

How to

manage corporate taxes in Brazil



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Overview

Taxation in Brazil is mainly regulated by the 1988 Federal Constitution, the National Tax Code of 1966 and the Income Tax Code. Taxes are payable by all private business entities resident in Brazil, including companies, limited liability companies, partnerships and sole partnerships, branches and agencies of corporations with head offices abroad. Taxes are levied by the federal, state and municipal governments.

Brazil has a complex system of corporate taxation in which the federal government imposes: (1) corporate income tax (IRPJ); (2) social contribution on net profit (CSLL); (3) federal value-added or excise tax on manufactured goods (IPI); (4) financial transactions tax (IOF); (5) banking tax (CPMF); (6) contribution on

intervention in the economic domain (CIDE); (7) social security funding contribution (Cofins); (8) social integration program contribution (PIS/Pasep); (9) employer social security contribution (INSS); and (10) rural property tax (ITR). Import (II) and export (IE) duties also are levied.

The Brazilian states and the Federal District of Brasília impose a value-added tax (VAT) on the circulation of goods and services (ICMS), tax on inheritances and gifts (ITCMD), and tax on motor vehicles (IPVA).

Municipalities and the Federal District impose taxes on the rendering of services (ISS), on urban property (IPTU), and on transfers of urban real estate (ITBI).

Taxable basis and rates

Resident companies are taxed on worldwide income. A legal entity is deemed to be resident in Brazil if it has been incorporated in Brazil.

A foreign company is only subject to Brazilian taxation if it performs certain sale activities in Brazil through (1) agents or representatives that are domiciled in the country and have the power to bind the foreign seller before the domestic purchaser, or (2) a branch domiciled in the country. In circumstances where the final transaction is carried out by the proper nonresident foreign company, the existence of a representative acting in Brazil as an agent does not imply the foreign company having a legal presence in Brazil.

Corporate income tax (IRPJ) is levied on the legal entity's taxable profit at a rate of 15%. In addition to the regular 15% IRPJ tax, a 10% surtax is imposed on taxable profits exceeding R\$ 240,000 on an annual basis.

Social contribution on net profit (CSLL) is levied on entities subject to the IRPJ, aimed at financing the Brazilian federal social security system. The CSLL rate is 9%.

The basic income tax applies to operating profits realized by a company in Brazil. Operating profits are

defined as gross operating receipts less (1) the cost of goods sold or services rendered; (2) commercial, administrative and operating expenses; and (3) other charges, reserves and losses that are authorized by law. Dividends received from other Brazilian companies and income corresponding to premiums received on the issuance of new shares are not included in taxable income.

Brazilian companies may opt to pay IRPJ and CSLL taxes based on either Taxable Profit ("Lucro Real") or Deemed Profit ("Lucro Presumido") taxation regime. The Taxable Profit regime is based on actual annual or quarterly taxable income, and the Deemed Profit regime is based on estimated or deemed taxable income.

Under the Taxable Profit regime, the taxable basis is pre-tax (IRPJ and CSLL) net income adjusted by add-backs (nondeductible costs and expenses) and exclusions (nontaxable income, such as dividend income).

Adoption of the Deemed Profit taxation regime is allowed for companies whose gross revenue in the preceding tax year did not exceed R\$ 48 million, where IRPJ and CSLL taxes are to be computed and collected on a quarterly basis. Under the Deemed Profit regime, IRPJ and CSLL taxes are levied on estimated profit, which is determined by applying a specific percentage on the revenue realized in each quarter. For services revenue, the

percentage is 32%, and for "industrialization" revenue the percentage is 8%.

Under the Taxable Profit regime, IRPJ tax is imposed on adjusted net income at a rate of 15%, plus 10% surtax on taxable income exceeding R\$ 240,000 on an annual basis. IRPJ tax liability shall be settled up to the last working day of the following month. Under the Deemed Profit method, IRPJ is levied on quarterly gross revenue and shall be settled up to the last working day of the month following the corresponding quarter.

Under the Taxable Profit regime, CSLL tax is also imposed on adjusted net income, with adjustments similar to those prescribed for IRPJ purposes. CSLL tax rate is 9%. CSLL tax liability shall be settled up to the last working day of the following month. Under the Deemed Profit regime, CSLL tax is levied on quarterly gross revenue and shall be settled up to the last working day of the month following the corresponding quarter.

