencies. This act further provides that attorneys are prohibited from providing legal assistance services to third parties by means of service rendering companies not eligible for enrollment with OAB. As a consequence, performance of the acts set forth in Article 71 of Law No. 4215 of April 27,

1963, by professionals and companies not enrolled with OAB, constitutes an illegal exercise of the profession of attorney.

PINHEIRO NETO  
*Advogados*  
*São Paulo, Brasil*