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LEGAL MEMORANDUM

The following is a brief summary of legal rulings and decisions recently enacted by the Brazilian Government:

I. LEGISLATIVE AND ADMINISTRATIVE RULINGS

IPI Tax Credit

To systematize application for tax credits on manufactured products (IPI tax), the Coordinator of the Taxation System issued Normative Ruling No. 6/80 establishing assured credit for initial purchase of raw materials, intermediary products and packaging material, when purchased for resale or in house use and employed in the manufacture of products that are subject to IPI tax. The credit is to be entered in company books when the materials are actually utilized in the manufacturing process (DOU-I, 1 of February 22, 1980).

Price Control

The Price Control Commission (CIP) issued Resolution No. 137/80 requiring industries to submit to the Commission, within 150 days of the close of the fiscal year, their financial statements, explanatory notes, and other information that may be requested. This requirement will apply to industries, corporations and all other companies that are subject to income tax based on actual profits.

Double-Taxation Treaty—Brazil/Japan

Brazil and Japan signed a Double-Taxation Treaty in 1967, which was amended in 1978. The Coordinator of the Taxation System has now issued Declaratory Act No. 2/80 to clarify that interest paid to a Japanese bank through an agency established in a third State is subject to the provisions of the treaty. The treaty will not apply, however, to interest paid to Japanese banks having their head offices in a third State (DOU-I, 1 of February 28, 1980).

Financing of Exports

In furtherance of the Government policy of substantially increasing Brazilian exports to correct the country's balance of payments, the Bank of Brazil issued Resolution No. 602/80 creating a program of official financing for export production. To join this program companies must sign a commitment with the Foreign Trade Department (CACEX) of Banco do Brasil S.A., assuming the obligation to export a

certain volume of national products within a one-year period. In Circular No. 508/80 the Central Bank established further that such financing will only be paid out to companies that have obtained a qualification certificate from CACEX specifying the amount of financing in United States dollars (DOU-I, 1 of March 7, 1980).

Passports

To simplify passport procedures for Brazilian citizens, the President of the Republic signed the new Passport Regulation (Decree No. 84.541 of March 11, 1980), replacing the 1938 procedure. Brazilian citizens will no longer be required to have an exit visa to leave the country, and normal passports will henceforth be valid for six years. The number of documents needed for passport application has also been reduced to the following: (a) identity card of birth or marriage certification; (b) voter's card; and, (c) evidence of payment of respective fees (DOU-I, 1 of March 12, 1980).

International Agreement

The Minister of Foreign Affairs of Brazil and the Ambassador of Poland signed an agreement establishing a Polish commercial office in the City of Rio de Janeiro (DOU-I, 1 of March 10, 1980).

Changes in Import Duty Rates

In an effort to correct Brazil's balance of payments by encouraging exports and discouraging imports, the President of the Republic signed Decree Law No. 1.775 of March 12, 1980, which alters the rates of import duty under the current Brazilian Customs Tariff. The increased rates are effective only until March 31, 1981, after which time the former rates will be reinstated. Products now subject to 30% or 40% import duties include a wide range of inorganic and organic chemical products, certain engines, earthwork and farming equipment, textile and tool machinery, electrical and optical equipment and instruments, and also certain test and measuring instruments (DOU-I, of March 24, 1980).

Software

To date, software has not received legislative, judicial, or other specific treatment in Brazil. To fill this gap, the Special Software and Service Commission was created (Portaria No. 003/80 of the Special Informatics Department). This Commission will supply the Department with information on software in Brazil to support Brazilian in-

formatics policy and to develop and consolidate the national software industry (DOU-I, of March 24, 1980).

Extinction of Export Incentives

By means of Portaria No. 187/80, the Minister of Finance determined the new dates for the gradual reduction of the tax incentive granted under Article I of Decree-Law No. 491/69. This incentive gives companies that produce and export manufactured products the right to tax credits on their exports and to deduct such credits from their IPI tax and other federal tax liability for domestic sales. This incentive will be subsequently reduced by 10% on each June 30 and December 31 of 1980, 1981, and 1982, and on June 30 of 1982, (DOU-I, of March 27, 1980).

