GLOBAL LEGAL INSIGHTS

Corporate Tax

Second Edition

Contributing Editor: William Watson

Published by Global Legal Group

CONTENTS

Brazil

Cristiano Frederico Ruschmann, Fábio Piovesan Bozza
& Ciro César Soriano de Oliveira
BRATAX – Brazuna, Ruschmann, Piovesan e Soriano Advogados

Overview of corporate tax

For tax purposes, a company is deemed resident in Brazil if incorporated under Brazilian law. Resident companies are subject to Brazilian Corporate Income Tax ("*Imposto sobre a Renda de Pessoas Jurídicas*" – "IRPJ") and Social Contribution Tax on Profits ("*Contribuição Social sobre o Lucro Líquido*" – "CSL"), jointly referred to as Brazilian Corporate Taxes. Such taxes are levied based on an assessment of the income generated by operational and non-operational (active and passive) activities, performed in either Brazil or abroad (worldwide income).

The amount of equivalent foreign income tax paid can be used to offset Brazilian Corporate Taxes through a tax credit imputation system, which is limited to the joint IRPJ/CSL rate levied on foreign profits recognised in Brazil. A Brazilian subsidiary of a foreign company pays Brazilian Corporate Taxes based on the actual profit method ("*lucro real*"). However, a company may opt for the presumed profit method ("*lucro presumido*") if its total gross revenue was equal to or less than BRL 78,000,000 in the preceding calendar year, among other requirements. Companies generally opt for one method over the other based on their profitability and their plans for future investments, among other factors.

The following entities are mandatorily subject to the actual profit method: (i) financial institutions such as banks, leasing companies and insurance companies; (ii) factors; (iii) Brazilian entities having subsidiaries or branches abroad; and (iv) entities enjoying IRPJ exemptions or benefits.

The standard IRPJ tax rate is 15% plus an additional surtax of 10% on taxable profits exceeding BRL 240,000 annually, while CSL is generally levied at 9%, resulting in a combined Brazilian general Corporate Taxes rate of 34%.

For companies involved in financial activities, CSL is levied at a higher rate of 15%. The Brazilian Corporate Taxes general rate for these entities is 40%.

Actual profit method ("*lucro real*"): under this method, the tax for Brazilian Corporate Taxes corresponds to the accounting profit ("*lucro contábil*"), adjusted by inclusions and exclusions determined by law. The company can choose to be taxed based on its quarterly or annual balance sheets.

In general, operating expenses are deductible for corporate tax purposes, provided that the company demonstrates that these transactions are necessary, normal and usual for its activities. Tax losses may be carried forward indefinitely, but not carried back or adjusted for inflation. Tax losses carried forward may be used to offset up to 30% of a company's taxable income in a given tax period (which means that no less than 70% of the income tax basis will be taxable in the relevant period).

Presumed profit method (*"lucro presumido"*): a company opting for the presumed profit method calculates Brazilian Corporate Taxes based on a tax basis made up of a set percentage of gross sales and service revenues. This percentage varies depending on the type of business the company is engaged in. Non-operational revenues – such as capital gains or other financial revenues – are not included in the presumed taxable income basis and consequently are fully taxed according to criteria set out in the real profit system. The presumed profit is calculated quarterly, on March 31st, June 30th, September 30th and December 31st of each year. If various activities are carried out (services and goods), the presumed profit percentages should be split: (i) 32% is the presumed profit margin applicable to gross revenues deriving from services; and (ii) 8% for IRPJ and 12% for CSL are the margins applicable to gross revenues derived from sale of goods. The result would then be subject to a maximum 34% Brazilian Corporate Taxes rate. Applying the maximum 34% rate to the presumed profits, the total tax burden on gross revenue is 3.08% for goods and 10.88% for services. The presumed profit tax method does not allow tax losses to be carried forward in order to be offset with a company's taxable income.

Double taxation treaties ("DTT") network: although Brazil is not an OECD member, its DTTs follow the OECD model. However, Brazil has not adopted the interpretation commonly applied under OECD guidelines for some articles of the OECD model DTT (for further details, please see *"Key developments in international treaties"* below). The Brazilian double taxation treaties network in force currently comprises Argentina, Austria, Belgium, Canada, Chile, China, the Czech Republic, Denmark, Ecuador, Finland, France, the Netherlands, Hungary, India, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Norway, Peru, the Philippines, Portugal, Slovakia, South Africa, Spain, Sweden, Turkey and Ukraine.

