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REGULATION OF FOREIGN INVESTMENT IN BRAZIL: A CRITICAL ANALYSIS*

KEITH S. ROSENN**

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I. INTRODUCTION

Brazil has long been a magnet for foreign investment. With more than $20 billion in registered direct foreign investment and reinvestment,\(^1\) Brazil is by far the largest repository of foreign investment in Latin America. Foreign investors have been attracted by Brazil's large market, enormous natural resources, rapid economic growth, relatively inexpensive labor supply, generous tax and credit subsidies, political stability and tradition of treating the foreign investor fairly.\(^2\) Brazil’s long-standing policy of erecting high tariff barriers to imports deemed similar to domestic manufactures has also been an important factor in attracting foreign investment.\(^3\)

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1. As of September 30, 1982, the Central Bank had registered a total of $20,232,631,000 in direct foreign investment, including $6,053,803,000 in reinvestment. The actual amount of direct foreign investment is substantially higher, however, because not all investment is registered with the Central Bank. See infra notes 43 and 44 and accompanying text. The principal countries of origin for this investment are the United States (31.3%), West Germany (13.5%), Japan (9.3%), Switzerland (9.2%) and the United Kingdom (5.3%). The great bulk of registered investment (73.3%) is in manufacturing, with service industries (20.8%) accounting for most of the remainder.

The magnet is losing some of its drawing force. New foreign investment has fallen steadily from a high of $2.5 billion in 1978 to $1.1 billion in 1982. The government has been forced to scale down its original estimate of $1.5 billion in new foreign investment for 1983 to only $400 million. Jornal do Brasil, July 31, 1983, 1st cad., at 34, col. 5.


3. This tariff policy, called the Law of Similars, is presently embodied in CACEX Com-
Brazil, however, has the largest external debt of any developing country, owing foreign creditors approximately $90 billion. Servicing this huge foreign debt currently consumes the great bulk of the country's export earnings, producing an extremely serious balance-of-payments crisis. In January 1983, Brazil was forced to suspend amortization payments on its foreign debt, to negotiate bailout financing from the International Monetary Fund (IMF), and to reschedule loans from major foreign banks.

Brazilians are understandably ambivalent about foreign investment. They resent having such a large part of their country's industrialized sector in foreign hands and so much of its export earnings consumed by foreign debt service. They are grimly aware of the vulnerability of their economy to recessions in developed

munique No. 7 of Mar. 4, 1982, which is based on Decree-Law No. 37 of Nov. 18, 1966; Decree No. 61.574 of Oct. 20, 1967; and Decree No. 64.017 of Jan. 22, 1969. It has induced many manufacturers that had been exporting to Brazil to set up shop there. One important study of American manufacturing investment in Brazil concluded that the “most powerful specific inducement to manufacturing investment has been the Law of Similars.” L. Gordon & E. Gommers, United States Manufacturing Investment in Brazil 147 (1962). Not only did the Law of Similars threaten foreign manufacturers with exclusion from the Brazilian market, but it also assured them of a protected market if they set up operations in Brazil. On December 7, 1979, President Figueiredo announced that the Law of Similars was being relegated to the scrap heap as part of a package designed to restore a greater semblance of free trade to the Brazilian scene. See Rosenn, Trends in Brazilian Regulation of Business, 13 Law Am. 169, 182 (1981). The Law of Similars has recently been revived as part of a new economic strategy for dealing with the present balance-of-payments crisis. Bus. Lat. Am., Oct. 27, 1982, at 339.


6. On December 29, 1982, the Central Bank informed foreign creditor banks that principal payments on medium- and long-term debt would not be remitted as of January 1983; instead, such sums have been deposited in interest-bearing accounts with the Central Bank, pending rollover as long-term debt. See Brazil Invents the Sambatorium, The Economist, Jan. 8, 1983, at 73. See also infra note 52 and accompanying text.

7. Foreign firms dominate many of the dynamic sectors of the Brazilian economy, such as the auto, electrical, machinery and pharmaceutical industries. For a recent breakdown of ownership shares, see W. Baer, The Brazilian Economy: Growth and Development 179-81 (2d ed. 1983).

8. See supra note 5.
countries. Because foreign firms have generally relied on capital-intensive technology, foreign investment has tended to create a well-paid elite class of skilled workers and managers but has done little to provide employment opportunities for the great mass of the population. Most Brazilians acknowledge that foreign investment has played a vital role in promoting speedy economic growth. Many blame this growth, however, for exacerbating the concentration of income, overly emphasizing production of luxury consumer goods at the expense of basic necessities, and drastically increasing foreign indebtedness and burgeoning social marginality.

They are also seriously concerned about the ability of Brazilian capital to compete successfully with foreign capital. Ambivalence towards foreign investment has been accentuated by Brazil's recent emergence as an exporter of industrialized products and technology.

After nearly two decades of authoritarian rule by the military, which has assiduously courted foreign investment, Brazil is well along the route to full restoration of democracy. Political prisoners and exiles have been granted amnesty, censorship has been relaxed and opposition candidates have recently assumed the governorships of 10 out of 23 states, including the three important states of São Paulo, Rio de Janeiro and Minas Gerais. Denationalization of Brazilian industry is a vital concern, and the proper role of foreign investment is a highly controversial issue. In recent elections,
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several politicians campaigned on platforms of defaulting on the foreign debt and closing the door to foreign investment. Even under military rule, which has largely repressed nationalistic political pressures to restrict foreign investors severely, the number of economic areas from which foreign investors have been precluded or forced to associate with local capital has steadily grown. Increasing political liberalization is likely to accentuate present trends toward increasing restrictions upon foreign investment.

The complex scheme by which Brazil attracts and regulates foreign investment is a unique blend of stable basic rules and a constantly changing series of regulations administered on an ad hoc basis. Brazil continues to welcome foreign investment, confident that the country's size, resources and administrative sophistication enable it to control the large multinationals without sacrificing national prerogatives or compromising national sovereignty. Multinational corporations have managed to live quite well with the Brazilian regulatory scheme, in part because of the tendency of Brazilian officials to be reasonably flexible and pragmatic in administering laws and regulations, and also because of the relative liberality of the Brazilian scheme in comparison with more restrictive foreign investment legislation in other parts of Latin America.

Nevertheless, the legislation by which Brazil regulates foreign investment is a hodgepodge of poorly conceptualized laws and decrees that make little economic sense. Not only does this hodgepodge cause resources to be misallocated, but it also exacerbates the country's bloated price structure by substantially increasing transaction costs and restricting competition in the Brazilian market. On the other hand, this regulatory scheme represents an important political compromise between nationalists who urge more severe restrictions upon foreign investment and internationalists who seek to attract more foreign investment. Public re-examination of the basic assumptions and results of this regulatory scheme has generally been avoided. As was once the case in Mexico, fear that something much worse might replace the existing scheme has tended to stifle serious criticism. Now that Brazil is undergoing a

sting shares or capital rights in institutions or firms whose functioning depends upon authorization and inspection by the Federal Government, unless the President issues a decree authorizing such expropriation. Decree-Law No. 856 of Sept. 11, 1969.

severe financial crisis, however, the need to attract more direct foreign investment and to avoid disinvestment of that already in place suggests that a fresh critical examination of Brazil's foreign investment regime is in order.  

This article has three purposes: (1) to describe the existing conglomeration of laws, regulations and administrative practices that constitute the scheme by which Brazil regulates foreign investment; (2) to analyze critically the strengths and weaknesses in this regulatory scheme; (3) to suggest how it should be improved.

II. THE BASIC REGULATORY SCHEME

Unlike many developing nations, Brazil has never adopted a comprehensive statute regulating foreign investment nor set up a commission or agency to screen foreign investment. Foreign investors are generally free to invest directly in any kind of legitimate venture in Brazil, but there are important exceptions.  

Although the establishment of a branch of a foreign company requires a presidential decree, no special permissions are required for foreign investors to organize a Brazilian company. Brazil regulates the foreign investor through an amazingly flexible combination of sticks and carrots. This combination includes exchange controls, direct and indirect taxes, tariffs, price controls, transfer of technology constraints, direct portfolio investment limitations, subsidized financing and investment incentives.

Brazil's scheme for regulating foreign investment serves numerous, if sometimes conflicting, purposes. These include:

14. On January 7, 1983, the Brazilian government publicized a "Letter of Intention" and a "Technical Memorandum of Understanding" with respect to a prospective $4.8 billion loan from the IMF. This Letter of Intention stated that "the Brazilian authorities will attempt to eliminate a number of exchange restrictions of minor impact, in an attempt to facilitate international payments and transactions and to replace them, if necessary, with measures that are not of an exchange nature." According to the Technical Memorandum of Understanding, the minor exchange restrictions include limits on remittance of technical assistance fees and royalties, as well as the supplemental tax on profit remittances. The then President of the Central Bank, Carlos Langoni, explained that the government contemplates a gradual reduction of the supplemental tax and the limitations on profit remittances, not their sudden extinction. Jornal do Brasil, Jan. 8, 1983, 1st cad., cols. 2-3. Brazil failed to comply with this Letter of Intention, which has been replaced by three subsequent Letters of Intention.

15. See infra notes 146-70.

16. Decree-Law No. 2.627 of Sept. 26, 1940, arts. 59, 60 and 64. These articles, inter alia, of the superseeded 1940 Company Law remain in force in accordance with article 300 of the 1976 Corporation Law, Law No. 6.404 of Dec. 15, 1976.
trolling balance-of-payments, (2) encouraging exports, (3) discouraging imports, (4) channeling foreign investment into high priority geographic areas, (5) preventing foreign capital from taking advantage of Brazilian enterprise, (6) aiding enforcement of the tax laws, (7) inducing foreign industries to set up operations in Brazil and (8) stimulating development of national technology.

A. The Antecedents of Present Regulation of Foreign Investors

The political pressures that originally led to Brazilian regulation of foreign investment stemmed from Brazilian nationalists' deep-seated conviction that foreign investors were unfairly exploiting Brazil's resources, siphoning off unconscionably high profits and thereby contributing significantly to the country's chronic balance-of-payments difficulties. Consequently, the historic thrust of Brazilian efforts to regulate foreign investment has been directed at controlling the amounts that foreign investors can remit.

Brazil's initial effort to regulate foreign investment in a systematic fashion was a 1946 statute requiring registration of foreign investment and loans with the Exchange Division of the Bank of Brazil.\(^\text{17}\) The amount of capital that could be repatriated in any year was limited to 20 percent; remittances of dividends and interest were restricted to 8 percent of registered capital. Any amounts remitted in excess of 8 percent were treated as repatriations of capital, effecting a \textit{pro tanto} reduction in the registered capital base. Like most Brazilian laws, however, this statute was not self-executing. Not until six years later did the government issue the regulations necessary for the implementation of the law.\(^\text{18}\) These regulations sent shock waves through the foreign investment community, primarily because they failed to permit the addition of unremitted earnings and interest to registered capital in order to build up the remittance base.\(^\text{19}\)

This regulatory scheme lasted less than a year. In 1953, the great bulk of remittances of profits and interest, as well as repatriation of capital, were freed from all restrictions.\(^\text{20}\) Foreign exchange

\(^{17}\) Decree-Law No. 9.025 of Feb. 27, 1946, art. 6. Foreign capital invested in government bonds or other fixed-income investments could be freely repatriated after two years.


merely had to be purchased for such remittances at the free market exchange rate. The only percentage restrictions retained were for a special category of investments and loans deemed "of special interest to the national economy." These categories were allowed to purchase foreign exchange for remittance of profits and interest at a preferential rate.

In 1955, Brazil began to woo foreign investors aggressively with an imaginative fiscal incentives program. The creation of an automobile industry was assigned top priority. Auto manufacturers were permitted to import used machinery at reduced tariff rates and were granted subsidized financing. They were also permitted to import component parts at reduced tariff rates, but only for a limited time. By 1959, however, at least 70 percent of each vehicle's total weight had to consist of nationally manufactured parts; by 1961, local content had to comprise 90 percent. Similar programs were established to stimulate development of other industries, such as pharmaceuticals, metallurgy, textiles and shoes. As a result, direct foreign investment in Brazil shot up from an annual average of only $13.3 million in the 1947-1954 period to an annual average of $102.4 million in the 1955-1961 period.

Unrestricted freedom to repatriate capital and remit dividends and interest continued from 1953 to 1962, when Brazil enacted a highly controversial and poorly drafted Profit Remittance Law. The statute limited capital repatriation to 20 percent of registered capital and yearly profit remittances to 10 percent. Its regulatory decree went well beyond the text of the law, denying remittance rights to an open-ended category called "national capital." The most controversial provision of the decree was its refusal to permit the addition of reinvested earnings to registered capital for the

21. Annual dividend remittances were limited to 10 percent of registered capital, and loan interest was restricted to 8 percent of principal. Law No. 1,807 of Jan. 7, 1953, art. 6. Such investments and loans had to be registered with the Superintendency of Money and Credit (SUMOC). SUMOC was abolished in 1964 and replaced by the Central Bank. Law No. 4,595 of Dec. 31, 1964, art. 8.


24. Id., arts. 31-32. To the extent that interest on foreign loans exceeded interest rates in the financial market where the loan originated, SUMOC was authorized to treat the excess as repatriation of capital. Id., art. 8.

25. "National Capital" was defined as foreign capital whose entry into Brazil could not be duly proven. Decree No. 53,451 of Jan. 20, 1964, art. 9.
purpose of determining the remittance base. The Profit Remittance Law, coupled with several expropriations of foreign firms and the chaotic economic conditions prevailing in the early 1960s, reduced Brazil’s foreign investment flow to a trickle.

B. The Present Profit Remittance Law

Soon after the military seized power in April 1964, the Brazilian Congress, purged of most left-wing nationalist elements, partially defanged the Profit Remittance Law by eliminating the percentage limitations upon remittance of profits, repatriation of capital, and loan interest. Since 1964, foreign investors have been free to repatriate all registered capital. They have also been allowed to remit as much in profits as they wish, subject to a toll charge in the form of a steep supplemental income tax on profit remittances averaging more than 12 percent of registered capital a year in any three-year period. Foreign loans must be approved by the Central Bank, which monitors all interest payments to insure that rates do not exceed the market.

