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BRAZIL

The following is a brief summary of several legislative and administrative rulings, and several judicial and administrative decisions of the Brazilian government which may affect foreign trade and investments in Brazil.

I. LEGISLATIVE AND ADMINISTRATIVE RULINGS

Foreign Vessels in Brazilian Coastal Navigation

The President of the Republic, through Decree 88.009 of December 30, 1983, has authorized the National Superintendency of the Merchant Marine (SUNAMAM) to grant permission, until December 31, 1983, for foreign vessels to engage in coastwise shipping if chartered by a domestic shipping company (DOU-1, December 31, 1982).

New Series of ORTNs Offers Option as to Method of Adjusting Redemption Value

The Minister of Finance has authorized issuance of a new series of Readjustable National Treasury Bonds - ORTNs. They are available for voluntary subscription, and offer the holder the option, at the time of redemption, of either having the value corrected on the basis of the coefficients fixed by the Office of the Secretary of Planning, or by using the Central Bank's coefficients, which are based on the change in the quotation of the cruzeiro on the exchange market. Under Ordinance No. 289-82, the new bonds will have a maturity of five years, will not yield interest, and may be either bearer or registered endorsable instruments (DOU-1 December 31, 1982).

Steps Taken to Reduce the Cost of Credit

The following Central Bank Resolutions are part of a "package" of measures taken recently to reduce the cost of credit on the

domestic market. All were published on January 13, 1983 (DOU).

Resolution No. 786/83 amending item 1 of Resolution No. 780/82 to increase, from 10% to 20% (including charges) the growth to be permitted in loans made by investment banks during the first quarter of 1983;

Resolution No. 787/83 reduces the Tax on Financial Transactions (10F) rate as it is presently levied on credit transactions. Subsequently, the Central Bank's Circular Letter, No. 842/83, explained that the reduced rate only applies when the event generating liability for the tax occurs either on 13th January, 1983 or thereafter;

Resolution No. 795/83, raises the limits on the expansion of credit by commercial banks.

Exemption from Import Duties - Telecommunications Equipment

The President of the Republic, under Decree-Law No. 2011 of January 18, 1983, has granted an exemption from import duties and from the Tax on Manufactured Products (IPI) for machinery, equipment, instruments and apparatus as well as accessories, components and parts thereof that have no Brazilian equivalent or "similar" and are imported by Empresa Brasileira de Telecomunicações S.A. (EMBRATEL) in connection with its domestic Satellite Communications Program (DOU-1, January 19, 1983).

Recent Bank Resolution on Leasing

Resolution No. 788/83 exempts (from the Tax on Financial Transactions) (10F) those operations involving commercial leasing of machinery and equipment purchased for cash and covered by a contract between the overseas lessor-purchaser and the lessee-seller domiciled in Brazil. Furthermore, the rate at which income tax is withheld on remittances of lease payments under such contracts has been reduced to 2%. The provisos are that the leased goods are to be used by the lessee in its own business, that there be a written agreement for at least eight years, and that the total value of the lease is less than 75% of the cost of the goods.

Resolution No. 789/83 amends Resolution No. 668/80 which permitted leasing of foreign-manufactured capital goods to be contracted for as little as five years between the foreign company and the ultimate user of the item in Brazil and which reduced the with-

holding tax on remittances of lease payments. Now the eligibility for the reduced withholding tax rate will no longer be restricted to capital goods, and the calculation of the cost of the leased item for purposes of determining that the total value of the lease is less than 75% of same may include the financial charges on the transaction (DOU-1, January 13, 1983).

Regulations on Incentives for Capitalization of Companies

The granting of financial credit, established by Decree-Law No. 1994/82, has now been regulated by Ministry of Finance Ordinance No. 13/83. Once the terms of the Decree-Law have been observed, then, in the case of capitalization of foreign loans taken out in foreign currency, the credit will be 10% on the capitalized amount if capitalization takes place by June 30, 1983, or 5% if capitalization occurs between July 1, 1983 and December 31, 1983. The benefit is to be used to offset income tax due for the year in which capitalization occurred, and the value of the credit obtained will be corrected according to the ORTN indices until such time as it is utilized (DOU-1, January 13, 1983).

Price Controls Imposed on Variety of Products

The Price Commission (CIP) has placed a limit on the percentage that manufacturers of 273 consumer products and providers of four types of services may raise their prices above the levels stated in their latest price lists filed with the CIP. The increases may not exceed 90% of the change in the par value of the Readjustable National Treasury Bonds (ORTNs) which occurs subsequent to February 24, 1983. The measure, which will be in effect through August 1985, is intended to soften the effect on domestic prices of the recent devaluation of the cruzeiro (DOU-1, February 24, 1983).

