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An Update on Brazilian Trading Companies and Export Credit*

THOMAS J. SKOLA**

Because of its pressing balance-of-payments problems, Brazil has made exportation of manufactured goods a high priority. Since the economics of Brazil's foreign trade is constantly changing, so are the rules and policies governing export activities, including, *inter alia*, institutions, procedures, financing and incentives. This brief comment depicts an important Brazilian export institution, the "trading company," and summarizes the current status of the "export credit."

I. *Brazilian Trading Companies*

A. *Nature.* The "commercial export company" (*empresa comercial exportadora*), commonly referred to in Brazil as a "trading" or "trading company," was created in 1972 by special legislation.¹ The trading company is the major exception to the general rule in Brazil that export incentives may only benefit the manufacturer who directly exports his products.

In addition to the general rules governing legal entities, trading companies must comply with the following specific requirements:

1. all voting power in the form of registered (nominative) stock;
2. a minimum capital equivalent to the par value of 114,000 Readjustable Treasury Bonds (ORTNs) as of April of each year (approximately Cr \$191,877,960 or U.S. \$1,297,875 at the exchange rate prevailing on April 5, 1982); and
3. specific registration with the Foreign Commerce Board of the Bank of Brazil and the Brazilian Internal Revenue Service.

B. *Purpose.* A trading company is primarily a commercial entity and, as such, may undertake all activities permitted by applicable law and its by-laws. In addition to normal commercial operations, however, a trading company enjoys special benefits when it purchases

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1. Decree-Law 1.248 of Nov. 29, 1972.

products specifically for export.² Thus, trading companies may undertake both taxable and tax-exempt types of activities. Among the activities of a trading company subject to normal taxation are the purchase and sale of goods in the domestic market, importation of goods for resale in Brazil, brokerage of transactions either in Brazil or abroad, and rendering of services in general. Unless a product is specifically purchased by a trading company for export, export benefits under Decree-Law 1.248 are normally unavailable. Nevertheless, if a trading company eventually exports a product not specifically purchased for export, it may still obtain an export credit and recoup any Industrialized Products Tax (IPI) included in its price. If the trading company purchased any such product from merchants exempt from payment of the IPI, part of the IPI payments may be recouped by applying the rate in effect on the date of purchase against fifty percent of the purchase price.

Trading company transactions qualifying for financial and tax benefits are purchases of products within Brazil for the specific purpose of exportation. All such transactions must comply with these two conditions:

1. the goods must be invoiced by the manufacturer-seller directly to the trading company with specific reference to Decree-Law 1.248; and
2. the goods must be delivered to the trading company directly at certain places established by the law (*e.g.*, port, airport or warehousing facility in a free-trade zone or special export customs area), from which such goods will be exported directly abroad.

C. *Role.* In export transactions, the trading company plays the role of a wholesaler purchasing domestic goods for sale outside Brazil. The trading company simplifies sales for the domestic manufacturer and qualifies such transactions for certain preferential treatment and incentives. Direct exportation requires manufacturers to assume all risks and costs related to the sale of their products outside Brazil, including *inter alia*, identification and penetration of the foreign market, credit risks, and foreign exchange risks. Since many smaller

2. Brazilian legislation places the trading company in the same position as a manufacturer that directly exports its products, thereby extending certain financial and tax benefits to the trading company. The expressions "trading" and "trading company" have evolved to distinguish this particular institution from other commercial entities also active in export activities and generally labeled commercial export companies.

and medium size firms lack the infrastructure and staff required for direct exportation, conducting export sales through the intermediary of a trading company is a sensible alternative. From the Brazilian manufacturer's standpoint, a sale to a trading company is completed upon invoicing and delivering export goods to a place established by law. All costs and risks of the export transaction pass to the trading company at the time of delivery. As a result, the export transaction is greatly simplified for the local manufacturer, who may more rapidly take advantage of the applicable export incentives and benefits.

D. Supplier Benefits. A local manufacturer exporting directly or through a trading company normally qualifies for the following benefits and incentives: exemption from IPI,³ exemption from the Tax on the Circulation of Merchandise (ICM), reapplication of IPI and ICM credits to the components of the exported product, income tax credits, import access under a drawback regime, and access to export financing.⁴ These benefits and incentives are practically the same whether the local manufacturer exports its products directly or through a trading company, with the exception of the export credit, discussed below in more detail. Many local manufacturers prefer to export through a trading company because they can obtain virtually the same export incentives and benefits without the costs and risks normally associated with direct sales abroad.

E. Trading Company Benefits. In addition to the availability of favorable financing, the trading company enjoys certain direct and indirect tax benefits. The indirect tax benefits result from purchasing goods exempt from normal duties and taxes (e.g., IPI and ICM). The direct tax benefits are the income tax deduction of the trading company's export profits and the export credit. For purposes of computing its income tax, the trading company may deduct from its net profit⁵ its gross export profit.⁶ In order to determine its gross export profit for any given export transaction, the trading company may add to the FOB sales price all amounts relating to freight and insurance, provided that Brazilian ships and insurance companies are utilized in such transactions. A trading company has an incentive to engage in non-export as well as export transactions, since it loses a potentially significant income tax benefit if its gross export profits exceed its total net profits.