The most critical modification of the Profit Remittance Law was allowing reinvested earnings to be added to the registered capital base for future remittance purposes. Firms producing luxury goods and services are theoretically barred from remitting dividends in excess of 8 percent of registered capital per year. This restriction has never been enforced; indeed, the meaning of “luxury goods and services” has never been defined. In the event of a serious balance-of-payments crisis, the statute authorizes the government temporarily to bar all capital repatriation, to restrict remittance of dividends to 10 percent of registered capital per year and to limit remittances of royalties and technical assistance fees to 5 percent of the remitter’s annual gross revenues. This provi-

26. Id., art. 31, sole paragraph.
29. This supplemental tax is discussed infra at notes 119-24 and accompanying text.
30. See infra notes 45-51 and accompanying text.
32. Law No. 4.390 of Aug. 29, 1964, art. 2; Decree No. 55.762 of Feb. 17, 1965, art. 11.
33. Law No. 4.131 of Sept. 3, 1962, art. 28; Decree No. 55.762 of Feb. 17, 1965, art. 49. The statute specifically prohibits imposition of corresponding restrictions upon remittance of interest and principal of registered loans.
sion has also never been invoked. Instead, Brazil has recently responded to its present balance-of-payments crunch by centralizing sales of foreign exchange in the Central Bank, which has instituted a rationing scheme. The Central Bank has set out four priority groups, none of which include royalties and dividend payments. Firms are experiencing lengthy delays in obtaining foreign currency for such remittances.

1. REGISTRATION OF DIRECT FOREIGN INVESTMENT

The key to the Brazilian regulatory scheme is registration with the Central Bank. Unless a foreign investment is registered, the investor cannot legally repatriate his investment or remit dividends, although he is free to enjoy the fruits of his investment in Brazil. With the exception of areas expressly declared off limits, Brazilian law permits a foreign investor to register any investment in the form of money or goods, such as machinery and equipment, transferred to Brazil from abroad and utilized in economic activity in Brazil. Only rarely, however, have Brazilian authorities permitted direct registration of intangible property, such as patents, trademarks, know-how or software, as a foreign investment. Royalties from registered technology transfer agreements, however, may be capitalized and registered as a foreign investment as long as a 25 percent withholding tax is paid.

34. As of August 1, 1983, the great bulk of all sales of foreign exchange has been centralized in the Central Bank. Central Bank Res. No. 851 of July 29, 1983; Central Bank Circular No. 804 of July 29, 1983.
36. As a practical matter, it is difficult to import machinery and equipment as a foreign investment. Permission from the Central Bank and the Foreign Commerce Board of the Bank of Brazil (CACEX) is required. The process is time-consuming, and permission will normally be granted only if the machinery or equipment is destined for an industrial setting or, to complement or modernize an already functioning firm. FIRCE Communiqué No. 32 of Aug. 23, 1978. Moreover, unlike a cash investment, which can be made through a holding company, capital goods can be invested only for shares of the company that will actually use them.
37. There is no formal legal obstacle to capitalizing technology. The reluctance of the Central Bank to register such contributions as foreign investments appears to stem primarily from uncertainty about the proper valuation of technology. Tozzini, Brazil: Technology as Capital Contribution, 43 Taxes Int'l 11-12 (May 1983).
38. A. Andrade, O CAPITAL ESTRANGEIRO NO SISTEMA JURÍDICO BRASILEIRO 93-94 (1979). On certain occasions, the Central Bank has permitted indirect registration of technology transferred to Brazil by re-characterizing the transaction as a sale of future royalties symbolically remitted abroad and subsequently reinvested in Brazil. For example, Hydreco was permitted to capitalize its technology by making a five-year sales forecast and projecting royalties on the basis of rates received from European licensees. The standard 25 percent
The registration certificate issued by the Central Bank is a crucial document. It identifies the foreign investor, his country of domicile or established place of business, the amount and currency of the investment (or the value of the capital goods invested) and the par value, class and number of the shares or quotas issued to the foreign investor by the Brazilian enterprise in which the investment has been made. The Central Bank acts expeditiously in issuing a certificate of registration and normally does not act as a screening agent. It will, however, make an effort to insure that the value placed upon foreign investments made in the form of capital goods is not inflated. The certificate may be transferred or assigned to another investor who purchases the underlying investment.

The statute states that the investment is to be registered in the currency of the country of origin. This requirement has been felicitously interpreted to mean that the investment will be registered in the currency in which the investment was actually made rather than the currency of the investor's native country. Thus, an Argentine investor can register his investment in dollars, francs or marks rather than rapidly depreciating Argentine pesos. On the other hand, the value of investments of capital goods will be registered in the currency of the country where the investor has his permanent establishment or domicile. This arbitrary rule precludes an Argentine from investing in the form of capital goods or increases transaction costs by forcing him to transfer these goods to a corporation domiciled in a country with a stable currency prior to investing in Brazil. Retained earnings that are eligible for reinvestment are registered in the foreign currency in which the investment has been registered at the average exchange rate before withholding tax on foreign remittances was then assessed upon the amount of this symbolic sale, and the balance was registered as an investment. Bus. Int'l Corp., A Corporate Guide to Solving Operating Problems in Brazil 19-20 (1978). Since no income is actually generated by the transference of the industrial property rights, this tax must be paid from capital.

39. Decree No. 55.762 of Feb. 17, 1965, art. 5, provides that the investment "shall be registered at the price contained on its commercial invoice, attending to the regulatory formalities." CACEX tries to insure that the invoice price is realistic. CACEX also makes it extremely difficult for foreign investors to include the cost of freight and insurance in the invoice, even though article 5 of Decree No. 55.762 appears to permit registry of such costs. A. Andrade, supra note 38, at 71.

40. Law No. 4 131 of Sept 3, 1962, art. 4.

tween the date of the balance sheet showing the earnings and the date of the shareholders' meeting at which they were capitalized.

A substantial amount of foreign investment in Brazil has never been registered with the Central Bank. Some estimates have placed unregistered foreign investment as high as the amount of registered investment, but that figure is probably too high. There are seven common explanations for nonregistration of foreign investment in Brazil: (1) inability to demonstrate to the satisfaction of the Central Bank the foreign origin of all or part of a pre-1962 investment, (2) purchase abroad of an existing investment for consideration greater than the registration value, (3) failure to comply with one or more of the technical conditions for effective registration, (4) refusal of the National Institute of Industrial Property (INPI) and/or the Central Bank to register technology or industrial property rights, (5) conversion of the foreign currency representing the investment into cruzeiros at the much more advantageous black market rate, (6) the Central Bank's refusal to register passive income stemming from interest or investments as reinvestment or (7) appreciation in the real value of the net assets of the Brazilian enterprise. Moreover, the registration system does not permit revalorization to adjust for inflation occurring in the country in whose currency the investment is registered. This results in substantial undervaluation of almost all registered investment.

2. REGISTRATION OF FOREIGN LOANS

Foreign currency loans must be authorized by, and registered with, the Central Bank. Unless a loan is registered, interest and principal payments may not be remitted abroad. In addition to prior approval by the Central Bank, authorization from the Secretariat of Control of State Enterprises (SEST) is required for any public sector foreign borrowing, whether the borrower be the federal, state or municipal government, an autonomous governmental

42. Law No. 4.131 of Sept. 3, 1962, art. 4. See also A. ANDRADE, supra note 38, at 67-68. The reinvestment is treated as though a remittance had been symbolically made and simultaneously reinvested in Brazil, but payment of the 25 percent withholding tax is not required.

43. See Robock, Controlling Multinational Enterprises: The Brazilian Experience, J. CONTEMPORARY BUS. 53, 56-58 (Aut. 1977), suggesting that the percentage of unregistered foreign investment is falling, although it is still quite significant. See also Seixas, Brazil's Law on Foreign Capital, 5 LAW. AM. 513, 516 (1973), estimating total foreign investment in Brazil at $4 billion at a time when only $2.91 billion was registered.

44. See infra notes 208-11 and the accompanying text.
agency, a public enterprise, or a company with mixed private and public participation. Private sector foreign borrowings are essentially unrestricted, although the Central Bank refuses to authorize foreign loans if the borrower is an individual or if the proceeds will be used to purchase Brazilian securities.

The Central Bank reviews loan applications to make sure that the interest rate corresponds to rates prevailing in the market where the loan originates and that the amortization schedule is not disproportionately heavy in the early years. It carefully reviews the spread above the prime rate or the London Interbank Offered Rate (LIBOR). Interest and principal payments are permitted only in quarterly, semi-annual or yearly installments. Within 30 days after drawdown, the loan must be registered with the Central Bank. Upon registration, the lender receives a registration certificate specifying the currency, interest and principal payment terms of the loan and identifying which party must pay the Brazilian withholding tax on interest payments.

The Central Bank has special rules for import financing. The Foreign Commerce Board of the Bank of Brazil (CACEX) must authorize import financing arrangements. Those which extend beyond two years need prior authorization and registration with the Central Bank, as well as CACEX approval. Central Bank registration is contingent upon a ruling by CACEX that Brazilian firms are unable to supply the imports. The Central Bank and CACEX also seek to ensure that prices paid for the goods financed by import loans are not out-of-line with the prices of comparable goods abroad. Payment of the amount financed, and the interest thereon, may be made only upon presentation of a certificate of authorization and the related schedule of payments issued by the Central Bank. Prior to shipment of the goods, total payments to suppliers for any non-financed amount may not exceed 20 percent of the import value.

45. Other approvals may also be needed. See generally Skola, Foreign Loans in Brazil: Theory and Practice, 15 Int'l Law. 73 (1981).

46. For machines and equipment with FOB value over $1,000,000, a minimum payment period of eight years is required; for FOB values between $300,000 and $1,000,000, the minimum payment period is five years; and for FOB values between $100,000 and $300,000, the minimum payment period is three years. Spare parts for durable consumer goods have a minimum payment period of one year, and all other products have a minimum payment period of 180 days. Central Bank Res. No. 767 of Oct. 6, 1982, and Central Bank Circular No. 737 of Oct. 6, 1982.


The Central Bank divides foreign currency loans into three basic categories: (1) Law 4.131 loans, (2) Resolution 63 loans and (3) Resolution 355 loans. Law 4.131 loans are made directly to Brazilian borrowers by foreign lenders. Resolution 63 loans are made by foreign lenders to Brazilian financial institutions, which in turn repass the loans to Brazilian borrowers in cruzeiros. Resolution 355 loans are primarily used for financing imports. The Central Bank currently requires a minimum term of 8 years and an amortization grace period of at least 30 months on all Law 4.131 and Resolution 63 loans.49 As an anti-inflationary measure, the Central Bank requires that 75 percent of the amount of all private sector foreign loans entering the country be held on deposit, without interest, with the Central Bank. One-third of this compulsory deposit is released in 60 days, another third is released in 90 days and the remainder is released in 120 days.50 Upon presentation of the registration certificate and evidence that the withholding tax on foreign remittances has been paid, the borrower is permitted to purchase the necessary amounts of foreign currency to remit the interest or principal payments due in accordance with the loan terms set out in the registration certificate. A borrower may not legally remit any interest to the lender in excess of the amount specified in the registration certificate without special Central Bank approval. Further, income derived from reinvestment of such excess interest payments can neither be added to the registered principal nor legally remitted from Brazil. Remittance of excess interest is treated as the remittance of capital.51

As a result of the current balance-of-payments crisis, the Central Bank has been holding principal repayments on most foreign loans in accounts opened in the name of the foreign creditor and denominated in the foreign currency borrowed.52 Interest pay-

49. Rosenn, supra note 6, at 173. These loan funds can, however, be reloaned to other Brazilian borrowers for terms as short as 18 months. Central Bank Res. No. 229 of Sept. 1, 1972; Central Bank Circular No. 186 of Sept. 1, 1972.
52. Central Bank Res. No. 813 of Apr. 6, 1983; Central Bank Circular Nos. 769 and 770 of Apr. 6, 1983. Exceptions to the blocking of amortization remittances include: loans with a term of less than 360 days; publicly issued bonds or floating rate notes; privately issued securities; loans from foreign governments; international organizations or their agencies; loans with at least 75 percent of their principal guaranteed or insured by foreign governments; obligations incurred in the financing of ships, aircraft or drilling rigs; banker's acceptances; and commercial paper. Sums in blocked accounts can be reloaned, however, to Brazilian borrowers, provided that the minimum term is for eight years with a thirty-month grace period on amortization payments.
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ments are still being remitted, but often with delays of several months.83

Foreign loans can be converted freely into registered capital investment.84 Although the government has sought to encourage such conversions, it has had little success. Its latest attempt is a tax credit for Brazilian firms capitalizing principal or interest of direct foreign currency loans or import financing prior to the end of 1983.85

C. Foreign Technology Transfers

Prior to 1958, licensing of technology and technical assistance agreements was virtually unrestricted. Although it often took a long time to register a patent, royalties could be freely remitted. In the mid-1950s, the Brazilian Treasury became concerned about substantial income escaping Brazilian taxation because of unreasonably high deductions being claimed by subsidiaries of multinationals as payments for patent and trademark royalties and technical assistance. In 1958, the income tax law was modified to limit royalties for patents and payments for technical assistance to a sliding scale (varying with the product classification) of 1 to 5 percent of gross sales. Trademark royalties were limited to 1 percent of gross sales if use did not derive from licensing of a patent, process or formula.86

This percentage limitation scheme on the deductibility of royalties for tax purposes was later incorporated into the 1962 Profit

53. In its allocation of scarce foreign exchange, the Central Bank is giving priority to interest payments on loans guaranteed by the National Treasury and on import financing. See supra notes 34 and 35 and accompanying text.
55. Decree-Law No. 1.994 of Dec. 29, 1982. The tax credit is 10 percent of the amount of foreign indebtedness capitalized prior to June 30, 1983. The credit, which is to be applied against the Brazilian company's income tax, was scheduled to fall to 5 percent for the balance of 1983, but Portaria No. 145 of the Finance Ministry, June 23, 1983, has extended the 10 percent credit through December 31, 1983.
56. Law No. 3.470 of Nov. 28, 1958, art. 74. Portaria No. 436, issued by the Finance Ministry on Dec. 30, 1958, established product groupings for patent royalties. The permissible royalty deduction varied between a minimum of 1 percent and a maximum of 5 percent of gross sales, depending upon in which group the patented product was placed. Deductions for trademark royalties were limited to 1 percent of gross sales. Since 1975, INPI has been refusing to approve technology agreements if royalties exceed these percentage limitations as applied to net sales. Normative Act No. 15 of Sept. 11, 1975, paras. 2.2.1 and 3.2.1. The tax law was modified in 1979 to reflect the switch from gross to net sales as the basis for royalty deductions. Decree-Law No. 1.730 of Dec. 17, 1979, art. 6.
Remittance Law as a ceiling for profit remittance purposes.\textsuperscript{57} Payments in excess of these percentages may still be made in cruzeiros, but the payee may neither remit these amounts nor add them to registered capital. Nor may the payor deduct them as a business expense for income tax purposes. If the foreign licensor directly or indirectly controls the Brazilian licensee, all royalty payments for patents and trademarks are both nonremittable and nondeductible for income tax purposes. Remittances for technical assistance can still be made, but they are considered dividends and charged against the 12 percent limit on registered capital.\textsuperscript{58}