Deductions

As a general rule, expenses may be deducted if they are necessary for the activities of the company. Exchange losses (whether realized or not) arising from foreign-currency obligations may also be deducted, while exchange gains (whether realized or not) are taxable.

Several regulations govern the deduction of expenses, e.g., limits are imposed with respect to royalties' and fees' deductibility. Deductions are also allowed in connection with certain specific programs or investments, such as Workers' Meal Program (PAT), and investments in the Northern Region and in TI equipment items.

Depreciation

Depreciation charges are calculated on a straight-line basis. Fixed assets are depreciated at preestablished rates applicable to asset classes, unless a higher rate is allowed by special provisions. Annual depreciation rates are: 4% for buildings, 20% for vehicles, 20% for computer hardware and software, and 10% for machinery, equipment and fixtures.

Companies operating two shifts a day may depreciate assets used in production at one-and-a-half times the ordinary rate. Companies that operate three shifts a day may use double the normal rate.

Accelerated depreciation is allowed for machinery and equipment items used in the development of technical research. The difference between regular and accelerated value is recorded in a special ledger for tax purposes.

Losses

Losses must be segregated as "operating" or "nonoperating". Nonoperating losses may only be offset by nonoperating gains. IRPJ tax losses and CSLL negative tax basis incurred in a given tax year may be carried forward indefinitely but the amount carried forward to each subsequent tax year is limited to 30% of the IRPJ and CSLL tax bases realized in the corresponding tax year. IRPJ tax losses and CSLL negative basis cannot be carried back to preceding tax years.

Imposition of tax on capital gains

The tax treatment of capital gains is similar to that of ordinary profits (subject to restrictions on the offsetting of capital losses by ordinary profits, in certain cases). Capital gains realized by nonresidents in connection with investments registered with the Central Bank of Brazil (Bacen) are subject to a 15% withholding tax. If the capital gain is realized by a legal entity domiciled in a tax

haven (i.e., a jurisdiction imposing no tax on income or imposing income tax at rates lower than 20%), the rate is increased to 25%. Gains realized by foreign investors in connection with investments in the Brazilian financial market might be subject to different withholding tax rates.

Withholding income tax

Dividends

Dividends paid to residents or nonresidents are exempt from withholding income tax (IRF). However, this rule is applicable exclusively to dividends corresponding to profits generated as from calendar year 1996.

Interest

Interest payments to nonresidents are generally subject to a 15% IRF tax. The rate is increased to 25% if the recipient is resident in a tax haven.

Royalties

Royalty payments to nonresidents are generally subject to a 15% IRF tax and to a 10% CIDE tax. The IRF tax rate is increased to 25% if the recipient is resident in a tax haven.

Transactions carried out between parties deemed related

Transfer pricing

Brazil's transfer pricing regime adopted in 1997 includes provisions aimed at preventing Brazilian subsidiaries of multinational companies from sending profits abroad by overpricing their intercompany imports or from reducing profits subject to Brazilian taxes by underpricing their intercompany exports. Brazilian transfer price rules are applicable solely to cross-border transactions carried out between related parties and to transactions carried out with related and unrelated entities domiciled in a tax haven.

Brazilian transfer pricing regulations deviate substantially from the OECD Transfer Pricing Guidelines, in that they do not adopt the "arm's length principle", but rather use fixed margins to calculate the transfer price.

The salient features of the Brazilian transfer pricing legislation are as follows:

- Exclusive use of transactional methods - comparable uncontrolled price, resale price and cost plus -for determining the price of uncontrolled transactions involving goods, services and rights;
- Statutory fixed margins (e.g., 15%, 20%, 30%) must be applied through the prescribed methods, unless a different margin is established based on data from official publications or on researches conducted by a technically qualified firm, which should be previously approved by tax authorities;
- Export safe-harbor rules are available to avoid application of the prescribed transactional methods;
- Regulation of transactions between Brazilian taxpayers and certain uncontrolled agents, distributors, or consortium partners, as well as transactions with a related or unrelated party domiciled in a tax haven or in a jurisdiction that allows secrecy regarding capital ownership; and

- Specified interest rates for controlled cross-border loans.