Although Brazil does not have a DTT with USA, both countries signed a Tax Information Exchange Agreement ("TIEA") in 2002, which entered into force in 2013.

Tax favourable jurisdictions, privileged tax regimes and sub-taxation regimes: under Brazilian law, tax-favourable jurisdictions (tax havens or sub-taxation regimes) are those countries or jurisdictions that do not impose taxes on income or that set income tax at a rate inferior to 20%. Tax havens have been recognised and registered on a "black list" by the Brazilian tax authorities (exhaustive list). "Privileged tax regimes" are special treatment tax regimes in some countries (not tax haven jurisdictions) that apply a low rate of taxation and/or do not tax foreign income or foreign residents. Privileged tax regimes have also been recognised and registered on a "grey list" by the Brazilian tax authorities (exemplificative list). Although transactions conducted between residents in Brazil and residents either in black- or grey-listed countries are subject to Brazilian transfer pricing controls, only transactions with black-listed countries are subject to a higher withholding income tax ("WHT") rate of 25%, compared with the general 15% rate. 'Sub-taxation regimes' is a specific term used by the new Brazilian CFC legislation, which is detailed below.

Thin capitalisation: Brazilian thin capitalisation rules apply in cases of interests involving: (i) financing granted by foreign persons in the same group; (ii) residents in tax havens; and (iii) entities benefiting from privileged tax regimes. Interests paid in connection with such financing are not deductible from Brazilian Corporate Taxes when they relate to a principal amount that exceeds the following percentages:

Loan from a(n)	Limit	Calculation basis
Directly related non-resident person	200%	of the non-resident's stake in the net equity of the Brazilian company

Loan from a(n)	Limit	Calculation basis
Indirectly related non-resident person	200%	of the total net equity of the Brazilian company
Non-resident person based in a tax haven or a beneficiary of a tax privileged regime	30%	of the total net equity of the Brazilian company

Transfer pricing: Brazil has unique transfer pricing rules for both export and import transactions carried out with related parties or with legal or natural persons domiciled in tax favourable jurisdictions or benefiting from privileged tax regimes. These rules do not follow the OECD standards and are based on alternative comparison methods, as defined by Brazilian law. These methods were changed by new legislation passed in 2012 and are mandatory since 2013.

Brazilian taxation on remittance of funds overseas: (i) dividends payable by a Brazilian subsidiary to any foreign investor are always tax exempt; (ii) interest on net equity (*"Juros sobre capital próprio"* – "JsCP") is an unique income type created by Brazilian legislation, which is calculated as the interest gained on the net equity of a company, limited to the Long-Term Interest Rate (*"Taxa de Juros de Longo Prazo"* – "TJLP", fixed quarterly by Brazilian Government at around 6% in the last few years), and is subject to a general 15% WHT rate (25% in case of tax-favourable jurisdictions); (iii) interests deriving from inter-company loans paid to non-residents are subject to general 15% WHT rate (25% in case of tax-favourable jurisdictions); (iv) fees, commissions and any other income payable by a Brazilian obligor to an individual, company, entity, trust or organisation domiciled outside Brazil in connection with any royalties or technical assistance agreements involving the transfers of technology or know-how are subject to a 15% WHT rate (25% in case of tax-favourable jurisdictions) or any other lower rate previously established by DTT (but never inferior to 10%); and (v) payments referring to royalties and technical assistance are also subject to an economic intervention contribution (*"Contribuição de Intervenção no Domínio Econômico"* – "CIDE") of 10%, which should be collected directly from the Brazilian subsidiary making the payment.[1]

Capital gains of non-residents: since 2003 Brazilian domestic legislation provides for a specific WHT obligation on capital gains generated by non-residents alienating Brazilian assets. The applicable rate corresponds to 15% (raised to 25% in case of tax-favourable jurisdictions) and reaches even transactions executed outside Brazil among non-residents (i.e., even if there is no financial flow through Brazilian territory). Brazilian authorities achieve the effectiveness of such tax provision by imposing a tax liability on the Brazilian purchaser of the assets or its Brazilian proxy, in case of a non-resident purchaser. None of the Brazilian DTTs, except the one executed with Japan, impose any limitation of such Brazilian tax competence to tax as source state, differing from the standards of the OECD model.