Since the creation of INPI in 1970,\textsuperscript{59} the procedures for obtaining payment for technology transferred to Brazil have become increasingly Byzantine. Unless a technology transfer agreement has been registered with INPI, the Central Bank will not authorize remittances of royalties abroad, nor will the Finance Ministry permit tax deductions for royalty or technical assistance payments.\textsuperscript{60} Even though INPI has issued a series of regulations, misleadingly labelled "normative acts,"\textsuperscript{61} that purport to set out guidelines indicating which technology transfer agreements it will register, INPI remains law unto itself. For example, even though no law or regulation requires a Brazilian forum for dispute resolution, INPI will usually refuse to approve an agreement with a clause requiring arbitration or litigation in some place other than Brazil. Instead, INPI insists upon dispute resolution through litigation before Brazilian courts or arbitration in Brazil in accordance with the Brazilian Code of Civil Procedure. Recent attempts to challenge INPI's virtually unfettered discretion in the courts have thus far proven unsuccessful.\textsuperscript{62}

INPI has broken down technology transfers into five categories: (1) patent licenses, (2) trademark licenses, (3) know-how licenses, (4) technical-industrial cooperation agreements and (5) specialized technical service agreements. If an agreement covers

\textsuperscript{57} Law No. 4.131 of Sept. 3, 1962, arts. 12-13.
\textsuperscript{58} Id., arts. 13-14.
\textsuperscript{59} Law No. 5.648 of Dec. 11, 1970.
\textsuperscript{60} FIRCE Communiqué No. 19 of Feb. 16, 1972.
\textsuperscript{61} The most important are Normative Act No. 15 of Sept. 11, 1975, which contains detailed rules concerning the registration and approval of technology transfer agreements, and Normative Act No. 32 of May 5, 1978, which requires prior consultation.
\textsuperscript{62} Decision of the 1st Federal Court of Rio de Janeiro, Nov. 27, 1979, and Decision of the 7th Federal Court of Rio de Janeiro, Mar. 19, 1980. These cases are reported in detail in 3 L. Eckstrom, Licensing in Foreign and Domestic Operations 29-231 to-245 (rev. ed. 1983).
more than one category, it must be broken down into separate contracts for each category.\textsuperscript{63} Agreements that do not fall readily into any of these five categories must be submitted to INPI for orientation.\textsuperscript{64}

1. PATENT LICENSING

The actions and inactions of INPI, coupled with several changes in Brazilian law, have made patent licensing so onerous, time-consuming and unpredictable that many patent holders have been dissuaded from licensing their patents in Brazil. Royalties can be collected only while the Brazilian patent is in force and actually being used. Theoretically, one can license a Brazilian patent for its entire life of 15 years (10 years for an industrial design or model).\textsuperscript{66} INPI, nevertheless, flatly refuses to register certain types of patents, such as product or process patents on drugs, food or medicine. If a patent has a shorter life in its country of origin, INPI will limit the Brazilian patent to that shorter life.\textsuperscript{66} Prior to 1971, when the present Code of Industrial Property was adopted, Brazil computed the term of a patent from the date of issuance. Since 1971, Brazil has computed the term from the date of application for the Brazilian patent. Because INPI processes patent applications with the speed of a tired tortoise (in 1980 it had a backlog of nine years),\textsuperscript{67} the useful life of a Brazilian patent is far less than the statutory term.

INPI has sharply curtailed the freedom of foreign licensors and domestic licensees to contract. A patent licensor must grant the licensee ownership of all improvements made by him and furnish him with detailed information on all improvements made by the licensor. The license may not contain any tie-in provisions, nor may it limit output, price or export of the product. In certain circumstances, territorial exclusivity might pass muster, but such

\textsuperscript{63} INPI, Normative Act No. 15 of Sept., 11, 1975, para. 1.1.1.
\textsuperscript{64} Id., art. II.
\textsuperscript{65} Industrial Property Code, Law No. 5.772 of Dec. 21, 1971, art. 24.
\textsuperscript{66} Nattier, Limitations on Marketing Foreign Technology in Brazil, 11 INT'L LAW. 437, 443-44 (1977).
\textsuperscript{67} Gazeta Mercantil, May 17, 1980. A study of 78 inventions, covering three technical fields, for which patent applications were filed in both Brazil and the United States between 1961 and 1975 revealed that only 5 percent of the Brazilian applications were granted (after an average pendency of 7\textfrac{1}{2} years), while the United States granted 85 percent of the applications. Pegan, Technology Exchange in Brazil, 4 THE LAW AND BUSINESS OF LICENSING, 520.195, 520.198 (M. Finnegan & R. Goldscheider eds., 1980 rev.).
provisions are generally disapproved. The licensor cannot prohibit free use of data and technical information after the expiration of the patent, nor can he limit research by the licensee.68 Contrary to accepted international licensing practice, the licensor may only charge for the basic engineering package delivered at the start of a licensing operation as an advance against royalties.69 Since 1975, royalties must be calculated as a percentage of net rather than gross sales,70 a sharp break with the prior practice under the income tax and profit remittance legislation. "Net sales" is defined as the invoice value less taxes, returns, discounts, freight, packaging, insurance, and the cost of imported components purchased from the licensor or third parties related to the licensor. This peculiar definition reduces remittable royalties even further.71 The combination of these restrictions has made patent licensing a decidedly unattractive way to conduct business in Brazil.

2. TRADEMARK LICENSING

The restrictions on trademark licensing generally parallel those imposed on patent licensing. No royalty payments may be made if a foreign licensor directly or indirectly controls a majority of the licensee's shares.72 Royalties for a trademark license can only be paid after the mark has been registered in Brazil and then only during the initial ten-year term; no royalties can be paid during a renewal period.73 No royalties can be paid if the deposit is made in Brazil without proof of priority in the country of origin.74 Moreover, INPI has recently taken the position that Brazilian trademark licensees cannot pay any royalties to foreigners on marks that constitute simple variations on the subject matter of previous registrations or applications.75 Unlike patent licensors, trademark licensors may not charge royalties greater than one percent of net sales.76

68. INPI, Normative Act No. 15 of Sept. 11, 1975, para. 2.5.2(b)(iii).
69. Nattier, supra note 66, at 445-46. The amount of the advance is calculated as a percentage of the sales price. Id.
70. See supra note 56.
71. INPI, Normative Act No. 15 of Sept. 11, 1975, para. 2.2.1.
72. Id. at para. 3.2.4(a).
73. Id. at para. 3.2.4(c).
74. Id. at para. 3.2.4(b).
75. INPI, Normative Act No. 61 of Mar. 24, 1982.
76. INPI, Normative Act No. 15 of Sept. 11, 1975, para. 3.2.1, coupled with Portaria No. 436 of the Finance Ministry, Dec. 30, 1958.
Every trademark licensing agreement must contain a clause giving the licensee the option of using his own trademark in conjunction with the licensor's mark on products covered by the agreement, as well as the right to use only his own mark on items not licensed under the agreement.\textsuperscript{77} INPI requires this option so that after termination of the license, the licensee can more readily compete with the licensor for customers developed by the licensee.\textsuperscript{78}

3. \textbf{KNOW-HOW LICENSING}

Many agreements that begin as patent licenses are ultimately recharacterized as agreements for the transfer of unpatented technology or know-how. Registration with INPI of an agreement transferring know-how is also onerous and time-consuming, but the parties need not wait for years for INPI to register a patent. The parties must satisfy INPI that the technology is unavailable domestically and that its transfer to a Brazilian licensee (1) is in line with national developmental priorities; (2) will bring short-term real advantages for the development of the industrial sector; (3) will improve the quality of the product's manufacture, principally with respect to exports; (4) will allow the substitution of imports of the product; and (5) will allow the licensee to absorb and master the technology within the life of the agreement.\textsuperscript{79} The licensor must supply INPI with all technical data and engineering drawings, as well as all information necessary to update the know-how. Moreover, the licensor must guarantee that it will not patent the know-how at some future date. A secrecy clause, which is critical with unpatented technology in Brazil,\textsuperscript{80} is permissible only if INPI deems it reasonable under the circumstances.\textsuperscript{81}

\begin{itemize}
\item \textsuperscript{77} INPI, Normative Act No. 15 of Sept. 11, 1975, para. 3.5.1(c).
\item \textsuperscript{78} Daniel, \textit{Trademark Policy in Brazil under the Second Basic Plan for Scientific and Technological Development}, 66 TRADMARK REP. 173, 176 (1976).
\item \textsuperscript{79} INPI, Normative Act No. 15 of Sept. 11, 1975, paras., 4.1.2 and 4.2(h).
\item \textsuperscript{80} Brazil regards unpatented know-how as part of the public domain, freely exploitable by anyone. INPI, Normative Act No. 17 of May 11, 1976, arts. 15.5 and 15.5.1. Brazil lacks any body of law that adequately protects against unauthorized use of know-how. Radway, \textit{Antitrust, Technology Transfers and Joint Ventures in Latin American Development}, 18 LAW. AM. 47, 61-62 (1983).
\item \textsuperscript{81} INPI, Normative Act No. 15 of Sept. 11, 1975, para. 4.5.2(d)(vi).
\end{itemize}
4. TECHNICAL-INDUSTRIAL COOPERATION AGREEMENTS

Technical-industrial cooperation agreements are designed to permit the Brazilian contractor to acquire the knowledge, techniques and services needed to set up plants and to manufacture specialized machinery, equipment and component parts. The agreement may not refer, even implicitly, to any industrial property rights. To register a technical-industrial cooperation agreement, one must satisfy INPI that the services to be rendered will: (1) involve technical levels unavailable locally; (2) produce short-term benefits to the sector consistent with national policy objectives for industrial technology and development; (3) produce a quality product, with export possibilities given particular consideration; and (4) permit substitution of imports.\textsuperscript{82} The supplier of the services may be compensated either on a cost plus basis or a royalty linked to net sales, but INPI must be satisfied that the compensation arrangements are reasonable and that any foreign technicians will not remain in Brazil longer than necessary. Generally, the term of technical assistance agreements cannot exceed five years, even between unrelated parties. If convinced that technological innovations require a greater period, INPI may permit extension of the agreement for up to five more years, but no advance assurance is available with respect to this possibility. In the event that INPI permits an extension, the supplier's remuneration is to be reduced to permit greater use of domestic engineering services.\textsuperscript{83} In no case, however, may a technical-industrial cooperation agreement exceed ten years.\textsuperscript{84}

5. SPECIALIZED TECHNICAL SERVICES

Specialized technical services agreements are designed to provide Brazilian companies with specialized services of foreign technicians, primarily for planning, feasibility and start up services. To register a specialized technical services agreement, one first has to satisfy INPI that needed technical services are not available domestically. The agreement must insure that the Brazilian company receives complementary technical information and assistance, that the services rendered will be sufficient to achieve the aims of the

\textsuperscript{82} Id., para. 5.1.2.  
\textsuperscript{83} Id. at para. 5.4.2.  
\textsuperscript{84} Law No. 4.131 of Sept. 3, 1962, art. 12(3).
agreement, that no industrial property rights will be asserted with respect to the transferred technology and that no restriction will be imposed on the full use of information and data received.\textsuperscript{85} INPI must approve a detailed schedule for each foreign technician of the services to be rendered, an estimate of the time his services will be needed, and his compensation. Engineering services can be imported only through a Brazilian engineering company unless the importing firm demonstrates that it has the necessary technicians to enable it to absorb the imported technology.\textsuperscript{86}

INPI has developed special rules to prevent its foreign-owned automobile industry from paying indirect technical assistance costs to parent companies. Since 1978, INPI has prohibited foreign auto manufacturers from charging their Brazilian subsidiaries for: (1) administrative, financial and marketing services; (2) salaries, travel or transfer expenses of foreign personnel assigned to activities not specifically linked to specific and temporary technical services; or (3) research and development performed by the parent company. Nor can payments be made for any plans of new models and manufacturing methods developed abroad, with the exception of plans for engines and mechanical components beyond the technological levels currently attained in Brazil.\textsuperscript{87} One can expect INPI gradually to extend this approach to other industries as Brazil makes a concerted effort to sever its foreign technology umbilical cord.

6. PRIOR CONSULTATION PROCEDURE

In 1978, INPI added an additional layer to the time-consuming process of securing its approval by requiring that virtually all technology agreements be submitted to it twice: first for preliminary approval, and later for final approval.\textsuperscript{88} Parties to technology transfer agreements, with the exception of technical services of an occasional nature involving less than $20,000 or the inspection or assembly of imported equipment, must submit a draft of the proposed agreement. This draft must contain a Portuguese translation in parallel columns to the language chosen by the foreign party. The draft must show the ownership of the Brazilian company, any

\textsuperscript{85} INPI, Normative Act No. 60 of Apr. 13, 1982, paras. 2.1 and 7.
\textsuperscript{86} Id., at para. 3.
\textsuperscript{87} INPI, Normative Act No. 30 of Jan. 19, 1978, as amended by Normative Act No. 60 of Apr. 13, 1982.
\textsuperscript{88} INPI, Normative Act No. 32 of May 5, 1978.
relationships between the parties, the need to import the technology, the exact terms of the compensation agreed upon, alternative sources of the technology (either in Brazil or abroad) and the reason for choosing this particular technology supplier.

During this prior consultation process, INPI not only scrutinizes the language of the agreement, but also verifies the status of patents and trademarks and evaluates the sophistication of the technology. Agreements involving technology deemed to be unsophisticated or already available in Brazil will be disapproved, even if the technology is available only to the proposed licensee's competitor. In addition, all existing or contemplated technology agreements between the parties must be submitted regardless of whether approval has already been granted or is unnecessary. Ostensibly designed to expedite the process of securing approval of technology transfers, compulsory preliminary approval has a tendency to slow the process down. INPI approval must be secured twice, and prior approval does not prevent INPI from refusing final approval. This dual approval procedure is designed to permit INPI to take an even more active role in making itself a party to the negotiations by insisting upon changes in the language and terms of the agreement.

7. MANDATORY INVESTMENT-NORMATIVE ACT NO. 64

In September 1983, INPI promulgated Normative Act No. 64, which imposes additional costs on those seeking approval of technology transfer agreements. Whenever it decides that Brazil should develop domestically the kind of technology that is the subject of a proposed technology transfer agreement, INPI intends to condition approval of the proposed agreement on the Brazilian contractor's assumption of a formal commitment to invest in research and development of similar technology. The amount of the investment will vary in accordance with financial situation of the Brazilian contractor and the amount being paid for the imported technology. The investment can be made either in a Brazilian research institute or in the Brazilian contractor itself.89

An additional requirement has been imposed whenever a foreign-controlled Brazilian company seeks to purchase technology from an unrelated foreign company. As a condition to approving

89. INPI, Normative Act No. 64 of Sept. 16, 1983, paras. 1.1 and 1.2.
such an agreement, INPI now insists that the parent company make an equity investment in its Brazilian subsidiary in an amount equal to the remittances that the subsidiary is obligated to pay for the technology. This investment has to be made prior to each respective remittance.  