Commission on Automation of Manufacturing Created

In Ordinance No. 004/83, the Office of the Special Secretary for Informatics (SEI) has created Special Commission No. 012-83 - Automation in Manufacturing (CEAM). The purposes of the new commission are: to report on and analyze the social, economic and technological implications of automation in the various industrial sectors, and to define the stages of technical development attained in computer-aided design, computer-aided manufacturing, and in

robotics. The commission's findings will be used in determining national policy in this area (DOU-1, February 10, 1983).

Foreign Investment in Brazilian Securities Market to be Stimulated

The National Monetary Council, in article 30 of Central Bank Resolution No. 790/83, has significantly reduced the period in which these foreign investments must remain in Brazil. Now they need only to be kept here for 90 days; previously the minimum was two years (DOU-1, January 14, 1983).

Export Taxes

The Central Bank of Brazil has issued Resolutions Nos. 799/83 and 800/83 approving the list of products which are to be subject to export tax at rates ranging from 10-30%. The tax is being levied in order to prevent the price of certain Brazilian export products from falling sharply due to the recent "maxi-devaluation" of the cruzeiro. Furthermore, in Ordinance No. 39/83, the Minister of Finance explains that this tax is to be paid at the time the respective exchange contract is liquidated or within 30 days after the date of shipment when the exports are made without exchange cover or when the export exchange was liquidated prior to the issue of the license by CACEX (DOU-1, February 21, 23 and 24).

II. JUDICIAL AND ADMINISTRATIVE DECISIONS

Taxation of Salaries Received Abroad by Brazilian Residents

Income from salaried employment received abroad in foreign currency is not taxable when earned by an individual who, having transferred his residence from Brazil, is eligible under article 3 of Decree-Law No. 1380/74 to opt for maintenance of his status as a resident of Brazil. However, when a Brazilian transfers his residence abroad with the intent that such a move be permanent, and in order to work for overseas branches, offices, or agencies of companies domiciled in Brazil (or for companies domiciled elsewhere in which at least 5% of the capital is held by companies domiciled in Brazil) his overseas salary will be subject to Brazilian income tax. (2nd Chamber of the 1st Taxpayers' Council-Decision No. 102-1884.

Deductibility of Temporary Lodging Expenses - Employee Coming from Abroad

Expenses incurred by employees of Brazilian companies who have come to Brazil from abroad, in payment of lodging for themselves and their families while arranging for permanent housing, are not deductible from gross income; in this regard it does not matter that they were employed abroad by a company which has an interest in the capital of their Brazilian employer (2nd Chamber of the 1st Taxpayers' Council - Decision No. 102-18.984).

Losses from Hedging Transactions

Losses from futures transactions on foreign commodities exchanges (hedging) may be taken into consideration in determining taxable profit (1st Chamber of the 1st Taxpayers' Council - Decision 101-73.204).

Income Tax on Remittances Abroad

Precedent No. 585 of the Federal Supreme Court (STF) states that income tax is not levied on the remittance of foreign exchange for payment of services rendered outside Brazil by a company which does not operate in Brazil (cited by 4th Panel of the Federal Court of Appeals, in appeal of Writ of Mandamus No. 96.216).

The following is a short essay on the Brazilian government's present system of taxation of D.L. 1.401 Investment Companies.

THE CURRENT SYSTEM OF TAXATION OF D.L. 1.401 INVESTMENT COMPANIES

In 1975, the Brazilian government gave foreign investors the opportunity to invest foreign funds on the Brazilian stock exchanges. Fearing, however, that these investments might be made for mere speculation and might hamper the development of the stock market, the government required that such investments be made through investment companies organized especially for such purpose. These foreign investments were to remain in Brazil for at least two years and were afforded the tax treatment defined in Decree-Law No. 1.401 of May 7, 1975. In practice, these special investment companies began to be called D.L. 1.401 Investment Companies ("Sociedades de Investimento - D.L. n. 1.401").

The shareholders of these D.L. 1.401 Investment Companies

are individuals or corporate entities (including investment funds) resident or domiciled abroad. These companies are managed by Brazilian financial groups through local investment banks or brokerage houses. The foreign funds raised by the D.L. 1.401 Investment Companies are direct investments (i.e. the foreign investor purchases or subscribes to shares of the D.L. 1.401 Investment Company), which are then invested on the Brazilian securities market.