PIS/COFINS: corporations in Brazil must also pay Social Integration Program Contribution Tax ("*Contribuição ao Programa de Integração Social*" – "PIS") and Social Security Financing Contribution Tax ("*Contribuição para o Financiamento da Seguridade Social*" – "COFINS") which are levied over the monthly gross revenue arising from the sale of goods or provision of services.

As a general rule, companies opting for the actual profit method would pay PIS/COFINS under a non-cumulative regime representing a total rate of 9.25% of monthly gross revenue. Under that regime, a manufacturing company is entitled to get PIS/COFINS tax credits arising from the purchase of raw materials and services used in its production activities, while a company solely engaged in sales may use PIS/COFINS tax credits from the acquisition of goods for resale. The extension of the non-cumulative system is very controversial: while tax authorities have a very strict understanding about the transactions generating tax credits, taxpayers in Brazil have been struggling before the administrative and judicial tax courts in order to defend a wider non-cumulative regime.

Companies opting for the presumed profit method are in general subject to cumulative taxation for PIS/COFINS purposes, representing a total rate of 3.65% over their gross revenues from the sale of goods or provision of services.

Insurance, capitalisation and financial companies or institutions, as well as companies from telecom, energy, newspaper and broadcasting, transportation, health care, education, IT, call centre and telemarketing, highways, hotel, fairs and events companies, among others, are mandatorily subject to the PIS/COFINS cumulative regime, even when opting for the actual profit method.

Capital gains are not subject to PIS/COFINS; financial revenues are currently subject to a 0% rate; and exports are PIS/COFINS tax-free.

Key developments in legislation affecting tax law and practice

Interaction between accounting and tax rules: until December 31st, 2007, the provisions of Brazilian Corporate Taxes legislation strongly influenced the Brazilian accounting practices (BRGAAP), defining the requisite form, moment and value of accounting entries. Such tax provisions were mandatory for tax purposes, but in many cases they prevailed in practice over the accounting standards provided by commercial law.

Starting on January 1st, 2008, after the issuance of Law 11,638, two important changes were implemented: (i) first, each and every adjustment determined by tax legislation, as well as by regulatory rules applying to certain activities, had to be made separately from the main accounting records, in auxiliary books and ledgers, with no effect on bookkeeping for commercial purposes; and (ii) second, the Brazilian accounting model underwent profound changes in order to align it with international accounting standards (IFRS).

Between 2008 and 2014, a temporary tax regime (*"Regime Tributário de Transição" – "RTT"*) was created to guarantee the neutrality of the changes made to Brazilian accounting rules and to allow taxpayers to calculate the Brazilian Corporate Taxes in accordance with the accounting rules, as they existed on December 31st, 2007 (BRGAAP).

As of 2015 (legal entities, however, may opt to adopt all the rules early, as of January 1st, 2014), in connection with Provisional Measure 627[2] ("MP 627"), the RTT should be abolished, and the concept of net income used in calculating the Brazilian Corporate Taxes will be that one obtained by the application of IFRS rules.

However, the same law that abolished the RTT also introduced a series of changes to tax legislation in order to maintain the tax neutrality of the IFRS rules. In several cases, accounting entries will not have the respective tax effects until the realisation of the corresponding asset or liability, in accordance with the concepts related to earned revenue and incurred expenses on the accrual method.

This is the case, for example, in the tax treatment given to fair value adjustments. The fair value adjustments seek to show the market value of a given asset or liability. The accounting recognition of the profits or losses arising from such adjustments does not affect the Brazilian Corporate Taxes calculation basis, if the respective adjustment is shown in a sub-account linked to the relevant asset or liability. Failure to provide such demonstration will result in taxation of any profit or the non-deductibility of any loss. Following these requirements, profits and losses deriving from fair value adjustments will provoke tax effects to the extent that the corresponding asset is realised, including through depreciation, amortisation, exhaustion, disposition, or a write-off, or when the liability is settled or written off.