These new, mandatory investment requirements will obviously discourage certain technology transfers by making the imported technology much more expensive. Brazilian companies must not only pay royalties or fees, but they must also pay for research and development expenses of the imported technology. Foreign parent companies will be forced to tie up capital in Brazil anytime their Brazilian subsidiaries need to purchase foreign technology from unrelated companies. Depending on how INPI administers these requirements, Normative Act No. 64 may lead to much reinvention of the wheel.

Despite its prior consultation procedure and the guidelines contained in its numerous normative acts, INPI is both unpredictable and dilatory. In recent years, it has been following a fairly restrictive policy because of Brazil's serious balance-of-payments problems. In 1979, INPI refused to approve about 36 percent of the applications it considered, a substantial increase from its 7 to 10 percent application refusal rate of the three prior years. These figures are somewhat misleading because they do not reflect the much larger number of agreements that had to be modified substantially to secure INPI approval.

D. Foreign Trade

The foreign exchange rate, imports and exports are all tightly controlled, providing additional techniques through which the Brazilian government controls foreign investors. Since 1968, the cruzeiro has been on a "trotting peg," subject to frequent mini-devaluations of 1 to 3 percent every few weeks (every few days thus far in 1983). In theory, these devaluations were to have been calcu-

90. Id., para. 2.

91. Jornal do Comércio, May 7, 1980, at 6. Of the agreements approved by INPI, 80 percent were in the areas of petroleum and petro-chemicals, nuclear and electric energy, capital goods, steel, and nonmetallic materials. The great bulk of the approved agreements were for engineering services. Id. Between 1972 and 1978, INPI approved 78.5 percent (9,764 out of 12,434) of the requests submitted to it. Fundação Casa de Rui Barbosa, Transferência de Tecnologia-Jurisprudência Judicial e Administrativa 43 (A. Bastos, Coord. 1981).
lated to adjust for the differential between Brazil's inflation rate and those of its major trading partners, but in practice, the rate of cruzeiro devaluation prior to 1983 was allowed to lag behind this inflation differential. From time to time, a maxi-devaluation was required to offset over-valuation of the cruzeiro. A chronically overvalued cruzeiro has made initial foreign investment more expensive but has increased the value of earnings and reinvestment. Brazil's initial agreement with the IMF called for the cruzeiro to be devalued at an average monthly rate at least 1 percent greater than the domestic inflation rate. After the 30 percent maxi-devaluation in February 1983, Brazil began pegging the exchange rate to its domestic inflation rate. In September 1983, Brazil began linking the exchange rate to the expurgated version of the consumer price index, which once again sets the cruzeiro on the path to overvaluation.

Imports require licenses from CACEX and are subject to substantial taxes and duties. The rates of duty vary between 0 and 205 percent ad valorem, with most products falling in the 30 to 85 percent range. Prior to December 1979, imports were not only subject to duty, but to a prior deposit in cruzeiros equal to the value of the import. This cruzeiro sum had to remain on deposit for one year without monetary correction or interest; with an inflation rate of roughly 100 percent, this scheme effectively doubled the price of imports. Exports were encouraged by exemptions from the Tax on the Circulation of Merchandise (ICM), credits against the Tax on Industrialized Products (IPI) and income tax exemption on profits from export sales. In December 1979, both the prior deposit and the IPI tax credit for exports were eliminated. For a time, the economic effects of these changes were offset by a 30 percent maxi-devaluation.

During the early part of 1980, CACEX began an informal policy of limiting imports of capital goods for a firm's own use to the value of the firm's imports in the previous year. Imports for resale were also limited to 80 percent of the previous year's imports. For-
eign-controlled firms were told either to import capital goods for their own use without exchange cover, thereby characterizing their imports as equity investments, or to arrange external financing for at least five years. Even Brazilian-controlled firms were told to arrange a minimum of five years external financing, although if such financing proved to be unobtainable, CACEX would consider waiving this requirement. Cash sales were not prohibited, but CACEX considered them "undesirable." Machinery components, whether imported by foreign or locally controlled firms, were required to have a minimum of two years' foreign financing and could be imported only for projects granted export incentives.66

In September 1980, CACEX's informal policy of constraining imports was codified in a Central Bank resolution that established a sliding scale of minimum external financing terms for imports, ranging from 3 years for those machines, equipment, instruments, vehicles, ships and airplanes with an FOB value of $100,000 to $300,000 and up to eight years for goods with values in excess of $5 million. A two-year minimum financing period was imposed on imports of spare parts when the import license was issued prior to December 31, 1980, and a one-year period was required on licenses issued thereafter. Durable consumer goods and raw and intermediate materials for the steel and chemical industries were required to have a minimum term of 180 days financing if the invoice amount were in excess of $100,000.9 At the end of 1980, the Tax on Financial Transactions (IOF) was increased from 15 to 25 percent.8 This tax is imposed upon the purchase of foreign exchange, which applies to a little over half of all imports, making the cost of these imports even more expensive. In September 1982, CACEX added more than 1,000 items to a list of goods for which it will not issue import licenses.9 In October 1982, the Central Bank reduced the value of imports requiring a minimum external financing term of eight years from $5 million to $1 million.100

Since August 1, 1983, when Brazil was forced to institute the rationing of foreign exchange, the Central Bank has become an additional screening agent for imports. If the Central Bank assigns a

100. See supra note 46.
low priority to an import, the importer may have to wait indefinitely to secure the necessary foreign exchange from the Central Bank or pay a much higher price by resorting to the black market. This rationing scheme substantially increases the transaction costs of importing goods into Brazil. The importer must buy foreign currency from a commercial bank to pay for the imported goods, but he has no idea as to when the Central Bank will remit the foreign currency to the exporter. Hence, the importer does not know when the merchandise will be shipped and how much it will eventually cost. This rationing measure should bolster the government's goal of reducing public sector imports by 29 percent and private sector imports by 22 percent in 1983.

Until recently, goods could be freely exported from Brazil with few exceptions. In the wake of the February 1983 maxi-devaluation, Brazil temporarily imposed export taxes of 10 to 20 percent on a number of commodity exports,\textsuperscript{101} supposedly to prevent importers from receiving the benefit of the devaluation. This ill-considered measure nullifies the major reason for the devaluation: stimulation of exports.

Exporting from Brazil is still difficult, despite the government's avowed desire to stimulate exports as much as possible. A non-transferable export license must be obtained from CACEX for all products except coffee, whose exportation is subject to special rules under the authority of the Brazilian Coffee Institute. Even after recent attempts to streamline the process, securing an export license can still involve as many as 1,470 separate legal actions before 13 government ministries and 50 agencies.\textsuperscript{102} CACEX controls the prices at which goods can be exported by publishing minimum export prices. At the time it issues the license, CACEX must approve the firm's expenses for freight, insurance and agent's commission. Generally, CACEX will not permit the payment of a commission to a parent or affiliated company if the company has received investment incentives in return for a commitment to export. If Brazil were really serious about promoting exports, abolition of the export license scheme would be the most logical reform.

\begin{thebibliography}{9}

\bibitem{102} Freed, \textit{Brazil Bureau Is Battling Bureaucracy}, Miami Herald, May 15, 1981, at 9c, cols. 3-6.
\end{thebibliography}
FOREIGN INVESTMENT IN BRAZIL

E. Income Taxation

Another way Brazil controls foreign investment is through income tax laws. Brazil's basic corporate income tax rate is now 35 percent. Brazil also has an excess profits tax of 10 percent on all income in excess of 40,000 ORTNs (about US $306,900 at the start of December 1983). Capital gains and losses are treated as ordinary income and losses. Generally, ordinary and necessary business expenses are deductible. One significant exception is that no royalty or technical assistance payments, made by a Brazilian company to a related foreign company, may be deducted. A second exception is that no royalty or technical assistance, even if paid in Brazil in cruzeiros, may be deducted as a legitimate business expense unless the agreement has been approved by INPI. The Brazilian Treasury has continued to adhere to this position despite a decision of the Federal Appellate Tribunal sustaining a taxpayer's challenge of this regulation on the theory that no law exists to support the tax authorities' interpretation.

In the absence of a tax treaty, Brazil also levies a 25 percent income withholding tax on all dividend, interest, rental, royalty and technical assistance payments made to nonresident individuals and corporations. Tax treaties in force with more than a dozen countries usually reduce this tax rate to 15 percent (12.5 percent for Japan). Foreign loan agreements commonly shift the burden of paying this tax to the Brazilian borrower. When this is done, the effective withholding tax rate becomes 33⅓ percent because the payment of the tax on the lender's behalf is treated as the equivalent of remittance of the amount of the tax to the lender. In 1975, the Central Bank decided to reduce the effective cost of

104. Id., art. 15(II).
108. Brazil currently has tax treaties in effect with Argentina, Austria, Belgium, Denmark, Finland, France, Italy, Japan, Luxembourg, Norway, Portugal, Spain, Sweden and West Germany. For discussion of some of these treaties, see A. Xavier, The Taxation of Foreign Investment in Brazil 86-99 (1980); Gouvea Vieira, Brazil, in Tax Incentives for Private Investment in Developing Countries 187, 201-03 (R. Anthoine ed. 1979).
foreign loans with minimum terms of 8 years by rebating 85 percent of the tax withheld to the Brazilian borrower. Once set as high as 95 percent, the rebate is presently 40 percent, primarily because of complaints by U.S. banks that the Internal Revenue Service's disallowance of the foreign tax credit with respect to that portion of the tax subject to rebate placed them at a competitive disadvantage.

A foreign investor may opt to reinvest earnings in the enterprise in which his investment is registered rather than remit them abroad. So long as the earnings are reinvested in the same enterprise, the investor need not pay the 25 percent withholding tax. If, however, a foreign investor reinvests part of these earnings in another enterprise, the withholding tax must be paid.

Earnings of Brazilian subsidiaries of foreign corporations reinvested in the enterprise in which they are earned remain exempt from the 25 percent withholding tax unless repatriated within 5 years after capitalization. Income earned by a Brazilian branch of a foreign corporation is immediately subject to the 25 percent withholding tax regardless of when the income is remitted to the parent. Such income is classified as an automatic dividend by invoking the legal fiction that it is immediately available to the parent. If a branch uses retained income for plant expansion, the withholding tax rate drops to 15 percent.

In 1975, the 25 percent withholding tax was reduced to 15 percent on distributions to foreign investors by investment companies authorized by the Central Bank to channel foreign investment into Brazil's capital market. If the investment capital entered Brazil prior to December 29, 1982, and has remained in the country for at least 6 years, the tax rate on distributions falls to 12 percent, and, after 8 years, the rate falls to 8 percent. Portfolio investment

112. In certain circumstances the Central Bank will permit tax-free reinvestment of dividends received from a different enterprise, provided the payor belongs to the same economic group as the recipient.
114. Income Tax Reg., art. 555 § 9; Normative Opinion of the Coordinator of the Tax System No. 5 of Mar. 6, 1974. See also A. Xavier, supra note 108, at 50.
116. Decree-Law No. 1.401 of May 7, 1975, art. 2.
117. Id. art. 5, as amended by Decree-Law No. 1.986 of Dec. 28, 1982.
entering Brazil subsequent to December 29, 1982, however, is taxed at a flat 15 percent rate on profit remittances regardless of how long it remains, but capital gains on such investment are exempt from withholding tax.118

An integral part of Brazil's regulatory scheme for foreign investment is a supplemental income tax on excess profit remittances. Foreign investors are free to remit all distributable earnings, but net dividend remittances (after deducting the normal 25 percent withholding tax) in excess of 12 percent per year of registered capital, are subjected to a progressive surtax. The tax rate is 40 percent on net remittances between 12 and 15 percent of registered capital; 50 percent on net remittances between 15 and 25 percent; and 60 percent on net remittances in excess of 25 percent.119 This supplemental tax is calculated upon a three-year moving average, so that a remittance of more than 12 percent of registered capital in any single year will not necessarily trigger the supplemental levy if there is sufficient slack in remittances in the other two years in the triennium to absorb the excess.120 These supplemental tax rates are not reduced in any of Brazil's tax treaties, but they may be creditable against the foreign investor's income tax in his home country.121 In a recent to make foreign investments in the Brazilian stock market more attractive, remittances of cash dividends and bonuses to foreign investors from Decree-Law 1.401 investment companies have been exempted from the supplemental tax.122

Few firms actually pay this supplemental tax. Since they are

119. Law No. 4.131 of Sept. 3, 1962, art. 43 § 1; Income Tax Reg., art. 559 § 1.
120. Income Tax Reg., art. 559 § 7. Calculation of the supplemental tax can be complicated, for typically one's registered capital changes from year to year, and the last two years of one period are the first two years of the next triennium. In other words, if the first triennium includes the years 1978, 1979 and 1980, the second triennium will be 1979, 1980 and 1981. Until recently, any supplementary tax withheld was inexplicably treated as remitted profit for the purpose of calculating whether supplemental tax was owed for the next triennium. Normative Opinion No. 77 of the Coordinator of the Tax System, Sept. 4, 1978, para. 10. This illogical interpretation was rectified in 1982. Currently, any supplemental tax paid is eliminated from remitted profits so that foreign investors are no longer taxed on taxes. Normative Opinion No. 49 of the Coordinator of the Tax System, July 14, 1982. For an explanation of some of the complexities in calculating the supplementary tax, see A. Xavier, supra note 108, at 78-86.
122. Decree-Law No. 1.986 of Dec. 28, 1982. Capital gains from these investment companies can now be remitted free from both withholding and supplemental tax. Id.
already subject to a 25 percent withholding tax on all dividend remittances, investors incur no supplemental tax liability unless they distribute more than 16 percent per annum on registered capital. This is a far greater rate of return than foreign firms have been averaging in Brazil. Indeed, it is doubtful whether this supplemental tax makes any economic sense. In a period of economic boom, some firms may wish to remit higher profits, but that is when Brazil can afford to allow them to do so. During hard times, most firms have few profits to remit. At the present time, foreign firms have had to rely heavily on internal funding due to high rates of inflation and extremely limited access to domestic financing sources.

Capital repatriation is not subject to tax. If, however, an investor sells his investment in Brazil at a price greater than the registered capital, the capital gain will be treated as if it were a dividend, and it will be subjected to the 25 percent withholding tax and the supplemental tax.

Brazil offers such a vast array of tax incentives that it is difficult to estimate the effective tax rate on foreign firms doing business in Brazil. Some of these incentives take the form of deductions, while others are tax credits. The principal tax incentives are discussed below in the more general context of investment incentives.