Official Acts of the INPI

The President of the National Institute of Industrial Property (INPI) issued Normative Act No. 40/80, altering the names given to the INPI's official acts and determining the authority to issue such acts. The INPI will henceforth issue *Atos Normativos* (AN) (Normative Acts), *Ordens de Serviços* (OS) (Service Orders) and *Portarias* (PT). The President will issue Normative Acts establishing Institute policy and rules of operation. The Directors, Coordinators, Delegates and Representatives of the various INPI Departments will issue Service Orders establishing specific rules and procedures regarding the services on all INPI administrative levels; and the President and other INPI authorities will issue *Portarias* for acts in connection with their respective staffs and for all contracts for services outside the INPI structure (Industrial Property Review of March 18, 1980).

Securities Commission

The Securities Commission (CVM) issued Opinion No. 8/80 for clarification of the following points. First, publication of the Board of Director's Report is an essential legal condition for a valid annual general meeting of the company. Failure to make such a publication cannot be remedied by attendance of all shareholders at the meeting because this defeats the purpose of making the report available to the general public. Secondly, no profit-sharing may be paid out to the company's directors or managers before the actual payment of dividends to shareholders. This should discontinue the interpretation of the Corporation Law allowing profits to be paid to directors or mana-

gers after dividends have been merely attributed to the shareholders (DOU-I, of March 28, 1980).

Central Bank Resolutions

The Central Bank of Brazil is now limiting investments made by commercial and investment banks and by credit, financing, and investment companies to 45% during 1980 (Resolution No. 605/80, followed by Circular No. 519/80). This increase will be calculated on various account totals of these financial institutions, as of December 31, 1979.

The Bank issued several other resolutions affecting financial institutions. Institutions authorized by the Central Bank shall, effective June 30, 1980, have their financial statements audited by independent auditors registered with the Securities Commission (CVM) (Resolution No. 607/80). Farming credit in connection with alcohol production shall be funded by the financial institutions themselves and not by the Programa Nacional do Alcool—PROALCOOL (National Alcohol Program) (Resolution No. 608/80). Finally, Bank Resolution No. 609/80 will maintain the present commissions and fees for the implementation of the Programa de Integração—PIS (Social Integration Program) and Programa de Formação do Patrimônio do Servidor Público—PASEP (Program for the Formation of the Civil Servant Fund), the former commissions and fees being maintained for the period between July 1, 1979 and June 30, 1980 (DOU-I, of April 8, 1980).

Changes in IPI Tax Rates

By Decree No. 84.634 of April 14, 1980, the President of the Republic eliminated the Tax on Manufactured Products, effective May 1, 1980, on several products including wooden frames and recipients, wooden household articles, carpets, cotton textiles, keys, signs, print composers and casters, orthopedic apparatus and manual stamps. The IPI tax was also eliminated on paper and cardboard packaging and articles, while smaller tax rate reductions were granted for sack containers, cooking stoves and trailers used in food transportation (Decree No. 84.637 of April 16, 1980). However, the IPI tax rate was increased to 32% for refreshments containing fruit juice. These changes are retroactive to January 1, 1980 (DOU-I, of April 15, 1980, and DOU-I, of April 17, 1980).

Corporate Tax Exemption

Despite recent imposition of harsh economic measures, the President of the Republic has promoted a measure to allow future corporate tax exemptions for small companies and firms. These small enterprises, mostly handicraft and family organizations, contribute decisively to increased employment and dispersion of business, but have great difficulties in complying with all the normal legal requirements. Thus, they are often operated illegally. Under the new measures (Decree-Law No. 1.780 of April 14, 1980), all companies and individual firms with gross annual incomes of less than 3,000 Readjustable National Treasury Bonds (ORTNs) (approximately Cr \$2.000.000,00) will, for the financial year 1981, base period 1980, be exempt from payment of corporate profit tax. They will also no longer be required to maintain accounting and tax books or correct their fixed assets and net worth. The exemption does not apply to: share companies; companies in which any of the partners is domiciled abroad; companies that have a stockholding in other companies except in the form of tax incentives; companies or firms in which the owner, partners or their spouses hold more than 5% of the capital of another company; companies which import foreign products, or deal in real estate, or store the products of third parties; companies which deal in exchange, insurance and distribution of securities, or publicity; or that render professional services of doctors, engineers, lawyers, dentists, veterinarians, economists, accountants, customs forwarders and similar occupations. It is expected that this tax favor will benefit approximately 60% of all companies now subject to corporate taxation (DOU-I, of April 15, 1980).