Likewise, the amounts arising from adjustments to determine the present value of assets or liabilities due to long-term transactions may be considered in calculating Brazilian Corporate Taxes only in the same tax period in which the income from the transaction is subject to taxation. Present value describes how much a future cash flow is worth today.

Losses deriving from impairment tests may be deducted for tax purposes only when the asset is disposed or written-off.

In contrast, several other changes should reduce the neutrality of the IFRS rules, as in the case of the tax treatment of premium arising from the acquisition of shares.

Under the previous regime (Law 9,532), the cost of a share acquisition was split into (i) the net equity value of the company in which the shares were acquired, proportionally to the corresponding stake, and (ii) any premium or discount in the acquisition price (which was tax deductible for a period not less than five years).

For tax purposes, the premium should be based mandatorily on one of the following economic reasons: (a) the fair value of assets of the invested company is higher than the accounting cost (book value); (b) expected future earnings of the invested company; or (c) goodwill, intangibles or other economic reasons.

The premium related to reason (a) could be deducted accordingly but only if the underlying assets were susceptible to depreciation or amortisation. The premium related to reason (b) could be deducted if it was supported by an appraisal report and only if it extended over a minimum period of five years. Finally, the premium related to item (c) was not deductible.

Additionally, in order to achieve the tax effects mentioned above, the premium paid and registered by the Brazilian investor company and the economic grounds for the same, found in the invested company, should be "united" through a merger, amalgamation or spin-off of the two companies. This was the moment when the amortisation of the premium was triggered for tax purposes. In this case, the surviving entity would book the original expense from the premium as an asset, subject to amortisation, that would generate deductible expenses for tax purposes.

Under the new regime provided by MP 627, the cost of a share acquisition must be split into: (α) the net equity value of the company in which the shares were acquired, proportional to the corresponding stake; (β) the difference, positive or negative, between the fair value (as determined by a report issued by an independent appraiser) and the book value; and, (γ) any premium (goodwill) or discount (gain from a bargain purchase), representing the difference between the acquisition cost and the sum of (α) and (β).

When an investment valued by the net equity method is sold, the acquisition cost will be equal to the sum of the three components mentioned above.

If the investor and the invested companies are merged, consolidated or spun-off, the amount representing the difference between the fair value and the book value may be considered as a part of the cost of the assets that gave rise to the difference for purposes of depreciation, amortisation, exhaustion, or capital gain or loss on disposal. The amount corresponding to goodwill arising from a share acquisition between unrelated parties may be amortised, as expense, for tax purposes, over a period not less than five years. The amount corresponding to gain from a bargain purchase must be amortised, as income, for tax purposes over a period of no more than five years.

Brazilian CFC legislation: Brazilian CFC rules were passed first during the 1990s, when worldwide income became taxable in Brazil. Generally, since 1996, profits accrued by controlled and/or affiliated companies located abroad should be taxed in Brazil, although the foreign income tax paid on such profits could be used as credit to offset with Brazilian Corporate Taxes.

Since then, taxpayers and tax authorities have been struggling over: (i) the concept of controlled and affiliated companies; (ii) the moment those profits could be subject to taxation in Brazil; and (iii) whether DTTs entered into by Brazil remained in force following the new legislation.

Besides the new tax rules resulting from the adoption of IFRS, MP 627[3] has also created new provisions aiming to resolve those disputes (which will probably create new ones).

Although Brazilian controlling companies are obliged to register the results accrued by any directly controlled companies in their accounting books, they are allowed to consolidate the results accrued among their directly or indirectly controlled companies under the conditions mentioned herein. Failure to observe such rules shall result in consolidation being disallowed.

The consolidation must be made at the controlling level and on an annual basis, by including profits earned by both directly and indirectly controlled foreign entities.

Only profits are subject to taxation. Exchange rate variation or other accounts reflecting controlled or affiliated companies' reserves should not be included in the Brazilian Corporate Taxes.