F. Investment Incentives

Another important technique Brazil uses to regulate foreign investment is its dazzling array of investment incentives. These in-

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123. According to the most recent data available, the annual rate of return on all U.S. direct private investment in Latin America was 15.8 percent for 1981 and 8.6 percent for 1982. The annual rate of return for U.S. direct investment in Brazil was only 3.3 and 6.3 percent respectively for these years. U.S. Dept. of Comm., 63 Survey of Current Bus. 11, 23-24, 29-30 (No. 8, Aug. 1983). Between 1971 and 1981 annual remittances on all registered foreign capital in Brazil averaged about 4.2 percent. W. Baer, supra note 7, at 187, 188.

124. The 25 percent tax is due and must be withheld at the time the excess cruzeiros are paid to the foreign investor, regardless of whether these cruzeiros are ever remitted abroad. Decree-Law No. 1.401 of May 7, 1975, art. 4. Permission from the Central Bank is required to remit any amount in excess of the registered capital, and the Central Bank will generally refuse such permission. A. Andrade, supra note 38, at 171. On the other hand, foreign investors are free to sell their investment outside of Brazil for foreign currency or stock whose value exceeds the registered capital, but the buyer's ability to remit profits or to repatriate capital will be limited to the amount shown on the registration certificate plus subsequent registered reinvestments.
centives consist of a continually changing mixture of subsidized financing, tax credits and tariff exemptions. Most of these incentives are available to both domestic and foreign-controlled firms, but some are restricted to Brazilian-controlled firms.

All Brazilian taxpayers are permitted to take a tax credit for a certain percentage of their Brazilian income tax for investments in economically depressed regions, such as the Northeast or the Amazon, or in activities deemed particularly desirable, such as fishing, tourism or reforestation. These tax credit funds are allocated by governmental agencies on a matching funds basis for approved investment projects. The taxpayer receives shares of a mutual fund, which in turn receives non-voting shares in the corporations operating the projects. These shares are non-transferable for four to five years. Any dividend payments on these shares is set quite low, making these tax credit funds a very inexpensive form of equity financing. Investment projects are approved on a case-by-case basis by the relevant agency. Normally, approval brings with it a considerable degree of governmental control over the investment project. Project approval also carries with it an exemption from the income tax and other indirect taxes for a 10 to 15 year period, subsidized credit from government development banks and the privilege of importing capital equipment duty-free or at sharply reduced tariff rates.

125. For descriptions of the basic incentives, see B. CARL, A GUIDE TO INCENTIVES FOR INVESTING IN BRAZIL (1972); P. GARLAND, DOING BUSINESS IN AND WITH BRAZIL 52-67 (1978); Gouvea Vieira, supra note 108; Pinheiro Neto & Dias da Silva, Incentives for Investment in Brazil, 13 Case W. Res. J. Int'l L. 123 (1981).

126. Legal entities can earmark up to 50 percent their total income tax for investment in the shares of the Northeast Investment Fund (FINOR) or the Amazon Investment Fund (FINAM). The comparable tax incentive for individuals was eliminated by Decree-Law No. 2.065 of Oct. 26, 1983. These mutual funds then invest in projects that the Superintendency for the Development of the Northeast (SUDENE) or the Superintendency for the Development of the Amazon (SUDAM) deem desirable for the economic and social development of their respective regions. In exceptional cases, such as when a corporate taxpayer has its own approved project, the tax credit may be applied directly to that project. Taxpayers can also receive tax credits for investing in the Sectorial Investment Fund (FISET). Up to 12 percent of any tax owed can be invested in tourism projects; up to 25 percent in fishing projects; up to 35 percent in reforestation projects; up to 1 percent in EMBRAER, the government-controlled aircraft manufacturer; and for companies with head offices in the State of Espirito Santo, up to 33 percent in a special fund for that state's reconstruction (GERES). There is an overall limitation of 50 percent of the tax due for each legal entity, increased to 51 percent if the taxpayer invests in EMBRAER. Income Tax Reg., art. 492. These tax credit funds are deemed domestic investment and cannot be registered with the Central Bank for foreign remittance purposes.

127. P. GARLAND, supra note 125, at 60-61.
The Industrial Development Council (CDI) reviews and approves, on a case-by-case basis, industrial projects it deems in the national interest.\textsuperscript{128} CDI currently grants the following incentives: (1) exemption from import duties for equipment and machinery not produced in the country and for component parts that supplement national production, (2) exemption from the Tax on Industrialized Products (IPI), and the Tax on the Circulation of Merchandise (ICM) for the purchase of domestically manufactured capital goods, (3) depreciation for income tax purposes at three times the normal rates and (4) subsidized governmental financing. Total tariff and IPI exemptions are reserved for projects in the national interest that are approved by the President of the Republic. On lower priority projects, CDI can grant 50 to 80 percent reductions in import duties, the IPI and the ICM. In order to stimulate the production of component parts in Brazil, granting of CDI benefits is frequently conditioned upon compliance with pre-established indexes of national content that must be met by certain target dates.\textsuperscript{129}

CDI utilizes incentives to control investment. It generally requires that industrial projects be designed to replace imports, to promote exports or to help reduce regional imbalances. In its early years of operation, CDI granted incentives quite freely. Since the 1974 balance-of-payments crunch, CDI has become increasingly selective and has been actively discouraging small projects. The number of projects approved has declined sharply, while the average investment per approved project has jumped substantially.\textsuperscript{130}

CDI incentives are available to both foreign controlled and domestic industries, and many projects of foreign-controlled firms have been approved. In deciding whether to grant incentives to foreign investors, the factors which CDI currently considers positive include: (1) the presence of a Brazilian partner; (2) inclusion of Brazilians in important managerial positions; (3) location of the investment outside the São Paulo, Rio de Janeiro and Belo Horizonte triangle; (4) bringing in a substantial percentage of the project’s capital requirements in the form of direct equity invest-

\textsuperscript{128} Tyler, Restrições a Importação e Incentivos Fiscais para o Setor de Bens de Capital no Brasil: 1975/79, 10 Pesquisa e Planejamento Econômico 435 (1980).
\textsuperscript{129} P. Garland, supra note 125, at 61-63; Robock, supra note 43, at 64-65.
\textsuperscript{130} In 1973, CDI approved 2,851 projects with an average investment of $1,300,000 each. In 1979, CDI approved only 130 projects with an average investment of $13,200,000. Tyler, supra note 128, at 447.
FOREIGN INVESTMENT IN BRAZIL

ment from abroad; and (5) bringing advanced technology to Brazil. In the past year, CDI has been actively seeking out potential foreign investors, preferring those willing to engage in joint ventures with Brazilian capital. If tax incentives have been granted to a Brazilian company, CDI frequently requires that the beneficiary agree not to transfer control of its shares to foreigners without first obtaining CDI's consent. Breach of this covenant normally results in loss of the benefits received.\textsuperscript{131}

A substantial set of incentives are available to exporters. Exporters of manufactured products can reduce their taxable income for income tax purposes by the same proportion that export sales bear to total sales.\textsuperscript{132} The 25 percent withholding tax on foreign remittances may be reduced or refunded for an exporter's payments for interest, commissions, publicity, market research and rents.\textsuperscript{133} A drawback regime permits an exemption, suspension or refund of import duties and the ICM on exported goods.\textsuperscript{134} Special legislation even permits the tax-free importation of an entire factory into Brazil, so long as its output is essentially designed for export.\textsuperscript{135}

The Commission for the Concession of Fiscal Benefits and Special Export Programs (BEFIEX) grants special incentives to firms that agree to export manufactured products.\textsuperscript{136} The incentives normally granted include: a 70 to 90 percent reduction of import duties and IPI on imported machinery and equipment; a 50 percent reduction on import duties and IPI on imported raw materials, components and intermediate parts; and a complete income tax exemption on profits attributable to exports of manufactured products. BEFIEX also has the power to permit Brazilian companies to use any supplementary tax on dividends in excess of 12 percent of registered capital paid to foreign shareholders as a credit against the Brazilian company's own federal taxes,\textsuperscript{137} as well as to extend any tax loss carried forward by two additional

\textsuperscript{131} Pinheiro Neto & Dias da Silva, supra note 125, at 133.
\textsuperscript{132} Income Tax Reg., art. 290. Unless renewed, this benefit expires in fiscal year 1985.
\textsuperscript{133} Id., arts. 561, 563.
\textsuperscript{134} Decree No. 68,904 of July 12, 1971.
\textsuperscript{135} Decree-Law No. 1,244 of Oct. 31, 1972.
\textsuperscript{136} BEFIEX consists of one representative from each of the following governmental organs: Ministry of the Treasury, Ministry of Commerce, Ministry of Planning, Customs Policy Council, CACEX and the Secretary of Federal Receipts. It was created by Decree-Law No. 1,219 of May 15, 1972, and was originally linked to the Treasury Ministry. Decree No. 74,199 of June 21, 1974, transferred it to the Commerce Ministry.
\textsuperscript{137} Income Tax Reg., art. 310.
years. These benefits may not, however, be enjoyed simultaneously with other tax incentives. If the President of the Republic deems the export program important to the economic interests of the country, full import duty and IPI exemptions can be granted.

Companies wishing to obtain BEFIEX incentives must sign an export commitment and meet certain FOB values for average yearly exports. In addition, the value of goods imported by these firms may not exceed one-third of the net value of their average yearly export of manufactured products. Export commitments are normally signed for ten years; nevertheless, recent commitments have been permitted for as little as five years. In response to a trade dispute with the United States, Brazil recently eliminated the IPI credit for the BEFIEX program. Firms that neither signed a new agreement with BEFIEX nor extended an existing agreement by March 1983, are no longer be eligible for the IPI credit.

Additional export financing is available from the Export Financing Fund of the Bank of Brazil (FINEX), which makes subsidized financing available to industrial companies that want to begin or increase foreign sales of their products. Short-term financing from commercial banks is also available at subsidized interest rates.

The National Bank for Economic and Social Development (BNDES) grants a number of incentives that are only available to companies controlled by Brazilian capital. BNDES is a source of heavily subsidized long-term financing. It also has four special subsidized financing programs to aid Brazilian firms in modernizing their equipment, engaging in research and development projects, expanding the capital of small or medium sized companies, and stimulating the purchase of machinery, equipment and capital goods produced in Brazil.

Brazilian government officials frequently use their powers to grant or withhold incentives to prevent foreign investors from buying out existing Brazilian-owned firms or to induce foreign investors to enter into joint ventures with domestic private capital and/or state capital. Even though no law may require a foreign investor

138. Id., art. 313.
140. Pinheiro Neto & Dias da Silva, supra note 125, at 135.
to acquire a Brazilian partner, the presence of such a partner frequently makes the difference between having a project approved or rejected.143

G. Restrictions on Foreign Investors

Most countries reserve certain sensitive areas of their economies to their own governments or to domestic capital. Brazil is no exception. The government monopolizes a few sensitive areas, while others are exclusively reserved for domestic capital. To invest in certain areas, foreigners must associate themselves with local investors; to invest in others, they need merely organize a Brazilian legal entity. Brazilian law requires national treatment for foreign capital;144 nevertheless, in several areas, foreign capital is subject to special constraints. When viewed in comparative perspective, however, these constraints on foreign investors are relatively mild.145

A few economic activities are off limits to the foreign investor because the government has a monopoly. The government-controlled oil company, Petroleo Brasileiro, S.A. - Petrobrás (Petrobrás), monopolizes oil exploration, research and drilling.146 Since 1976, Petrobras has permitted foreign oil companies to prospect for petroleum pursuant to risk contracts requiring the foreign oil companies to set up Brazilian branches or subsidiaries.147 Other government monopolies or near monopolies include distribution of electricity, telecommunications, lotteries, railways, ports and other

143. P. E vans, Dependent Development: The Alliance of Multinational, State and Local Capital in Brazil 200-05 (1979).

144. Article 153 of the Constitution "assures Brazilians and resident aliens the inviolability of their rights to life, liberty, security, and property, in the following terms: § 1. All are equal before the law. . . . " The equivalent language in the 1946 Constitution has been interpreted by the Supreme Federal Tribunal, Brazil's highest court, as guaranteeing the right of property to non-resident aliens as well. R. E. No. 33.919, Agência A. C. Fernandes Ltda. v. Henrique Barbosa & Cia., 3 R.T.J. 566 (1957). In addition, the Profit Remittance Law provides: "Identical juridical treatment to national capital under conditions of equality shall be dispensed to foreign capital invested in the country, prohibiting any discrimination not provided for in this law." Law No. 4.131 of Sept. 3, 1962, art. 2.

145. See R. Robinson, National Control of Foreign Business Entry: A Survey of Fifteen Countries xix-xxiii (1976), showing that Brazil had the least restrictive barriers to foreign investment of all fifteen countries in the study.

146. Law No. 2.004 of Oct. 3, 1953, art. 29.

Constitutional constraints exclude foreigners from participation in a few areas. The Constitution expressly bars foreigners from the communications media and coastal shipping companies. Although the Constitution also limits participation in mining or hydroelectric power to Brazilians or Brazilian legal entities, any legal entity organized in Brazil is deemed to satisfy this requirement, even if it is entirely owned by foreigners.

Domestic airline concessions are restricted to Brazilian corporations whose head office or place of control is located in Brazil. At least 4/5 of the voting shares must be owned by Brazilians and no voting shares can be transferred to non-Brazilians, even if they will own less than 1/5 of the voting stock. In addition, direction of the corporation must be exclusively in the hands of Brazilians.

The 1962 Profit Remittance Law prohibits a foreign bank from acquiring more than 30 percent of the voting shares of Brazilian banks if the laws of the country in which the foreign bank has its head office, impose any restrictions on Brazilian banks. The Profit Remittance Law also imposes on every foreign bank authorized to operate in Brazil the same restrictions imposed on Brazilian banks by the laws of the country of the foreign bank's head office. Although no law formally prohibits foreign banks from establishing branches in Brazil, the Central Bank must give prior approval. The Central Bank has an unwritten policy of refusing virtually all requests by foreign banks for permission to establish new branches, but the rights of existing foreign branch banks have been respected. The Central Bank also has a policy of refusing to allow foreign investors to own more than one-third of the voting stock.

151. Decree-Law No. 32 of Nov. 18, 1966, art. 69, as regulated by Decree No. 72.898 of Oct. 9, 1973, art. 10.
152. Law No. 4.131 of Sept. 3, 1962, art. 51.
153. Id., art. 50.
154. The number of foreign banks established in Brazil has only grown from 10 in 1948 to 19 in 1976 because of this unwritten policy of the Central Bank. Tavares & Teixeira, Transnational Enterprises and the Internationalization of Capital in Brazilian Industry, 14 CEPAL REV. 85, 103-04 (Aug. 1981).
shares or more than one-half of the total capital of investment banks. 