Changes in Tax on Financial Operations (IOF)

To fight inflation by reducing money supplies, the Brazilian Government has introduced another economic measure to increase revenue, to make imports more costly and to reduce the difference between the cost of domestic and foreign money (Decree-Law No. 1.783 of April 18, 1980, and subsequent Resolution No. 610 of the Central Bank of Brazil of April 18, 1980). In addition, the Tax on Financial Operations (IOF), which applies to credit, exchange, insurance and securities transactions, has been increased 0.5%/month for all loans, opening of credit and discount of bills, 2% of the premium for life, personal and work insurance, 4% of the premium for property insurance and 10% for transactions with bills and securities. For transactions involving imports of foreign goods or services, the tax is

15% until August 31, 1980, and 10% thereafter. The borrower, insured or purchaser of foreign currency or securities will be liable for the IOF tax. On April 23, the Central Bank issued a circular (Circular No. 523) clarifying the new tax rates and establishing that the tax will be levied in the following manner: 0.6%/month for credit of less than one year but 6.9%, payable in one lump sum and immediately, for credit of more than one year; for exchange transactions in connection with imports of goods or services the rate is 15% for exchange purchased pursuant to import licenses issued prior to August 31, 1980, and 10% for exchange purchased for import licenses issued after such date (DOU-I, of April 22, 1980).

Strong reaction to these measures in the real estate market provoked the Central Bank to issue Circular No. 525 on April 30, 1980. The IOF tax is to be paid by the original borrowers, whether individual or corporate, of any credit granted by the Housing System to build, renew or expand real estate. The tax payment should be made when the funds are made available to the borrower. Tax on credit released in installments may also be paid by installments. Circular No. 525 exempted the following credit transactions from the new tax: (a) contracts between the Housing Financial System and the parties responsible for real estate building, renewal or expansion prior to April 22, 1980; (b) proposals for credit for such real estate works received by the Housing Financial System prior to April 22, 1980, with the agreements signed before May 30, 1980; (c) contracts between the Housing Financial System and individuals to finance the sale of residential units for which the respective "habite-se" has already been obtained; (d) contracts between the National Housing Bank and the Housing Financial System, and (e) taxes granted by the National Bank for community works and community housing development, apart from other less frequent cases. Mortgage guaranteed loans to purchase a home not under the Housing Financial System will pay a reduced tax of 1% if the respective proposals were accepted before April 22, 1980, and the agreements signed before May 30, 1980 (DOU-I, of May 5, 1980).

Tax on Financial Operations (IOF)

On May 8, 1980, the Central Bank of Brazil issued Resolution No. 610 concerning application of IOF tax and its exemptions for exchange transactions involving the importation of goods and services. Exemptions would extend to imports shipped abroad prior to April 22, 1980, to shipments authorized by Central Bank for foreign financing prior to April 22, 1980, and to imports of services approved by

the Central Bank before April 22, 1980. An additional exemption was granted to drawback and back-to-back operations, to Petrobrás oil imports, to National Treasury and Free Zone of Manaus imports, to imported books, newspapers and magazines, and to remittances of exchange in payment of international travel and freight, demurrage and container rental. Also included in the exemptions were imports for agricultural fertilizers and seeds, as well as any imports converted into a direct foreign capital investment (DOU-I, of May 13, 1980).

Also, on May 8, 1980, the Central Bank issued Circular No. 530 to slightly alter the previous Circular No. 523 and to define the concept of importation of services (DOU-I, of May 13, 1980).

To consolidate the Tax on Financial Operations regulations, the Central Bank issued Resolution No. 619, renaming those regulations Tax on Credit, Exchange and Insurance Operations. Such consolidation is effective June 16, 1980 with a rate for consumer credit operations of 3.6% on the principal and financing charges. Although a 6.9% rate shall be applied to the purchase of new or used housing financed by the Federal Savings Banks, this will apply only to that portion of the house in excess of 2,250 UPC (Standard Capital Units). No tax shall be levied on contracts to finance, under the Housing Financial System, sales of concluded and authorized units. The new Regulation also confirmed the previous exemptions for the tax (DOU-I, of May 30, 1980).