The Brazilian government came to the conclusion that the investment companies had not attracted the expected volume of foreign funds because the tax treatment that had been afforded to the companies who had invested was too restrictive. In fact, the capital gain earned by foreign investors on selling their shares in the D.L. 1.401 Investment Company was subject to the withholding of a 15% income tax at its source and to a supplementary income tax at rates that varied from 40% to 60%. The income distributed by the D.L. 1.401 Investment Company to its shareholders (cash dividends and bonuses) was, in turn, subject to withholding tax of 8% to 15% (depending on how long the investment remained in Brazil) and also to a supplementary income tax.

Seeking to encourage the inflow of foreign funds through D.L. 1.401 Investment Companies, the Brazilian government has now reduced the tax burden on the income paid by such companies to their shareholders, whether individuals or corporate entities and whether resident or domiciled abroad. Decree-Law No. 1.401/75 has thus been partially revoked. It is expected that, at the beginning of 1983, the National Monetary Council will approve new changes, for which the Central Bank of Brazil will then issue regulations, in a further attempt to attract foreign funds to the Brazilian securities market through the D.L. 1.401 Investment Companies. One of the changes should be the reduction of the minimum two-year period in which these investments must remain in Brazil.

The cash dividends and bonuses distributed by D.L. 1.401 Investment Companies to shareholders, resident or domiciled abroad, are subject to the withholding of income tax, at its source, at the rate of 15% (article 2), provided that the taxable income was earned on investments that entered Brazil as of December 29, 1982, the date of publication of Decree-Law No. 1.986/82 in the Official Gazette of the Federal Executive and the date of effectiveness of the new legal provision. According to the new system, the progressive reduction of the withholding tax on income (cash divi-

dends and bonuses) was maintained only for investments that entered Brazil before the date of effectiveness of Decree-Law No. 1.986/82 (article 3). For all investments that entered the country after that date, the reduction was eliminated, and the applicable withholding tax rate is henceforth exclusively 15%, regardless of the period in which the funds remain in Brazil.

Accordingly, the withholding tax on income earned on investments that entered Brazil before December 29, 1982 and that are fully maintained in Brazil for the periods listed below (counted as of the date of registration of the initial investment) will, after the sixth year of permanence in Brazil, be due according to the following rates:

| <i>Period of Permanence</i> | <i>Applicable Tax Rate</i> |
|-----------------------------|----------------------------|
| up to six years | 15% |
| from six to seven years | 12% |
| from seven to eight years | 10% |
| more than eight years | 8% |

The remittance abroad of the cash dividends and bonuses distributed by D.L. 1.401 Investment Companies is now exempt from the supplementary income tax required under article 43 of Law No. 1.401 of September 3, 1962, as amended by article 1 of Law No. 4.390 of August 29, 1964 (article 3). Under the prior system, the remittance was subject to supplementary income tax of 40% to 60%.

Income tax exemptions were also granted for capital gains made by individuals or corporate entities, resident or domiciled abroad on selling their shares in D.L. 1.401 Investment Companies, subject to the rules and conditions established by the National Monetary Council (article 5). Under the former system, these capital gains were subject to a withholding tax of 15%, and also to a supplementary income tax.

It should be pointed out that articles 1 and 6 of Decree-Law No. 1.986/82 merely reproduce articles 1 and 7, respectively, of Decree-Law No. 1.401/75. Article 7 of Decree-Law No. 1.986/82 specifically revoked articles 1, 2, 3, 5, 6 and 7 of Decree-Law No. 1.401/75. Article 4 of Decree-Law No. 1.401/75 thus remained in effect. It establishes that the capital gains made by residents of other countries on foreign currency investments not covered by Decree-Law No. 1.401 (meaning investments in the capital stock of companies not considered as D.L. 1.401 Investment Companies) shall continue to be taxed with a withholding tax of 25%.

In summary, according to the system of Decree-Law No. 1.401/75, as amended by Decree-Law No. 1.986/82, foreign investors cannot invest directly in the Brazilian stock exchanges or securities market. These investments must always be made indirectly through the D.L. 1.401 Investment Companies. The foreign investor thus purchases or subscribes to shares of a D.L. 1.401 Investment Company, and the respective investment is registered at the Central Bank of Brazil. On selling the shares held in the D.L. 1.401 Investment Company, the foreign investor can repatriate the capital gain free of tax but each investment must remain in Brazil for at least two years (this period may be reduced by the National Monetary Council). The income distributed by the D.L. 1.401 Investment Companies (cash dividends and bonuses) may also be remitted abroad and is subject to a withholding tax at the standard rate of 15%, regardless of the period in which the investment remained in Brazil (except for investments that entered Brazil before December 29, 1982, for which the withholding tax rate may be reduced according to the table shown in item 9 above).

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