Foreigners may acquire undeveloped rural land only under certain conditions. Corporations controlled directly or indirectly by foreign capital must secure prior approval from the Ministry of Agriculture to purchase rural land for agricultural, livestock, industrial or colonization projects. Foreign individuals need permission from the National Institute of Colonization and Agrarian Reform (INCRA) to acquire more than three units of rural land. Any single foreigner, or foreign corporation, is prohibited from owning more than one-fourth of the total area of a county (municipio). Further, foreigners of the same nationality may not own more than 40 percent of any municipio. In addition, in zones within 150 kilometers of Brazil’s frontiers, Brazilians must own, and predominantly manage, at least 51 percent of the capital of any firm engaged in arms manufacture, mining, electric energy or communications.

In recent years, foreigners have been foreclosed from a number of other economic activities. Highway transportation is restricted to firms in which Brazilians own at least 80 percent of the stock. Moreover, all the directors and managers of such firms must be Brazilians. Foreign investors may not acquire, either directly or indirectly, more than one-third of the capital of insurance companies or brokers, but the rights of existing investors have been “grandfathered.” An unpublished Central Bank policy prohibits foreign capital from controlling more than one-third of the voting stock of leasing and finance companies. The government generally insists that Brazilians own a majority of the equity in virtually all large mining projects. In petrochemical ventures, the government has generally pushed for a three-way split among state capital, pri-
vate Brazilian capital and foreign capital.\textsuperscript{162}

In a few areas, Brazil has adopted a policy of reserving all or part of a market for Brazilian firms. Thus, in order to stimulate the development of a domestic film industry, Brazilian law requires that a theater showing a full-length foreign film must also exhibit a Brazilian-made short-length cultural or news film. Moreover, full-length Brazilian films must be featured in all Brazilian theaters for a determined number of days each year.\textsuperscript{163}

The most important application of the reserved market approach is in data processing and related fields. The Special Secretariat for Informatics (SEI), which must approve all technology transfer agreements (in addition to INPI) and imports relating to data processing (in addition to CACEX), has mandated a rigorous preference for Brazilian equipment in any purchases of equipment by governmental agencies.\textsuperscript{164} It has also developed an extremely broad view of “similarity” as a device for rejecting requests to import foreign computers and components.\textsuperscript{165} Continuing and expanding upon a 1977 policy determined by its predecessor,\textsuperscript{166} SEI has also reserved the mini- and micro-computer industries, as well as testing and measuring instrumentation systems, to Brazilian firms. SEI approval of all new data processing and testing and measuring projects is being withheld unless control of the stock and effective power for orientation and functioning is permanently and exclusively in the hands of persons who are both residents and domiciliaries of Brazil, and the project utilizes technology developed in Brazil.\textsuperscript{167} In addition, government agencies and enterprises are prohibited from hiring foreign engineering, consulting or data processing firms unless Brazilian firms are either unavailable or unable to perform the needed service.\textsuperscript{168} In such event, the policy

\textsuperscript{162} P. EVANS, supra note 143, at 228-49.

\textsuperscript{163} Law No. 6.281 of Dec. 9, 1975, arts. 13, 14. See also Decree of the Council of Ministers No. 544 of Jan. 31, 1962, art. 3, requiring TV stations to show at least one Brazilian film per week.

\textsuperscript{164} SEI, Normative Act No. 5 of June 25, 1980.

\textsuperscript{165} SEI, Normative Act No. 14 of Mar. 18, 1981. "National instruments of analogous technology shall be considered similar to imported digital technology when intended for the same use." \textit{Id.}, art. 1, sole para.

\textsuperscript{166} See Vidal, \textit{Brazil Declares Computer Independence}, N.Y. Times, Feb. 19, 1978, Sec. 3, at 3, cols. 1-4. SEI’s predecessor was the Commission for the Coordination of Electronic Processing Activities (CAPRE).

\textsuperscript{167} SEI, Normative Acts No. 16 of July 10, 1981 and No. 24 of May 31, 1983.

of the government is to employ a foreign-controlled firm only if it agrees to associate itself with a Brazilian firm in performing the contract.

SEI must also approve all international data links. Corporations are encouraged to use local data processing, even if this requires importation of equipment not yet available in Brazil. Corporations wishing access to foreign data bases are encouraged to install and operate copies of those data bases in Brazil.\textsuperscript{169} Recently, Brazil established a national registry of software to encourage local production of software and to guard against importation of unnecessary software.\textsuperscript{170}

1. DISCRIMINATION AGAINST FOREIGN INVESTORS

Government agencies constantly pressure foreign firms to accept local partners and to increase the percentage of Brazilian content in their products as a \textit{quid pro quo} for subsidized financing, tax incentives, import privileges or relaxation of price controls. Brazilian financing agencies, such as the BNDES programs, Financing for Small and Medium-sized Business (FIPEME) and the Fund for the Financing of the Acquisition of Industrial Machinery and Equipment (FINAME), discriminate against foreign-controlled firms in extending subsidized credit. The usual rationale is that multinational firms can tap the international loan market more easily, and at more favorable rates, than can Brazilian firms. An increasing number of fiscal and financial incentives are being denied to foreign-controlled firms.\textsuperscript{171}

Government regulatory policy has been to require the private

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\item Government agencies to contract for data processing services only with a Brazilian company, which is defined as a Brazilian legal entity, established on a permanent and unconditional basis and operating under the decision-making, technological and capital control of individuals resident and domiciled in Brazil with at least two-thirds of its technological staff made up of Brazilians. Governmental agencies can contract with foreign companies for data processing services only with the special consent of the SEI.

\item Hummer, \textit{International Legal Principles: Common Law and Civil Law}, in \textit{PRIVATE INVESTORS ABROAD - PROBLEMS AND SOLUTIONS IN INTERNATIONAL BUSINESS IN 1982}, 71, 81 (M. Landwehr ed. 1982). As of March 1982, SEI had approved 23 out of 32 applications for transnational computer communications systems, while two applications were pending. Five of the seven denied were applications for data systems; these were rejected because the applicants had failed to ensure that information structuring and information resources would be located in Brazil. \textit{Id.}

\item SEI, Normative Act No. 22 of Dec. 2, 1982.

\item See supra notes 142-43 and the accompanying text.
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banking system to make an increasing percentage of its loans to Brazilian-controlled firms. The Central Bank requires that 70 percent of all credit extended by banks, credit companies and financial institutions must go to Brazilians or locally controlled firms. The remaining 30 percent must be divided between multinational and state companies. Prior to 1980, foreign-controlled firms could freely tap the domestic credit market by selling debentures. In 1980, the Securities Commission (CVM), invoking an unwritten rule, began requiring that foreign-controlled firms bring equity capital into Brazil in an amount equal to that raised by issuing debentures. In 1982, the CVM raised the ante, requiring fresh foreign funds equal to three times the value of debentures sold by foreign-controlled firms on the Brazilian capital market.

2. THE 1976 CORPORATION LAW

In 1976, Brazil adopted a well-drafted, modern corporation law. This statute, which was carefully designed to stimulate the Brazilian capital market, has produced several significant changes in the foreign investment climate.

The Corporation Law substantially enhances the legal protection available to minority shareholders. This makes it more attractive for the foreign investor to take a minority position in a joint venture with Brazilian capital, which is virtually a must for a mining venture. The new corporation law also provides for compulsory dividend distributions of 50 percent of the net profits of a sociedade anônima (a stock corporation), unless the charter provides for a lower percentage. If it were not circumventable, this provision would make it more difficult to build up a remittance base by reinvesting earnings in Brazil.

One of the loudest complaints of Brazilian nationalists has been against the denationalization of Brazilian industry by foreign takeovers. While foreign investors have acquired a substantial

173. Rosenn, supra note 6, at 188.
177. See Decree-Law No. 1.240 of Oct. 11, 1972, providing substantial incentives to mining ventures that are Brazilian-controlled.
178. Law No. 6.404 of Dec. 15, 1976, art. 202. This percentage can be reduced as low as 25 percent by charter provision. Id.
number of private Brazilian companies, in the past decade the percentage of foreign ownership of the Brazilian economy appears to have declined significantly, while the percentage of state ownership has increased dramatically. Brazil has never formally required prior approval for foreigners to acquire a domestic firm, but a last minute amendment to the corporation law, the so-called Lehman Amendment, has made it more difficult for foreign companies to take over existing Brazilian firms. The Amendment requires CVM approval prior to acquiring a controlling interest in any company whose shares are traded on a stock exchange or over the counter. Moreover, any takeover bid has to include a simultaneous offer of common shares to the general public, and the minority shareholders must be offered the same terms for their common shares as are offered to the controlling shareholders.

Another amendment requires that all members of the board of directors and administrative councils of Brazilian companies be Brazilian residents, creating minor problems for foreign investors operating sociedades anônimas. In Brazil, the administrative councils serve the general policymaking functions of U.S. boards of directors, while the directors discharge most of the management functions of officers of U.S. corporations. In the past, it was common practice for members of the administrative councils of foreign-controlled Brazilian companies to be non-residents and make occasional trips to Brazil for council meetings. Companies with closed capital can dispense with the administrative council, but companies with open capital must move key personnel to Brazil or operate with straw representatives on the council.

3. PORTFOLIO INVESTMENT

Brazil does not permit non-residents to invest in Brazilian companies by directly purchasing stock on the Brazilian stock market. Since 1975, however, non-residents have been permitted to

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180. Such legislation was drafted as a decree-law in 1975 but never published in the Diário Oficial. Rosenn, supra note 6, at 206, n. 100. There have been isolated cases, such as Phillips-Consul, where the Brazilian government blocked a foreign takeover of a domestic firm. Finheiro Neto, Multinationals in Brazil, 8 CASE W. RES. J. INT'L L. 311, 317 (1976).


182. Id., arts. 145, 146, and 162.
make portfolio investments in Brazilian companies through the purchase of shares in mutual funds (called Decree-Law 1.401 funds), administered by special management companies under Central Bank supervision. Investments are made through subscription agents in the investor's home country, pursuant to agency agreements registered with the Central Bank. All mutual fund investments must be registered with the Central Bank in order to be able to remit dividends, capital gains and capital repatriation.

A series of restrictions has circumscribed the operation of these mutual funds and has made foreign portfolio investment in Brazilian companies quite unattractive. All mutual fund shares must be sold outside of Brazil, and, no Brazilian resident or company may acquire the shares of a Decree-Law 1.401 fund. The boards of directors of the special management companies must consist solely of Brazilian residents holding no shares of the Decree-Law 1.401 funds they are managing. The management companies must invest at least 50 percent of their portfolio investments in shares or convertible debentures of open capital corporations controlled by private Brazilian shareholders. The remaining 50 percent (or less) can be applied in ORTNs; nonconvertible debentures of open capital companies controlled by private Brazilian shareholders; stock of any corporation listed on a Brazilian stock exchange, including foreign-controlled companies; and registered new issues of stock in Brazilian corporations. The portfolios of the mutual funds must also be diversified. Not more than 10 percent of any mutual fund's portfolio can be invested in a single corporation, nor can any mutual fund own more than 10 percent of the voting shares of any Brazilian corporation. No mutual fund can own more than 20 percent of the total capital of a Brazilian corporation, nor may its average investment in any single corporation exceed 5 percent of the fund's total portfolio.

Originally, foreign investors were required to leave their portfolio investments in Brazil for a minimum of three years, after which they could begin repatriating a maximum of 20 percent of their capital each six months. Tax incentives were offered to encourage investors to keep their capital in the country for longer

In an effort to increase the thus far disappointing amounts of foreign investment made through these Decree-Law 1.401 funds, the minimum holding period has been reduced, first to two years, and recently to 90 days.

H. Labor Restrictions

Like many other nations, Brazil tries to preserve job opportunities for its nationals. Brazilian labor law requires that two-thirds of the employees of every commercial or industrial firm must be Brazilian, and that the Brazilian employees must receive two-thirds of the firm's payroll. For the purposes of this law, foreigners who have resided in Brazil for at least ten years and who have a Brazilian spouse or child are considered Brazilian. Relief from this two-thirds rule can be obtained only if both the National Labor Department and the Social Security Statistical Department certify that a shortage of qualified Brazilian workers exists for the jobs in question. Brazilians must also receive the same compensation as foreigners for equivalent work. If a firm has to lay off workers, non-Brazilians must be laid off prior to dismissal of Brazilians performing the same work. Practically speaking, these requirements have created few problems for foreign firms operating in Brazil.

I. Price Controls

Despite decades of proven ineffectiveness in controlling inflation, price controls have become a more or less permanent feature of governmental regulation of business in Brazil. Several agencies perform price control functions. The National Superintendency of Supplies (SUNAB) controls the prices of essential foodstuffs. The Superintendency of Private Insurance (SUSEP) sets insurance rates, while the National Petroleum Council (NPC) sets gasoline prices.

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187. Decree-Law 1.401 of May 7, 1975, art. 5. See supra notes 116-18 and the accompanying text.
189. Consolidated Labor Laws [hereinafter cited as CLT], Decree-Law No. 5.452 of May 1, 1943, art. 354. The two-thirds rule does not apply to rural or agricultural firms.
190. CLT, art. 353.
191. CLT, art. 358. Exceptions are created for seniority, commission payments and experience differences. Id.
192. CLT, art. 358, sole para.
The principal price control agency is the Interministerial Price Council (CIP), which reports to the Ministry of Planning. In the late 1970s, CIP controlled the prices of most industrial products and some consumer goods, as well as public utility rates. Like a number of Brazilian agencies, CIP has regulated without issuing clearly defined rules. In addition to trying to contain inflation, CIP has made an effort to reward efficiency and to stimulate the development of local industry. If a firm imported items that CIP believed could have been purchased locally, CIP often either pared the price increase sought or withheld approval until concessions with regard to greater local content were forthcoming. CIP actions have been particularly hard on foreign pharmaceutical firms, some of which have been forced to operate in the red.\textsuperscript{193}

At the end of 1979, a significant change was made in Brazilian price control policy. Instead of permitting price increases whenever justified by increasing costs, Brazil decided to limit firms to only two price increases a year. These increases were to correspond to increases in the general price level rather than to increases in a firm's actual costs. The results of the policy were predictably disastrous. Business profits and investment fell sharply, and many firms had serious losses. In November 1980, the government abandoned this strategy, permitting most firms to operate without controls under a regime denominated "Accompanied Liberty."\textsuperscript{194} In the wake of the February 1983 maxi-devaluation, price controls were reimposed on 299 products and four types of services. Firms are now compelled to obtain special permission from CIP to increase prices on these items by more than 80 percent of the percentage increase in the ORTN rate.\textsuperscript{195} Since the rate of monetary correction on ORTNs is less than 80 percent of the inflation rate, the prices of controlled items are falling substantially in real terms.\textsuperscript{196}

\textsuperscript{193} Rosenn, \textit{supra} note 6, at 183.