Controlled foreign companies

Under Brazilian law, profits earned by controlled foreign corporations (CFCs) and by certain foreign affiliates (noncontrolled subsidiaries) of Brazilian entities shall be included in the Brazilian controlling or parent company's IRPJ and CSLL tax bases.

Profits earned by CFCs and noncontrolled subsidiaries of Brazilian companies will be considered taxable to the controlling or parent company in Brazil (and therefore subject to taxation) at the end of each tax year. All taxes paid abroad should be creditable in Brazil (credit method as the means to avoid double taxation), regardless the existence of a tax treaty signed with Brazil.

Thin capitalization

There are currently no thin-capitalization rules in effect. Therefore, provided a cross-border loan agreement has been registered with Bacen, underlying interest expenses may be treated as deductible item for purposes of IRPJ and CSLL taxes. If the loan agreement has not been registered with Bacen, deductibility of related interest expenses will be limited to Libor + 3% spread, under Brazilian transfer pricing rules.

Consolidation

Brazil does not have tax-consolidation rules. Each corporate entity is taxed separately from other related entities.

Indirect taxes and duties

The most important indirect taxes are:

Social Integration Program (PIS) and Social Security Funding (Cofins) contributions

PIS and Cofins are federal contributions imposed on monthly gross revenue. Both contributions are aimed at financing the social security system. The rates of PIS and Cofins under the Taxable Profit regime are 1.65% and 7.6%, respectively.

Under the Deemed Profit regime, the rates are reduced to 0.65% and 3.0%, respectively. Eligible export companies are exempt from PIS and Cofins collection, provided foreign funds have actually been transferred into the country in connection with export operations carried out. The import of goods and services is subject to PIS and Cofins at a combined rate of 9.25%.

Federal VAT (IPI)

IPI is a federal-level single-stage VAT-type tax levied on the manufacture of goods in Brazil and on the import of goods. Exports are exempt from IPI tax. For IPI purposes, the taxpayer is the manufacturer or the importer. For IPI purposes, the term "industrialization" comprises, among other activities, assembly, transformation, packaging and reconditioning. The applicable IPI rate is determined by reference to the Harmonized Tariff Code (NCM) and varies according to the good's nature.

State VAT (ICMS)

ICMS tax is a VAT levied by the Brazilian states on the circulation of goods and the provision of interstate and

intermunicipal transportation and communications services. The tax is applicable also in circumstances where the transaction and/or the provision of service are initiated in another country.

A noncumulative tax, ICMS is imposed on intrastate transactions by most states at the rate of 17%, except for São Paulo and Minas Gerais states, where 18% is the rate imposed on intrastate transactions. There are also interstate rates of 12% and 7%, depending on the location of the recipient.

Service Tax (ISS)

The ISS tax is imposed, at municipal level, on the rendering of services not subject to the state-imposed ICMS tax. The list of relevant services is found in Complementary Law #116/03 issued by the federal government. The ISS tax basis is the price charged for the service rendered.

The ISS tax is generally collected by the municipality in which the service-providing entity is established. In exceptional cases, ISS may be charged by the municipality where the services are performed.

ISS rates may vary between 2% and 5%, depending on the municipality and the type of service rendered.

The importation of services is subject to ISS. The exportation of services may be subject to ISS depending on whether their rendition gives rise to benefits within Brazil.

Since the ISS is not a creditable tax, like IPI and ICMS taxes, it is usually charged from the customer as part of the agreed-upon price.

Other taxes

Tax on Financial Operations (IOF)

The federal tax on financial operations is imposed on several types of transactions, including loans, issuance of insurance policies and short-term money market investment. The IOF rate may vary from 0% to 25%. The IOF tax imposed on credit operations carried out in Brazil is computed at a daily 0.0041% rate.

Provisional Tax on Financial Transactions (CPMF)

CPMF is a federal tax of 0.38% assessed on the circulation/transfer of funds within Brazil and to foreign investors. Investors are exempt from the CPMF tax when they purchase Brazilian shares or invest in Brazil's derivatives or futures markets.