Taxation of Profits made in Sales of Corporate Interests

Under 1976 Decree-Law No. 1510, profits made by individuals in the sale of corporate interests are subject to inclusion in annual income tax returns and to tax prepayment equivalent to 1% of the sales price. In addition, the Minister of Finance issued Portaria No. 227 of April 25, 1980, concerning the tax liability for installment payment of sales of corporate interests. Tax liability will apply to the full value of the transaction regardless of the form of payment and any monetary correction of the installments or any interest thereon shall be taxed separately in the event of an installment payment (DOU-I, of April 30, 1980).

Withholding Tax Rebate on Foreign Loans

By resolution No. 613/80, issued on May 8, 1980, by the Central Bank of Brazil and effective May 13, 1980, the National Monetary Council modified Resolution No. 587/79 to reduce from 95% to 40% the rebate available to Brazilian borrowers of duly registered loans in

foreign currency and qualified import financing transactions. Under the rebate system, 25% withholding tax due on interest, commissions and expenses paid by borrowers to foreign lenders under the terms of the loans and financings referred to above has been rebated directly to the borrowers. The net amount paid to the government was 1.25% of the total amount of interest, commissions and expenses subject to withholding tax. With the reduction, the net amount that will be paid to the government will be 15% of the amount subject to withholding tax. This net percentage is correspondingly reduced in cases where a treaty for avoidance of double taxation reduces the basic 25% withholding tax rate to some lower percentage (DOU-I, of May 13, 1980).

Government Bidding

The President of the Republic signed Decree No. 84.701 of May 13, 1980, to institute the Certificate of Regular Legal and Fiscal Situation (CRJF). This certificate is required as evidence of legal capacity and payment of all tax encumbrances by all individuals, firms, and companies that tender bids for supplies, works, and services purchased by Government entities, agencies and foundations. The President also signed, on the same day, Decree No. 84.702 which simplifies the evidence requirements for release from taxes, contributions, annuities and other charges, and restricts such requirements to the scope of the federal Government (DOU-I, of May 14, 1980).

Temporary Admission of Imports

In Normative Ruling No. 57/80, the Secretary of Federal Revenue determined that the special customs ruling of temporary admission shall also apply to aircraft and their equipment, provided that the Ministry of Aeronautics authorized the importation and confirmed that the importation does not fall under the provisions of Article 17 of Law No. 6.099/74 (commercial leasing) (DOU-I, of May 28, 1980).

Proposed Legislation Relating to Multi-national Corporations

Draft Law No. 2.248/76 approved by the House and now awaiting Senate passage, consists of a Code of Conduct for multi-national corporations operating in Brazil. The proposed Code would prohibit: (1) intervention in the internal affairs of Brazil or in the country's relations with other nations; (2) acting as an instrument of foreign policy for another country; and (3) any failure to comport with national priorities and objectives of development. Also prohibited would be obstruction of the gathering of information pertinent to the ac-

tivities of such companies which is to be used for evaluation of their compliance with public policy. Also sanctionable are company actions which detract from the scientific and technological development of the country, restrictive business practices or abuse of economic power, and disrespect for the social and cultural identity of the country. Violation of the provisions of the Code will subject the applicable business to one or more of the following penalties: (1) suspension of tax and economic incentives; (2) government intervention in the business; (3) cessation of right to operate in Brazil; and (4) appropriation of control of the business by means of seizure of shares. If passed, the Code will be effective 90 days after its publication.

Another draft law relating to multi-national corporations would amend Law No. 4.131/62 (the Foreign Capital Law), by requiring that all foreign investment in Brazil be represented by registered shares. This law would also require that Brazilian companies, controlled by foreigners, comply with the financial reporting and disclosure requirements and certain other rules of the Brazilian Securities Commission (CVM) applicable to open companies. As a footnote to the financial statements, information on the foreign currency operations of the company during the period covered would also be required. If approved, this law is scheduled to become effective on January 1, 1981.

Holding Foreign Currency Abroad

Draft Law No. 920-A, written by Representative Eptácio Cafeterira and already approved by the Commission of Constitution and Justice and by the Commission of National Security, is being examined by the House. The law would make it a crime against national security for a Brazilian domiciled in Brazil to maintain foreign currency deposits in a bank account abroad without the approval of the Brazilian authorities.