\textsuperscript{194} Bus. Lat. Am., Nov. 12, 1980, at 361-62. Under this regime firms were free to set prices, provided they did not go beyond what CIP deemed to be tolerable limits.


\textsuperscript{196} During 1983, the unexpurgated general price index rose by 211 percent, while the ORTN rose by only 156.6 percent. Without special dispensation, the maximum increase permitted for prices controlled by CIP during this period was only 125.3 percent, slightly less than 60 percent of the reported inflation rate.
III. A CRITICAL ANALYSIS OF BRAZIL'S REGULATORY SCHEME

Brazil's Profit Remittance Law was enacted more than twenty years ago when much foreign investment was in public utilities or other forms of monopoly. This gave rise to the suspicion that foreign investors were earning unreasonably high rates of return. The law was enacted in a climate of intense nationalism and great political agitation. The President never even signed the law, preferring to allow the President of the Senate to promulgate it. The Executive did not issue the regulatory decree necessary for the state's implementation until 16 months after its promulgation. Although several of the statute's most objectionable features were revoked in 1964, the framework remains basically that of the poorly conceived 1962 profit remittance control scheme. That scheme contains numerous technical defects.

First, the Profit Remittance Law naively assumes that the ratio between invested capital and net profits does not vary greatly from industry to industry. Consequently, the 12 percent remittance limit severely discriminates against service firms, such as those of accountants, engineers or lawyers, whose registered capital base is generally quite low in relation to their net earnings. It also discriminates against firms in high risk activities, such as mineral exploration, where one would expect to earn higher returns in the event of a felicitous strike. An intelligent attempt to prevent remittance of unreasonably high rates of profit ought to factor risk disparities and capital-labor intensivity into its regulatory scheme instead of setting across-the-board figures.

Second, the flat prohibition on the remittance of patent and trademark royalties to related corporations is a blunderbuss approach to the common problem of income shifting by multinationals. Prior to September 1983, a multinational could circumvent this prohibition handily by transferring technology to its Brazilian subsidiary from another subsidiary that owns no stock in the Brazilian transferee, rather than by making the transfer directly. INPI's Normative Act No. 64, which requires that every foreign parent of a Brazilian subsidiary that purchases technology from an unrelated foreign company make an equity investment equivalent

198. See supra notes 89 and 90 and the accompanying text.
to the remittance payments due for the technology, is an attempt to eliminate this loophole. The probable effect of Normative Act No. 64 will be to prevent foreign-controlled Brazilian subsidiaries from acquiring technology from unrelated foreign firms, unless the parent company finds it convenient to make an equity investment in its Brazilian subsidiary at that time. This type of transfer arrangement increases transaction costs considerably for purchasers of foreign technology.

Related companies, however, are still free to make payments for know-how and technical assistance, and a considerable amount of manipulation of transfer pricing still occurs under the guise of technical assistance payments. Indeed, a comprehensive study disclosed that 62.1 percent of all foreign technology payments made by Brazilian firms were styled as technical assistance payments. Once registration has been granted, INPI and the Central Bank do little auditing to ensure that technical assistance agreements are actually being performed and that the payments cease when the technology has been absorbed. The regulatory process simply results in a higher tax rate because the Brazilian payor cannot deduct these payments as business expenses when they are paid to a related party. If income is escaping taxation by excessive royalties, the better way to handle the problem is to reallocate the income or to disallow part of the attempted deduction. Erecting a flat prohibition against the remittance of royalties between related firms badly distorts both the concept of an income tax and proper accounting procedures.

Third, the percentage limitations upon remittances and deductions for patent and trademark royalties are purely arbitrary, as is the exigency that royalties be calculated as a percentage of net sales. Royalties on all trademarks, regardless of commercial importance, are limited to 1 percent of net sales. Radio and television patents are limited to royalties of 1 percent of net sales, while transformers and generators are limited to 5 percent. Toothpaste and soap patents are limited to 2 percent of net sales, while chemical products may be as high as 4 percent. For example, if a seatbelt

199. Nevertheless, INPI is currently viewing these payments with a jaundiced eye and is unlikely to approve them unless the know-how or technical assistance is deemed essential for national development. Moreover, the Brazilian payor will not be able to deduct these payments as business expenses.
201. Id. at 111.
202. Supra note 76.
is classified as an auto part, the maximum royalty permitted will be 5 percent of net sales. On the other hand if it is classified as a metal artifact, the maximum royalty will be 3.5 percent.\textsuperscript{203}

Market conditions have produced myriad methods for calculating royalties. Royalties are often calculated as a percentage of either gross or net sales, but it sometimes makes eminent sense to calculate royalties as a percentage of savings in manufacturing costs or a flat fee per unit of volume.\textsuperscript{204} Although 5-6 percent of net sales is a common royalty rate,\textsuperscript{205} there are many variations. Exclusive licenses normally bring higher royalties than non-exclusive licenses. Royalties on technological "breakthroughs" are typically higher than on refinements of pre-existing technology. In certain industries, such as pharmaceuticals, 10 to 15 percent of net sales is a common royalty for an exclusive license, while nonexclusive licenses commonly result in royalties from 4 to 7 percent.\textsuperscript{206} The vice of the Brazilian system is that it attempts to prefix the proper royalty rate with a group of meaningless categories administered by a group of bureaucrats with no idea of what the "proper" royalty is for a given technology. This approach has contributed significantly to Brazil's image as a technological backwater, producing goods that are not competitive in world markets.

Fourth, the Brazilian attempt to regulate technology transfer is insufficiently coordinated among INPI, CACEX and SEI. CACEX controls implicit technology transfer that occurs through the importation of machinery and equipment, with SEI having a veto on computer-related products. INPI controls explicit technology transfer that occurs through licensing and technical assistance agreements, subject to SEI's veto in the computer area. Even though both types of technology transfer are interrelated, placing control over them in different entities has resulted in a failure to develop a unified approach.\textsuperscript{207}

Fifth, the Profit Remittance Law assumes that the foreign cur-


\textsuperscript{205} J. L. Eckstrom, \textit{supra} note 62, at 9-156; Finnegan & Mintz, \textit{supra} note 204, at 3D-14.

\textsuperscript{206} Finnegan & Mintz, \textit{supra} note 204, at 3D-14.

\textsuperscript{207} S. Fung & J. Cassiolato, \textit{supra} note 197, at 133.
rencies in which investments have been registered do not suffer from inflation. During the 1970s, however, not even the world’s strongest currencies retained their purchasing power. Paradoxically, Brazil, a world leader in indexing its economy for inflation, does not monetarily correct the real value of foreign investment to assess its supplementary income tax. Yet the real value of a $10,000,000 investment registered in U.S. dollars in 1967 was roughly $30,000,000 at the start of 1983, while the real value of a 1967 investment of 10,000,000 French francs was roughly 39,000,000 francs. Restricting a foreign investor to remitting 12 percent in 1983 dollars or francs on investments made in 1967 dollars or francs limits remittances in real economic terms to 4 and 3 percent respectively. This distortion would be partially corrected if the foreign investor were permitted to register as reinvestment, in foreign currency, capital increases resulting from monetary correction of corporate balance sheets. The Central Bank’s unwritten policy, however, is to refuse such registration. Further, the Central Bank will not permit foreign investors to register passive income stemming from investments in stocks or real estate as reinvestment. The Central Bank’s policy, which has no basis in law, is to restrict reinvestment to earnings from the active conduct of a business.

Sixth, the Profit Remittance Law, operating in tandem with the Brazilian income tax structure, exacerbates Brazil’s external debt, as well as the ordinary “thin” capitalization problems, by offering surprisingly substantial incentives to foreign investors to register their investment as debt instead of equity. Remittable interest on foreign loans is geared to market rates, while remittable dividend income is fixed at 12 percent. In the past decade, with dollar interest rates as high as 18-22 percent, the economic incentive to structure investments as loans was especially powerful. Dividend income is taxed twice in Brazil: once at the normal corporate rate when earned by a Brazilian enterprise, and again at 25 percent when distributed to the foreign investor. Interest income is

210. A. ANDRADE, supra note 38, at 156; French, supra note 141, at 408.
211. French, supra note 141, at 401, n. 4.
212. Intercompany dividends are also subject to tax at the rate of 23 percent, creditable
taxed only once, at 25 percent, when paid to the foreign lender. Moreover, the Brazilian payor can deduct interest payments. Another incentive to structuring an investment in a Brazilian subsidiary as debt is the rebate to the Brazilian subsidiary of a substantial portion of the 25 percent withholding tax on interest remittances, a benefit that is not available on dividend remittances. Furthermore, in the event of a balance-of-payments crisis, the Profit Remittance Law protects interest remittances from reduction. Therefore, it should not be surprising that an estimated $8 billion of Brazil's foreign debt is essentially disguised equity investment, and that the tax incentives to induce foreign investors to convert debt to equity have been largely ineffective.

Structuring an investment as a loan rather than as equity encourages the investor to remove his capital more rapidly. Declaration of dividends is discretionary, whereas servicing debt is, within reasonable tolerances, mandatory. Consequently, capital outflow is likely to be more rapid with debt than with equity. Moreover, the practice of disguising equity as debt distorts the statistics of Brazil's foreign debt. Not only does the external debt appear larger than it really is, but it is also impossible to know how large the debt really is.

Seventh, the inflexibility of a 12 percent profit remittance limitation fixed in nominal terms is highly undesirable. Brazil's effective limit of 12 percent on profit remittances is well below other Latin American countries, including those with a very restrictive attitude towards foreign investment, such as the Andean Common Market. In the past decade, when investors were able to earn 18 to 20 percent returns on bonds or certificates of deposit in devel-


214. Decision 24 of the Andean Commission originally set a ceiling on net profit remittances of 14 percent of registered capital. Recognizing that a 14 percent return was too low, the Commission raised the ceiling to 20 percent in 1976. Since then, several ANCOM countries have either increased the ceiling or are presently exploring ways to do so. Resolution 4/83 of CONTE, Peru's Foreign Investment Commission, permits firms to remit up to 40 percent of registered capital if they comply with certain conditions relating to export sales, use of local inputs and location. Alternatively, firms can remit up to 10 percent above the LIBOR rate that is in effect at the end of the month prior to the remittance. Bus. Lat. Am., Sept. 21, 1983, at 299. For a current summary of the remittance regulations of the Latin American countries, see Bus. Lat. Am., Aug. 24, 1983, at 268-69; Bus. Lat. Am., Sept. 7, 1983, at 284-85.
oped countries with relatively little risk, Brazil's 12 percent limitation on equity returns looked ludicrously low.

Eighth, the Central Bank's general policy of refusing to permit foreign investors to capitalize their technology makes no sense. To the limited extent the Central Bank permits an investor to register industrial property rights by symbolically selling them to a Brazilian subsidiary, the 25 percent withholding tax levied upon the proceeds of the symbolic sale substantially discourages capital investment. Since no income is generated to pay this tax, the investor must pay it from capital. This bizarre aspect of Brazil's regulatory scheme discourages foreign investors from bringing much needed modern technology into the country.

Ninth, the Profit Remittance Law creates needless tensions between foreign and Brazilian joint venturors. The foreign investor, who often brings technology into the joint venture, is unable to register that technology as part of his remittance base without paying a 25 percent tax on his capital contribution. The foreign investor generally wants to declare minimal dividends in order to build up his remittance basis, while the Brazilian investor generally wants to maximize his payout. The foreign investor generally wants to characterize as much of his investment as possible as debt in order to minimize remittance problems, while the Brazilian investor wants to maximize the equity brought in by the foreign investor. To be sure, a certain amount of tension is inevitable in joint ventures between foreign and domestic investors, but the Brazilian regulatory scheme needlessly exacerbates that tension.

Tenth, Brazil's curious refusal to permit foreign investors to invest directly in stocks of their choice has been fatal to attracting foreign capital to Brazil's stock market. Despite Brazil's expressed desire to stimulate the stock market as a means of financing the economic growth of private corporations, it has inexplicably refused to open up the stock market to direct foreign portfolio investment. Given the thinness and volatility of the Brazilian market, few investors are sufficiently irrational to lock in their capital in a mutual fund for even three months. Predictably, in the past five years, foreign portfolio investment in the stock market has totaled only a disappointing $55 million. It is likely to continue at this dismal level until Brazil permits such investments directly.

Eleventh, Brazil defines foreign investment by using the investor’s residence rather than his nationality. This leads to anomalous results. For example, if a Brazilian living in Panama were to invest funds in Brazil, his investment would be categorized as foreign so long as his funds came from outside Brazil. On the other hand, a Swiss citizen residing in Brazil would be unable to register a foreign investment, even if he brought in funds from abroad. This paradox results from conceptualizing foreign investment in terms of exchange control, but the result is illogical, even from that narrow perspective. If a foreign investor were to move to Brazil, it is unclear whether the registration certificate would be nullified or merely suspended.216

Perhaps the chief vice of the Brazilian regulatory scheme is that it delegates nearly unlimited discretion to administrative agencies like the Central Bank and INPI. These agencies operate on the paternalistic premise that foreign firms have greater bargaining power than the Brazilian firms with which they deal, and that governmental intervention is both necessary and helpful to redress the imbalance. By making themselves parties to contractual negotiations between the foreign investor or lender and Brazilian firms, Brazilian bureaucrats substantially increase the time, expense and uncertainties of the negotiation process.

Even though INPI and the Central Bank have published some of the criteria used in deciding whether to approve foreign loans and technology transfer agreements, they also operate on the basis of unpublished rules. Moreover, even when the rules are known, the Brazilian government feels no inhibitions about disappointing legitimate expectations by changing the rules of the game in midstream. All too frequently, Brazilian agencies make important and sometimes retroactive modifications of the rules with little or no notice to the public.217

The costs of regulating foreign investment in this style are quite high and essentially unmeasured. The difficulty in knowing the ground rules, coupled with frequent mid-stream changes, produces considerable insecurity among investors and businessmen. As Max Weber so cogently observed, private investment requires a legal system that offers security and predictability.218 Brazil’s flex-

216. Compare Teixeira, supra note 41, at 8, with A. Andrade, supra note 38, at 9.
217. Rosenn, supra note 6, at 172-79.
218. 2 M. WEBER, ECONOMY AND SOCIETY 883 (G. Roth & R. Wittich, eds. 1968).
ible and cumbersome regulatory style enormously increases the transaction costs of doing business. Part of these costs stem from additional fees for lawyers and despachantes,219 and part result from the income lost while investment projects are delayed as renegotiations proceed before the Central Bank and INPI. Worthwhile projects have been abandoned because of the difficulty in simultaneously obtaining all of the necessary governmental permissions.