This consolidated tax regime should be applicable up to 2022, provided that the controlled company: (i) is located in a country with which Brazil has a TIEA (in the event that no TIEA exists, controlled/affiliated companies must make their accounting information available to Brazilian tax audits); (ii) is not located in a tax haven or a country considered as having a privileged tax regime, or sub-taxation regime; and (iii) does not accrue active revenues over and above 80% of its total revenues.

Controlled companies may offset their own losses under a carry-forward regime, if such losses are reported to Brazilian tax authorities, but their profits are not included in the consolidating procedure. Profits accrued from affiliated companies are taxed as soon as they become available, provided that the affiliated company: (i) is not located in a tax haven or a country considered as having a privileged tax regime, or sub-taxation regime; and (ii) does not have a directly controlling company located in a tax haven or a country considered as having a privileged tax regime, or sub-taxation regime.

An affiliated company should fall under the Brazilian CFC regime if it holds in excess of 50% of the equity of another foreign controlled company directly or jointly with other affiliated companies.

For the purpose of these regulations: (i) active revenues are defined as those accrued from proprietary business purpose activities, which do not include royalties, interest, dividends, equity, rent, capital gains on assets acquired within the last two years, financial fees or investments; and (ii) sub-taxation regimes are those which tax the profits of the legal entity domiciled abroad at a nominal rate lower than 20%.

Profits accrued by controlled foreign-bank institutions (such as interest, financial fees and investments), duly authorised by a foreign jurisdiction, are also considered active revenues.

Finally, for existing profits which have not yet been taxed, MP 627 allows for tax payments on CFC profits as those profits become available, though payment may be made over 8 (eight) years, provided that a 12.5% minimum is paid the first year. LIBOR interest applies beginning on the second year upon all subsequent instalments.

Key developments in jurisdiction affecting tax law and practice

Premium amortisation: as above mentioned, under certain circumstances the acquisition of Brazilian company shares – through any kind of transaction, such as purchase and sale, swap or subscription for capital stock – may generate tax benefits to the purchaser, which should not occur if the assets are acquired directly (e.g. real property, trademarks). Thus, from a tax optimisation standpoint, in principle the acquisition of a Brazilian company's shares is better than the acquisition of its assets.

Though premium amortisation structures are very common in Brazil, they are not completely risk-free. The tax authorities scrutinise such structures for an effective business purpose in this kind of tax planning and disregard some of them after a case-by-case analysis of the respective economic substance. The controversy is based on the requirements imposed by the tax authorities for validating taxpayers' structures, many of them with no legal grounds.

In the Gerdau case (2012), the premium was generated by transactions that occurred within the Gerdau Group, i.e., performed by related parties with a common ultimate shareholder. Summarising the facts, the Gerdau Group holding company had two controlled companies and decided to subscribe for new shares in one of them with the shares of the other. As the transaction was performed at fair value, the holding company booked the shares it had subscribed for at an amount higher than their equity value, based on the expected future earnings and backed up by an appraisal report. At the same time, it had accrued (i) a capital gain from the disposal of the shares as payment for the subscription, and (ii) a premium by the amount exceeding the shares' equity value. Latter, one controlled company merged into the other, triggering the premium amortisation for tax purposes.

Tax authorities then considered the corporate reorganisation as an artificial scheme for tax evasion, carried out through deceptive accounting that improperly generated a deductible premium within the same economic group, without any actual cash disbursement.

However, the Brazilian Administrative Tax Court (*"Conselho Administrativo de Recursos Fiscais"* – "CARF"), all of whose members are considered to be tax experts, ruled in favour of Gerdau. The decision also addressed the concepts of tax avoidance and tax evasion by stating that planning to mitigate intentionally the tax burden is not illegal, revealing a strong opposition by the CARF against any requirements imposed by the tax authorities to tax planning which are not found in express law provision.

More recently, in the Santander case (2014), CARF took a different position and considered the premium arising from the acquisition of investments during the process of privatising companies in Brazil not subject to tax deduction. As the premium amortisation would not be available if shares in a Brazilian company were purchased directly by a non-resident, the Santander Group decided to acquire the share of the target company through a Brazilian acquisition vehicle. However, CARF deemed the vehicle company to lack economic substance and legitimate business purpose apart from its parent company.