Withdrawal of Foreign Loans

According to Central Bank Resolution No. 589 of December 7, 1979, the funds of "Resolution 63" loans deposited with the Central Bank would only be released upon 15 days' prior request, provided that, if such funds were to be destined for repass to a Brazilian borrower, a period of at least 180 days had elapsed between the date of deposit and the date of intended release. This Resolution has now

been revoked by Resolution No. 618 of May 23, 1980, which provides the following: if the funds are to be used for the repayment of the foreign loan, the release is automatic and no longer subject to the 15-day delay; if the funds are to be repassed in Brazil, they will be released immediately if the release is to occur within 15 days of the deposit; after this 15-day period, the funds will only be released for repass in Brazil with a delay of 180 days and subject to 15 days prior notice to the Central Bank (DOU-I, of May 26, 1980).

Taxation of Profit Distributions

Formerly, individuals receiving dividends or profits had the option of choosing between immediate taxation at the source or taxation under their annual income tax return. The same Decree-Law No. 1.790 of June 9, 1980, has now eliminated this option by establishing that all dividends, cash bonuses, individual profits and other interests distributed by companies and individual firms to individuals domiciled in Brazil will be subject to the withholding of 15% income tax at source. This figure applies to distributions made by public companies and service companies. The rate is 25% in all other cases. This 25% withholding thus affects distributions made by "limitada" companies. Another novelty in this respect is the withholding of 15% income tax on profit distributions made by one company to another within the country, except in the case of express tax exemption (DOU-I, of June 10, 1980).

Informatics Regulations

Special attention is now being given by the Brazilian Government to the field of informatics. The Special Informatics Department thus issued the following regulations (DOU-I, of June 26, 1980):

a) Normative Act No. 3/80 requiring the prior consent of the Special Informatics Department for local or foreign purchase or lease of automatic information processing machinery and its units by Government agencies and foundations;

b) Normative Act No. 4/80 establishing conditions for the analysis of new projects for the manufacture of certain products; and

c) Normative Act No. 5/80 determining that when purchase bidding for informatics equipment and services by government agencies and foundations is involved, preference shall be given to national alternatives.

II. JUDICIAL AND ADMINISTRATIVE DECISIONS

Disguised Profit Distribution

Hidden within the Brazilian Income Tax regulations, there is a distribution of profits clause triggered by company grants to officers or partners, and their relatives or dependents, of loans without documenting them with a written agreement on interest to be paid, any discounts given, and monetary correction. The First Chamber of the First Taxpayers Council has now determined (Decision No. 101-71.551) that in the event of noncompliance, income tax will be due on the total amount of the withdrawals made during the base period, if the reserves shown on the last balance sheet posted before the date of the loan or withdrawals exceed the amount of the loans or withdrawals.

Decision No. 101-71.580 of the First Chamber of the First Taxpayers Council considered raw materials imported from a partner abroad for a price far above the market prices (difference ascertained on the basis of the international prices available to CACEX, of Banco do Brasil S.A.) to be a disguised profit distribution.

Travel Expenses of Employees

According to the Fourth Chamber of the First Taxpayers Council, if an employment contract specifies that the employer will pay an employee's air fare for a return to his country of origin, this payment is considered income for salaried work and must be classified in Schedule "C" of the employee's annual income tax return. This decision is in direct conflict with the holding by the Second Chamber of the same Taxpayers Council that held such expense not to be personal income of the employee.

Employment of Foreigners

The decision of the Second Group of the Regional Labor Court of São Paulo on Appeal No. 9.834 upheld that it is irrelevant, for purposes of establishing an employment relationship with a foreigner, whether the foreigner is or is not authorized to legally exercise his profession. If a company hires a foreigner and the requisites for the employment relationship are satisfied, the company cannot demand that the employee be registered as a self-employed person for not

having obtained authorization to carry out a certain profession in Brazil.

Brazilian Jurisdiction over Foreign Sovereigns

According to a decision of the Third Federal Court of Brasilia, when a foreign state acts in a private capacity to contract works or make purchases, it is held equivalent to a member of the community and is thus subject to the jurisdiction of the Brazilian federal courts.

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São Paulo, Brazil
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