Considerable amounts of technology have never been transferred to Brazil, either because some governmental agency refused to approve the agreement or because the foreign licensor balked at the conditions or delays. Here again, the result appears to deprive Brazil of access to many of the really important technological advances taking place in the world. The immediate victims of the government's restrictions are private Brazilian companies that are deprived of needed technology and the mini- and medium-sized multinationals that lack the capital to set up plants around the world. The large multinationals can afford to set up manufacturing plants in Brazil, thereby reaping the benefits of their technology through direct sales. Paradoxically, the government's activities in making licensing unattractive and importation virtually impossible serve to immunize the large multinationals from technological competition with smaller foreign and domestic firms in the Brazilian market. This translates into higher prices and inferior products for the Brazilian consumer.

IV. A Blueprint for Reform

Despite its many flaws, the Brazilian scheme for regulating foreign investment has several positive features. The judicious application of the carrot and the stick has permitted Brazil to attract a huge influx of foreign investment that has significantly contributed to the country's phenomenal economic growth during the past 15 years. Because multinationals are more concerned with maximizing their overall income than with promoting the economic and social development of the countries in which they have invested, Brazil has understandably felt the need to devise a strategy for

219. Despachantes are expediters or red tape cutters. These officially recognized professionals are indispensable to securing any kind of document or permission from the Brazilian bureaucracy. See Rosenn, The Jeito: Brazil's Institutional Bypass of the Formal Legal System and its Developmental Implications, 19 AM. J. COMP. L. 514, 536-37 (1971).
making foreign investors more responsive to the country's needs and for achieving a pattern of foreign investment that contributes effectively to the country's economic and social objectives. The unfettered discretion of the Brazilian bureaucracy in determining whether to grant fiscal incentives, subsidized financing and tariff reductions, or whether to apply the full weight of the complex regulatory apparatus, has proven highly effective in keeping foreign capital under control and in causing multinationals to engage in activities deemed highly beneficial to the country's economic priorities. Without raising the hackles of foreign investors by imposing across-the-board disinvestment or nationalization requirements, Brazil has managed to achieve similar objectives in sensitive areas through ad hoc negotiation and flexibly applied unwritten rules.

Brazil's restrictive policies on technology transfers may exasperate foreign investors, but they have sometimes served Brazil reasonably well in fostering the development of national technology and in paying the lowest possible prices for certain imported technology. Brazil has calculated that the large multinationals have already recovered their research and development costs by exploiting their technology in the developed countries, making it unnecessary to offer high rates of return on advanced technology to attract foreign firms to the Brazilian market. As Professor Harry Johnson has explained, this calculation is not irrational:

... [F]or most of the countries of the world, and especially the less-developed countries, the contribution that the opportunity to earn a profit in their markets makes to the encouragement of investment in the creation of new commercial knowledge is negligible, so that any profit they allow to be earned from the command of advanced technology is for them a short-run loss with no compensating long-run gain from the encouragement of technical progress. To make the point somewhat differently, playing the rules of allowing monopoly gains to be made from economically useful knowledge involves the cost of paying for foreign knowledge that would probably be available anyhow, in the hope of a gain from the reciprocal obligation on foreign countries to pay monopoly profits on the use of knowledge commanded by your own producers. ...
This calculus may change as Brazil develops more of its own technology. In the past, however, it has made a certain amount of sense to conserve foreign exchange by sharply restricting payments for the transfer of technology.

Of course, there has been an obvious conflict between Brazil's open door policy towards foreign investment and its policy of aiding domestic firms in acquiring foreign technology cheaply. To the extent that Brazilian policies not only permit, but encourage setting up operations directly in Brazil, foreign firms have a corresponding disincentive to license their technology to Brazilian firms.222 Those firms that bear the brunt of Brazilian policies making technology licensing difficult are the small and medium-sized foreign firms that would like to exploit the Brazilian market but cannot afford to set up their own plants, as well as the Brazilian firms that need to acquire foreign technology to compete effectively.

Brazilian restrictions on technology payments between related companies may be justifiable, but just barely. Brazil has a legitimate interest in protecting its fisc from tax evasion by the transfer pricing policies of multinational firms. Shifting income either downstream or upstream through non-arm's length sales or technology transfer agreements is a common tax planning device for multinationals. Reallocating income in a realistic fashion is a difficult task, even for countries with well-trained cadres of sophisticated tax collectors. While hardly optimal, Brazil's policy of barring all royalty payments between related companies and restricting the deductibility of technical assistance payments between related companies is probably an acceptable second best solution.

On the other hand, INPI's restrictive policies have also resulted in higher costs both for imported and domestic technology. INPI substantially increases transaction costs of technology transfer; ultimately, these costs result in more expensive products. By largely insulating imported and domestic technology from foreign competition, INPI's activities permit companies to charge higher prices in the Brazilian market. INPI's operations have also prevented Brazil from importing needed technology. In the long run, INPI's activities are saddling Brazil with increasingly obsolete
222. S. Fung & J. Cassiolato, supra note 197, at 133.
Even though the 12 percent limitation on profit remittances lacks needed flexibility and is arguably too low for current market conditions, the limitation does have some specific advantages. It helps allay nationalist concerns about foreign investors earning unreasonably high rates of return and provides a substantial reinvestment incentive. The felicitous 1964 amendment that permits the addition of retained earnings to the remittance base has not only made the measure more palatable, but has also had the beneficial effect of attracting investors who are in Brazil for the long haul. Moreover, the supplementary tax has not seriously constrained most investors. In recent years, rates of return on foreign investment in Brazil have been considerably lower than in most Latin American countries. With high rates of inflation and relatively little access to local sources of credit, foreign firms operating in Brazil need to retain substantial portions of their net profits irrespective of the existence of the supplemental tax.

Brazil has sensibly restricted access to subsidized local credit by foreign firms. While the wisdom of granting these subsidies to anyone is open to serious question, it makes little economic sense to transfer scarce Brazilian capital to foreign investors. On the other hand, Brazil's attempts to discourage foreign firms from acquiring domestic firms is probably misguided, at least from an economic perspective. If takeovers are forbidden, foreign firms incur higher costs of entry because they have to construct new plants. If the foreign firm has superior technology, it can out-compete the domestic firm in the market place. In this situation, the prohibition against takeovers causes the domestic firm a capital loss by depriving its owners of the opportunity to receive going concern value, as well as the capitalized value of a slice of the profits the foreign firm intends to earn through its superior technology.

Brazil has a legitimate interest in protecting its balance-of-payments, but the existing system of exchange controls does more harm than good. The present system has resulted in a thriving black market, a chronically overvalued cruzeiro, a vast waste of governmental resources devoted to enforcement, increased transaction costs associated with exports and imports, and the flight
abroad of much needed private capital. The controls make exporting difficult without subsidies that regularly engender charges of GATT violations. The controls also reduce competition in domestic markets. Shifting to a freely floating exchange rate would improve economic efficiency substantially and obviate the need for restrictions upon profit remittances.\footnote{225. See J. Bhagwati, Anatomy and Consequences of Exchange Control Regimes 82-121 (1978).}

Nevertheless, profit remittance and exchange controls will likely remain in force in the foreseeable future because no significant political force in Brazil advocates dismantling the present control system. Therefore, it is useful to consider several piecemeal reforms that should significantly improve the existing scheme for regulating foreign investment.

1. The supplemental tax on dividend remittances should be triggered only by remittances in excess of a floating percentage of registered capital. This percentage point limitation triggering the supplemental tax should be set at 5 percentage points above the LIBOR rate for six-month loans on the last business day of the month preceding the remittance. Pegging the remittance limitation to 5 points above LIBOR would automatically adjust it for inflation and changes in the cost of capital, thereby providing a much fairer yardstick for the foreign investor.\footnote{226. Peru has recently permitted foreign investors to remit 10 percent points above LIBOR. See supra note 214.}

2. Registered foreign investment ought to be subjected to monetary correction in accordance with coefficients drawn from the consumer price index of the country in whose currency the investment is registered. This reform would permit the foreign investor to remit the same real rate of return without incurring supplemental tax liability if inflation causes the currency of registry to depreciate.

3. As an alternative to the supplemental tax, a modest surtax should be imposed upon remittances of firms engaged in service or high risk activities. Since service firms, such as accountants, engineers or lawyers, rarely invest significant amounts of capital, they are unfairly discriminated against by a system of supplemental taxation triggered by profit remittances in excess of 12 percent of registered capital. Firms engaged in high risk activities, such as oil drilling or mineral exploration, suffer a similar form of discrimina-
tion because the returns on a successful strike must be much higher than on a normal investment to compensate for the greater risk. Imposing a 10 percent surtax on the dividend remittances of these firms as an alternative to the supplemental tax regime would substantially improve the fairness of the Brazilian scheme.

4. Foreign investors should be permitted to make direct portfolio investments in the Brazilian stock market and to liquidate or change their investment at any time. Rational investors contemplating investments in a thin market such as Brazil’s need to be able to choose for themselves the companies in which they wish to invest and to divest at any time. The present requirement that investments be made through mutual funds and remain in the country for a fixed period is unrealistic. Another measure that would help stimulate direct investment in the Brazilian stock market would be to permit foreign investors to register earnings reinvested in the shares of Brazilian companies other than the one for which their foreign investment was originally registered as foreign investment, and thus, allow them to avoid the 25 percent tax on foreign remittances. Brazil’s present policy of treating such reinvestment as a dividend remittance is unsound.

5. Brazil ought to reduce the present tax differential between dividends and interest payments in order to induce more firms to convert debt into equity. A foreign investor’s dividend income is effectively taxed at 47.5 percent (aggregating the taxes levied on the Brazilian payor and the foreign recipient and assuming no supplemental tax liability or excess profits tax), \[227\] while his interest income is taxed at 25 percent (or 33.3 percent if the onus of paying the withholding tax is shifted to the borrower by contract). Interest payments are deductible by the payor, and dividend payments are not. It would, therefore, make sense for Brazil to reduce the withholding rate to 10 percent on dividend payments to foreign investors.

6. INPI should be prohibited from refusing to register any patent licensing agreement because of failure to secure a Brazilian patent if the application for the Brazilian patent has been pending for more than one year. INPI needs incentives to register patents expeditiously, particularly if domestic development of technology

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227. This figure is calculated by adding the 25 percent withholding tax levied on the remaining 70 percent of earnings to the regular 30 percent corporate tax \( [30 + .25 \times 70] = 47.5 \).
is to be encouraged. The present system encourages delay since INPI can rationalize its dilatoriness in registering patents as the conservation of foreign exchange.

7. Foreign investors ought to be allowed to register investments in technology with the Central Bank without paying a 25 percent tax on their investments. The Central Bank’s policy of refusing to permit such registration is arbitrary and discourages acquisition of new technology. Charging a 25 percent tax on an investment of technology on the theory that royalties have been symbolically remitted and reinvested is certifiable fiscal insanity.

8. Foreign investors ought to be defined on the basis of nationality rather than residence. Brazilians residing abroad ought not be considered foreign investors, nor should foreigners residing in Brazil be considered domestic investors. The definition of a foreign investor used in Brazil’s Profit Remittance Law makes sense only in the context of exchange controls. If Brazil were to shift away from an exchange control regulatory scheme to one that concentrates on promoting national development and avoiding economic abuses, the definition of a foreign investor should be significantly altered.

9. Brazil ought to promote competition among industrial firms by enforcing its antitrust laws more vigorously and by reducing its high protective tariff barriers. In its twenty years of existence, the Administrative Council for the Defense of the Economy (CADE), the agency entrusted with the enforcement of Brazil’s antitrust laws, has brought only 69 cases. Only 36 cases have gone to trial, and only 7 have resulted in judgments against defendant companies. CADE has been so ineffective that it has been widely regarded as moribund. If the federal government permitted CADE to operate effectively, or relaxed Brazil’s high tariff laws, Brazilian consumers would be the beneficiaries of lower prices. The infant industry argument for maintaining high tariffs may have made sense in Brazil during the 1940s and 1950s, but it makes little sense in 1983.

10. SEI should be relieved of the power to veto foreign investment and technology in the computer field. Access to the most modern computer technology is critical if Brazilian industry is to become competitive in world markets. Creating monopolies for Brazilian computer companies may ultimately prove as disastrous to Brazilian development as the creation of a government monop-

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V. Conclusion

Brazil's regulatory scheme for foreign investment is a hodgepodge of exchange control, income tax, technology transfer and stock market measures. The scheme suffers from serious conceptual and administrative problems that could be ameliorated by the adoption of the reforms suggested above. Yet any major overhaul of the existing scheme is likely to generate highly charged nationalist debates that might well result in much worse legislation. Despite its imperfections, the Brazilian regulatory scheme has worked tolerably well in practice. It has provided ample work for lawyers, despachantes and bureaucrats, without greatly reducing the amount of foreign investment. Unfortunately, its chief economic effects are adding to Brazil's bloated price structure by increasing transaction costs and foreclosing competition, and hindering Brazil from obtaining the technological edge necessary to make its manufactured products competitive in world markets. During its period of economic boom, the Profit Remittance Law was a luxury that Brazil could afford. In its present economic crisis, Brazil ought to consider seriously the prospect of relegating it to the statutory scrapheap and thoroughly revamping the scheme by which it regulates foreign investment.†

† During publication of this article, Brazil modified the supplemental tax on foreign remittances that exceed 12 percent of registered capital. Decree-Law No. 2.073 of December 21, 1983, makes the taxable event the distribution rather than the remittance of dividends to the foreign investor. It also shortens the period for payment of the tax from 30 days after the close of the fiscal year to 60 days after the distribution of the dividend.

Because the exemption from supplemental tax for reinvestment in Brazil has been retained, shifting the taxable event from remittance of dividends to their distribution is relatively insignificant. Foreign investors seldom receive cruzeiro distributions that are neither remitted nor reinvested in Brazil. The significant change is the increase in the effective tax rate from requiring payment of the supplemental tax within 60 days; under the prior system the tax payment tax could be deferred for nearly a year if the dividend were remitted early in the declarant's fiscal year. With an inflation rate in excess of 200 percent, the privilege of deferring payment of the tax until the next fiscal year reduced the effective supplemental tax rates by as much as 75 percent. Under the current regime of Central Bank Resolution 851, which centralizes all sales of foreign exchange in the Central Bank, the supplemental tax may have to be paid long before foreign exchange becomes available to remit the dividend.

From a purely revenue-preservation standpoint, Decree-Law No. 2.073 makes eminent sense. From an international standpoint, Decree Law No. 2.073 is a good example of the current regime's uncanny ability to shoot itself in the foot by sending precisely the wrong signal to nervous foreign investors at a time when Brazil desperately needs to increase the capital inflows from foreign investment.