The judgment of cases with regard to the use of premium for tax purposes have been characterised by their inconsistency, alternating favourable and adverse decisions to taxpayers. Furthermore, there are no precedents ruled by the Judicial Courts in this matter yet.

Key developments in international treaties affecting tax law and practice

Treaty overrule on article 7: on December 2013, Brazilian tax authorities issued the Opinion 2,363 ("Parecer PGFN/CAT 2,363/2013"), consolidating their new approach to the application of international tax treaties to avoid double taxation in the payment of technical services with no transfer of technology.

In a nutshell, the controversy over such matter corresponds to the question of whether: (i) Brazilian source should tax such payments at 10%, 15% or 25% based on article 12 ("royalties"), 14 ("independent professional services") or 21/22 ("other income") of DTTs; or (ii) if article 7 ("business profits") would block any Brazilian source taxation over such technical services as long as no permanent establishment of the foreign service provider is characterised within Brazilian territory.

Parecer PGFN/CAT 2,363/2013 was issued in response to an official request from the Government of Finland, challenging Brazil's position of imposing source taxation on remittances for payments of technical services to that country. According to the position previously adopted by Brazilian tax authorities on Declaratory Act 1/2000, remittances on the concept of technical services with no transfer of technology should be considered in the scope of the article of "other income" of DTTs and thus subject to taxation at source in Brazil.

The new position adopted by Brazilian tax authorities on Parecer PGFN/CAT 2,363/2013 is that payments for technical services with no transfer of technology should no longer be classified under the article of "other income" of the treaties entered by Brazil, but rather under the article of "business profits". Nonetheless, the same Parecer PGFN/CAT 2,363/2013 expressly waived those cases where there are specific treaty provisions including any type of technical services in the articles of "royalties" or "independent personal services", which should prevail over the article of "business profits" in order to sustain Brazilian source taxation.

Theoretically, the general premise adopted by Parecer PGFN/CAT 2,363/2013 should dismiss taxation at source in Brazil, since income classified on the article of "business profits" of the treaties is only taxable in the country of residence of the beneficiary. However, in practice, taking into account that most of the DTTs entered into by Brazil provide that income derived from any technical services fall within the scope of the articles of "royalties" or "independent personal services", taxation at source in Brazil on remittances on such concepts will continue to be levied in the great majority of cases, even after the entering into force of Parecer PGFN/CAT 2.363/2013.

Brazilian CFC and DTTs: the Superior Court of Justice (*"Superior Tribunal de Justiça"* – "STJ") has recently ruled the Vale case (2014), which deals with the application of the Brazilian CFC rules on profits earned by subsidiaries located in countries with which Brazil has treaties to avoid double taxation (under the former regime previous to MP 627). The Brazilian tax authorities had challenged Vale charging Brazilian Corporate Taxes on the profits of foreign subsidiaries located in Belgium, Denmark, Luxembourg and Bermuda, based only on the Brazilian CFC rules. However, STJ affirmed the prevalence of international tax treaties over internal rules and decided that the double taxation is prohibited under article 7 ("business profits") of the DTTs entered into between Brazil and Belgium, Denmark and Luxembourg. In relation to the subsidiary domiciled in Bermuda, since Brazil does not have a DTT with such jurisdiction, STJ considered that the Brazilian CFC legislation could be applied.

Attractions for holding companies

The Brazilian tax environment is definitely not one of the most receptive in terms of the incorporation of holding companies as platforms/hubs for international investments.

Since January 2002, Brazilian CFC legislation has implemented a "presumed dividends" regime on any accrued profits existing every December 31st on a foreign subsidiary's balance sheet, including all types of foreign income (active and passive) regardless of the tax domicile of the foreign subsidiary (in a tax haven or not). A single 10% participation in the capital of a foreign subsidiary or a minimum level of management influence is enough to trigger the application of the aforementioned CFC rules.

The above mentioned MP 627 brought new "enhanced" CFC rules, to enter into force as of 2015, which should consolidate the results from directly and indirectly controlled foreign companies.