Urban property tax (IPTU)

The urban property tax is an annual tax assessed on the ownership of real estate property located within municipal area. The tax, collected by the municipality where property is located, is calculated on the property's "referential value". The tax rate varies from city to city, but may be estimated in the range of 0.3% to 1.0% of the real estate referential value.

Real estate transfer tax (ITBI)

The real estate transfer tax is due upon the transfer of title to real property (land, buildings). The tax rate is progressive, ranging from 2% to 6%, calculated, roughly, on the sales price. The buyer is responsible for payment of the ITBI tax.

Rural property tax (ITR)

Rural property tax is an annual tax assessed on the ownership of rural property at rates ranging from 0.03% to 20%, depending on the region and the utilization of the property.

Motor vehicle property tax (IPVA)

Motor vehicle property tax is assessed annually, on the ownership of vehicles such as motorcycles, cars, trucks, buses, boats and airplanes. The tax rate varies from state to state, but may be estimated in the range from 1% to 4%.

Import duty (II)

Import duty is paid by the importer, and is imposed on the aggregate of the good's price plus insurance and international freight (CIF value). Since the tax amount is not refundable, it represents a cost for the importer. The tax rate applicable on imported goods varies according to the Harmonized System Code (NCM).

Export Tax (IE)

Despite of other taxes, the export tax purpose is only regulatory, being levied on a few products. Therefore the rates vary according to economic and social interests in Brazil. These products and its rates are listed in the legislation. The tax basis for export tax is the good's export price.

Contribution on intervention in the economic domain (CIDE)

CIDE is imposed on royalties and service payments abroad, in connection with transactions implying transfer of technology, or when the services provided are of technical assistance nature. CIDE tax is calculated at a flat 10% rate. This tax is to be borne by the Brazilian payer and, insofar as it represents a cost to the Brazilian entity, it is not creditable by the foreign beneficiary.

Social security contribution (INSS)

This contribution is levied on the employee's salary and shall be collected to the National Institute of Social Security (INSS), Brazil's social security agency, on a monthly basis. The INSS contribution coverage includes

medical and hospital assistance; sick pay, after 15 days of absence, at 90% of the so-called "benefit salary" (which is calculated according to specific regulations); maternity benefits of up to one-month minimum wage; and retirement pay.

Employees' contributions are computed at rates range from 7.65% to 11%, according to their salary categories. Employers' contributions are computed at a flat 20%, imposed on the employees' monthly gross wages. In addition to the 20% contribution, employers shall pay from 1% to 3% as workers' compensation insurance and from 0% to 5.8% as contributions to other entities and

funds (e.g., education allowance, INCRA, SENAI, SESI). Therefore, the combined rate may vary from 21% up to 28.8%. Charity organizations are exempt.

Tax on Inheritances and Gifts (ITCMD)

ITCMD is levied on inheritances and donations. It is assessed on the fair market value of the transferred asset or right. The ITCMD tax rate varies according to the state, ranging from 1% to 8%.

Tax compliance and administration

The tax year in Brazil is the calendar year and each tax has a specific due date.

Every legal entity domiciled in Brazil (including corporations, partnerships, branches and agencies of companies domiciled abroad) must file, by the last working day of June, an annual corporate tax return (DIPJ) covering the preceding calendar year. The balance of any income tax due for the year is payable by the last working day of March; Tax overpayments may be utilized to offset future tax liabilities. Refunds of

corporate income tax are usually not practical.

In order to spontaneously settle overdue IRPJ and CSLL taxes, the taxpayer is subject to late-payment penalty (capped at 20%) and arrears interest (by reference to the accumulated variation in the Selic benchmark interest rate). In situation where overdue IRPJ and CSLL taxes are assessed by the tax authorities, in addition to arrears interest (based on Selic rate) the taxpayer is subject to a late-payment penalty that varies from 75% to 150%.

Imposition of taxes on foreign legal entities and tax treaties

Brazil has signed a number of tax treaties with other jurisdictions, which generally reduce the withholding tax on dividends, interest, royalties and technical-assistance fees.

The table below discloses the withholding tax rates that apply to dividend, interest and royalty payments by Brazilian companies to nonresidents, under said tax treaties. Domestic rates apply if they are lower than the treaty rate.