3. Recently confirmed in Normative Instruction SRF 11 of Mar. 12, 1982.

4. Central Bank Res. 674.

5. "Net profits" means the total net profits of the trading company, as reflected on its balance sheet, from all of its activities, including export transactions.

6. "Gross export profits" means the difference between the domestic purchase price and the FOB sales price paid abroad.

In addition to these tax benefits, a trading company can take advantage of many pre-export and export credit lines. For example, a trading company can obtain cash advances against foreign exchange contracts relating to its purchase orders. Subsidized credit for the sale of capital and durable consumer goods abroad is obtainable,⁷ as is financing for, *inter alia*, foreign research and promotional expenses, consignment sales, and the acquisition of capital in foreign companies.⁸ Under certain conditions, a trading company may also qualify for financing the discounting of warehouse deposit receipts.⁹

II. *Export Credit*

An important export incentive in Brazil is the "export credit" (*premio de exportação*).¹⁰ Although generally regarded as an incentive within the IPI incentive program, it is more commonly referred to as simply the export credit, and is normally paid in the form of a cash refund.

The export credit is tied to the nature of the underlying export transaction and the type of product being exported. As a general rule, this credit applies only to foreign sales of qualified products in readily convertible foreign exchange. All products qualify for this incentive unless expressly excluded by pertinent legislation.¹¹ For example, imported products that are subsequently exported will only qualify if transformed, improved or assembled in Brazil; exports of used products and scrap iron do not qualify for the export credit. On the other hand, products exported on consignment and for industrial fairs and expositions do qualify for this credit, as do goods supplied for use or consumption aboard vessels or airplanes operating in international routes, provided that payment is made in convertible foreign exchange. Curiously, a product need not actually be exported abroad to qualify for the export credit. Capital goods sold to leasing companies abroad for use in Brazil in commercial leasing transactions qualify for this export incentive if they produce convertible foreign exchange, as do locally manufactured products sold to PETROBRAS (the state petroleum monopoly), its contractors or subcontractors (including those active in risk contract activities offshore), so long as they are invoiced in convertible foreign exchange. Similarly, domestic products

7. Central Bank Res. 509.

8. CONCEX Res. 68.

9. Cf. Central Bank Res. 330.

10. Decree-Law 491 of Mar. 5, 1969.

11. A list of non-qualifying products was first published in Ministry of Finance Ruling 78 of April 1, 1981.

used in the repair of ships, airplanes and certain industrial and agricultural equipment also qualify, as do investments made abroad without foreign exchange coverage.

The beneficiary of the export credit is always the entity which actually does the exporting. The manufacturer of the exported product only receives this credit if it exports the product directly; manufacturers exporting through a trading company or any other type of commercial intermediary will not normally qualify.

The credit is computed according to fixed rates in effect on the date of shipment of the product, deemed to be the date appearing on the export license or declaration corresponding thereto.¹² This export credit is computed on the basis of the "net FOB price," defined as the amount in foreign exchange appearing on the respective export license or declaration after deduction of certain items provided by law. Deductible items include the following: commissions to be paid to agents or representatives abroad, all deductions or discounts, fines and contractual penalties, the CIF price of components imported under the drawback regime in excess of twenty-five percent of the net FOB price of the corresponding export, and interest on financing obtained under Central Bank Resolution No. 509/79 or on other credits obtained from the federal government. Once the net FOB price has been determined, the foreign currency value is converted into cruzeiros at the official buying rate in effect on the date of shipment, as documented in the export license or declaration.

The export credit is collected by the exporter at the same bank at which the foreign exchange contract is negotiated pursuant to a Declaration of Export Credit. With respect to exports paid in cash, the credit is to be paid to the exporter upon shipment of the goods abroad. With respect to exports sold on credit terms of 180 days or less, the credit is to be paid to the exporter after negotiation of the corresponding foreign exchange contract. With respect to exports sold on credit terms exceeding 180 days, the credit is to be paid after delivery to the bank of the corresponding shipping documents.

Any violation of the rules governing this incentive subjects the beneficiary to fines and penalties, as well as to payment of interest and monetary correction on the amount involved. For example, if the exports qualifying thereunder are not paid for, or are partially paid

12. For example, if the product is shipped between April 1, 1981 and March 30, 1982, the exporter will receive a 15% credit. Such credit shall be gradually reduced to 9%, starting on April 1, 1982.

for outside Brazil, the beneficiary is subject to the aforesaid penalties and charges. But the beneficiary is not subject to such penalties or charges if the failure to pay for such exports is attributable to causes beyond its reasonable control.

Provided it is properly accounted for on the books of the exporter, the amount of the export credit shall be deemed to constitute "export income" of the exporter for purposes of all applicable income tax incentives.

The above notes and comments are meant for general orientation purposes only, since, as previously mentioned, this subject matter is constantly suffering significant modifications and policy changes. Frequent updating is advisable, as well as close review of the pertinent legal text and consultation with experienced counsel.