From a comparative law perspective, the old and the new Brazilian CFC rules definitely sound quite bizarre and unreasonable, exactly because they do not encourage the expansion of Brazilian multinationals into the global market. On the one hand the Brazilian government allows for foreign tax credits (but with some restrictions for tax credits generated by indirectly controlled companies), while on the other hand the 34%-40% Brazilian Corporate Taxes are levied on Brazilian companies' worldwide income, thus restricting their competitiveness against other players operating offshore with reduced corporate tax rates.

On top of the CFC rules, the Brazilian foreign currency exchange controls are some of the most bureaucratic in the world, in addition to a Tax on Financial Operations (*"Imposto sobre operações financeiras"* – "IOF") rate of 0.38% on the total amount of foreign currency converted into BRL.

The main concern with regard to IOF is that the rules may be amended without a change in statute: IOF rules may be changed with a simple decree or federal administrative measure, which makes it a very "efficient" economic policy instrument for the Brazilian government to interfere in the value of the Brazilian currency. Only the maximum IOF rate for exchange transactions is provided for by statute and should not exceed 25%.

There is very little to do when a given modality undergoes IOF changes, and dealing in a previously "IOF-free" environment does nothing to prevent future changes either: there are no "grandfathered" assets/contexts as far as IOF goes. In other words, if the rules do change down the road, investors might suddenly find themselves in a new IOF context (being obliged to pay IOF when previously it was unnecessary).

Brazilian companies aiming to expand their horizons to foreign lands usually utilise the Brazilian DTTs network to obtain a minimum level of protection against their awkward national CFC rules. Spain and Austria are the preferred jurisdictions due to the participation exemption regime on dividends provided for by both treaties. Nevertheless, relevant litigation is taking place in Brazilian Courts without a clear tendency emerging. The tax authorities accuse taxpayers of engaging in fraudulent "treaty shopping" or "conduit companies structures" and ignore the existence of holding companies in order to tax the undistributed dividends of indirectly controlled companies. In their defence, taxpayers allege the hierarchical prevalence of the treaties over domestic legislation, amplified, in some cases, by evidence of economic substance present in the foreign holdings.

In the past, Denmark was another jurisdiction preferred by Brazilian multinationals due to a specific treaty clause prohibiting Brazilian taxation of the undistributed dividends of Danish companies (which, in practice, annulled the effects of the Brazilian CFC rules in force since January 2002). Brazilian tax authorities moved fast, and a protocol to the treaty with Denmark was executed in Copenhagen in March, 2011, to exclude that provision. The protocol has not yet taken effect, given that legislative ratification procedures are still pending.

Finally, it is worth mentioning that instead of incorporating a Brazilian holding company in such an unfriendly environment, one may consider using an already operative and profitable Brazilian company to serve simultaneously as a platform to hold stakes in other foreign operative subsidiaries in order to optimise the tax deduction of the Brazilian JsCP. In the event that the corporate tax burden of the foreign jurisdiction equals or exceeds 34%–40%, there is no additional tax burden in Brazil under such a holding structure.

On top of Spain and Austria, Brazil has also participation exemption regimes on dividends in the treaties executed with Argentina, Ecuador and India. This means that those jurisdictions would also fit well below a Brazilian operative company from a tax structuring point of view.

The accrued profits existing on every December 31st in the corresponding balance sheet of the foreign entities would increase the Brazilian taxable profits and thus allow a higher payment of JsCP to the foreign shareholders, with a net 19% corporate tax savings in Brazil. One disadvantage, though, if and when the foreign dividends actually flow into Brazil, is an IOF of 0.38% on the currency exchange transaction.

The year ahead

The year ahead may be hectic for both Brazilian taxpayers and Brazilian tax lawyers due to MP 627.[4] The MP 627 has been surrounded by intense political and economic debate since its publication back in November, 2013. Different amendments made by the Congressmen in the first quarter of 2014 may have tackled some issues, but certainly reopened other ones.

There is a high expectation also on how fast the Brazilian tax authorities will regulate MP 627, especially the tax aspects involving IFRS and Brazilian CFC rules. After the publication of such regulation, Brazilian taxpayers will then have a clearer picture of the concrete effects of the new rules and will be able to identify the necessity or not of going into Court in order to litigate against unreasonable positions and interpretations commonly made by Brazilian tax authorities.