WITHHOLDING TAX RATES UNDER BRAZIL'S TAX TREATIES			
Country	Dividends (%) ⁽¹⁾	Interest (%)	Royalties (%)
Argentina	0	15	15
Austria	0	15	10/15/25
Belgium	0	0/10/15	10/15/25
Bulgaria	0	10/15	15/25
Canada	0	15	15
Chile	0	15	15/25
China	0	10/15	15/25
Czech Republic	0	15	15/25
Denmark	0	15	15/25
Estonia	0	15	10/15/25
Finland	0	0/10/15	10/15/25
France	0	10/15	15/25
Hungary	0	15	15/25

WITHHOLDING TAX RATES UNDER BRAZIL'S TAX TREATIES (continued)			
India	0	15	10/15
Israel	0	15	15/25
Italy	0	15	15/25
Japan	0	12.5	12.5/15
Korea	0	0/10/15	10/15
Luxembourg	0	15	15
Mexico	0	10/15	15
Netherlands	0	15	15/25
Norway	0	15	15/25
Philippines	0	0/10/15	15/25
Poland	0	15	15
Portugal	0	10/15	15/25
Slovakia	0	0/10/15)	10/15
Spain	0	15/25	10/15
Sri Lanka	0	15	15
Sweden	0	0/10/15	15/25
Ukraine	0	15	15/25

(1)Brazil generally does not impose withholding tax on dividends.

Export Finance Incentives

There are financial incentives to exports. The main financing funds are:

- Export Financing Program (Proex), granted by the National Bank of Economical and Social Development (BNDES) and operated by the Federal Government's financial agent, Banco do Brasil;

- BNDES funds, Special Agency for Machinery and Equipment Financing (Finame) funds, with funds from banks authorized to operate with foreign exchange, and funds from foreign financial institutions. In these cases Proex will be responsible for expenses related to equalization of the interest rates.

Investment Incentives

- ADENE Area: an investment incentive area in Northeastern Brazil. Obtainment of this incentive is contingent upon a project being submitted to and approved by the Agency for Development of Northeastern Region (ADENE). The tax and financial incentives are: Income Tax reduction; Import Duties and IPI Tax exemption or reduction in imports; State and Municipal incentives; and financial support from the Northeastern Region Investment Fund (FINOR).

- ADA Area: an investment incentive area in Northern Brazil - mainly the Amazon area where tax and financial incentives similar to ADENE incentives are granted. Financial support is provided by the Amazon Region Investment Fund (FINAM).
- Manaus Free Trade Zone (ZFM): exemption from Import Duties when the imported goods are consumed within ZFM or when the manufactured or stored goods will be subsequently exported.

Mercosur

The Southern Cone Common Market (Mercosul in Portuguese and Mercosur in Spanish) is a trade agreement executed by Brazil, Argentina, Paraguay and Uruguay. In 1994 member countries created the Mercosur Customs Union, including the following:

- Member countries may exchange products without tariff imposition, provided 60% of the products' components are local;
- Member countries can specify import product categories they sought to exclude from the common external tariff;
- A bilateral accord permitting products manufactured in Brazil's Manaus Free Trade Zone or Argentina's Tierra del Fuego Region to be traded under full tariff exemption within Mercosur.

The common external tariff is applicable to Mercosur members and ranges from 0% to 35%, according to the product, based on which applicable IPI and II tax rates are defined. The most recent modifications and exceptions list were established by Resolution no. 42, of December 2001, issued by Brazil's Foreign Trade Chamber.

The Mercosur-Andean Community Free Trade Area was incepted in 2004, aimed at eliminating imposition of import duties by signatory countries within a 15-year term. The block has 67 schedules for the reduction and possible elimination of import duties among the nine members (Mercosur plus Andean Community, comprising Bolivia, Colombia, Ecuador, Peru and Venezuela).

Still in 2004, Mercosur members signed an agreement with the countries of the South African Custom Union (comprising Botswana, Lesotho, Namibia, South Africa and Swaziland) to adopt special tariffs in trade between them. This agreement is aimed at the gradual reduction and possibly elimination of trade tariffs. In 2005, a similar agreement was signed with India.

Brazil is also a member of the World Trade Organization (WTO) and the Latin American Integration Association (LAIA).

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