* * *

Also contributed to the organisation and review of this article

José Luis Ribeiro Brazuna

Co-author of Brazilian Chapter of *Global Legal Insights – Corporate Tax*, First Edition. Brazuna has a Law degree (1998) and Masters Degree in Economic and Tax Law (2008) from the Law School of the Universidade de São Paulo (USP); Professor of Tax Law in post-graduation courses and author of books and articles on Brazilian tax law; Judge in the Administrative Tax Court of the State of São Paulo (TIT). Brazuna has a solid background in tax law and wide experience with issues related to internal taxation, especially taxation in the industry, commerce, and service sectors. International legal directories and publications, such as Chambers and Partners, Latin Lawyer 250, The Legal 500 Latin America and World Tax 2014, have acknowledged his work.

Endnotes

1. Such transactions would also be taxed by: (i) municipal tax on services (*"Imposto sobre serviços"* – "ISS"), which rate varies between 2% and 5%, depending on the municipal legislation and the service involved; (ii) PIS/COFINS on the importation of services (at the total consolidated rate of 9.25%); and (iii) Tax on Financial Operations (*"Imposto sobre operações financeiras"* – "IOF") at 0.38%.
2. Please note that until the final review of this article, MP 627 was still pending on final approval by the President of Republic in order to be converted into law. During the converting process performed at the Brazilian Congress, many amendments to the original MP 627 wording were proposed and introduced by Congressmen, it being therefore still uncertain what should be the final content of the new legislation to be passed, since some of the provisions of MP 627 may be eventually vetoed by the President of Republic.
3. *Idem*.
4. *Bis idem*.

Cristiano Frederico Ruschmann
Tel: +55 11 3584 8980 / Email: rus@bratax.com.br
Law degree (1996) from the Law School of the Universidade de São Paulo (USP); Masters Degree in German Law with an emphasis on International Taxation (2005) from the Albert-Ludwigs-Universität, in Freiburg im Breisgau, Germany; Professor of Tax Law in post-graduation courses; author of books and articles on Brazilian tax law. Cristiano has wide experience in national and international tax law. Strong performance in consulting (review of contractual structures and tax planning schemes) and litigation. Recognised for strong support for multinational companies investing in Brazil, as well as with large companies in the IT sector. International legal directories and publications, such as Chambers and Partners, Latin Lawyer 250, The Legal 500 Latin America and World Tax 2014, have acknowledged his work.

Fábio Piovesan Bozza
Tel: +55 11 3584 8980 / Email: fpb@bratax.com.br
Law degree (1999) from the Law School at the Universidade de São Paulo (USP); Masters Degree in Economic and Tax Law (2014) from the Law School of the Universidade de São Paulo (USP); Professor of Tax Law in post-graduation courses; author of books and articles on Brazilian tax law. Fábio has recognised experience with issues related to direct taxation, tax planning, and accounting. He works with highly complex tax questions and has a strong background in federal administrative law court litigation. World Tax 2014 has acknowledged his work.

Ciro César Soriano de Oliveira
Tel: +55 11 3584 8980 / Email: cso@bratax.com.br
Law degree (1993) from the Law School of the Universidade de São Paulo (USP); MBA in Business Economics (2001) from the Fundação Instituto de Pesquisas Econômicas (FIPE); MBA in Business (2013) from the Fundação Dom Cabral. Ciro has solid experience with direct taxation, foreign investment, and corporate restructuring accumulated over 20 years, beginning with work at a large auditing firm. He has also strong performance in analysis of tax issues related to contract drafting and tax litigation. World Tax 2014 has acknowledged his work.

BRATAX – Brazuna, Ruschmann, Piovesan e Soriano Advogados

Rua Tenente Negrão, 140, 13th floor, 04530-030 – São Paulo – SP, Brazil
Tel: +55 11 3584 8980 / Fax: +55 11 2584 8981 / URL: http://www.bratax.com.br

Other titles in the *Global Legal Insights* series include:

- Banking Regulation
- Bribery & Corruption
- Cartels
- Corporate Real Estate
- Employment & Labour Law
- Energy
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions

Strategic partners:

ECLA

European Company Lawyers Association

www.globallegalinsights.com