Brazil

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1.0 OVERVIEW

The Brazilian constitutional system attributes different and independent taxing powers to the federal, state, and municipal governments, as well as to the Federal District to impose, regulate and collect taxes. Brazil imposes corporate and personal income tax on its residents, including Brazilian subsidiaries of foreign entities, in respect of income and capital gains earned anywhere in the world. Federal income tax is imposed under the Brazilian Income Tax Regulation (BITR) and other federal laws and regulations. Non-residents who carry on business in Brazil or are employed in Brazil or sell certain types of assets in Brazil are also subject to Brazilian income tax.

Brazilian income tax is only levied at the federal level and Brazil does not have state or municipal income tax. The BITR also imposes a withholding tax on remittances abroad such as interest payments, rents, royalties and services fees, at rates varying from 6% to 25%. The Brazilian payer of any such amount is liable for withholding and collecting this tax on behalf of the non-resident recipient. The Brazilian double-taxation treaty (DTT) network is composed of 36 signed DTTs[1] , which will reduce or eliminate the applicable withholding tax rate on such types of income. Brazil is not currently an Organisation for Economic Co-operation and Development (OECD) member; however, its treaty policies follow the main system of OECD model with some provisions considerably adjusted to the Brazilian policy and to its internal law. Some of the relevant changes are in consonance with the United Nations model convention.

Brazil decided not to sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, but opted to update and amend its tax treaties through bilateral negotiations, in order to submit each of them individually to the National Congress. Most DTTs recently signed or renegotiated by Brazil demonstrate a clear alignment with base erosion and profit-shifting projects, with the insertion of some recommended provisions in its treaties, such as the access to the mutual agreement procedure clause, adoption of the Principal Purpose Test rule and a simplified style limitation on benefits clause, as a means to prevent treaty shopping.

In addition to income tax, several other direct and indirect taxes are imposed at federal, state and municipal levels on different business activities, financial transactions and on the transfer or holding of property, which result in several different and specific compliance rules to be followed. The efficient administration of tax payment is one of the greatest challenges of Brazilian companies.

2.0 LEGAL SYSTEM

Brazil is organized as a federative republic formed by the union of its states and the Federal District. The federal constitution ensures the fundamental rights and guarantees of the citizens; regulates the tax system; provides for socioeconomic and financial policy; and establishes the legislative authority of the federal union, states and municipalities. While the ability to make certain laws is in the exclusive domain of the federal government, other laws are within the scope of state and municipal authorities. In some cases, the federal, state and municipal governments exercise concurrent jurisdiction.

Court decisions are issued based on the interpretation of the laws prevailing in Brazil. Judicial precedents are not binding in Brazil, although they are relevant in influencing the court's future decisions. Some particular decisions ruled by the Supreme Court of Justice must be followed by the administrative and lower judicial courts.

3.0 TAXATION AUTHORITIES

In Brazil, the main directives for taxation are provided by the federal constitution, which establishes the general principles of taxation, the limitations on the power to tax, tax competence across levels of government, as well as tax revenue sharing provisions.

Although the federal constitution and laws set forth general rules for all taxes, the federal government and each state or municipality has their own discretionary powers to enact their laws and regulations for the collection of their taxes. The Brazilian Internal Revenue Service (IRS) manages the federal tax system, including social security contributions and customs taxes. States and municipalities have similar collection agencies to administrate and collect outstanding taxes.

1 The treaties signed with Switzerland and Singapore are still pending completion of the ratification process.

Almost all Brazilian taxes are self-assessed and tax returns must be filed in the taxpayer's place of domicile. There are currently multiple tax returns, created by federal, state and municipal governments. Brazil presents a heavy tax burden, complex and dynamic legislation and an agile and efficient collection system. The non-compliance of tax ancillary obligations may result in extraordinarily heavy penalties.

Brazilian tax authorities may assess taxes within five years if no tax return is filed, or if the taxpayer files a tax return with incorrect information. In situations where proper accounting records have not been kept by the taxpayer, tax authorities may disregard the accounting records and conduct an arbitrary assessment.

If a tax assessment is issued by the Brazilian federal tax authorities, a regular 75% fine is imposed on the principal amount of unpaid tax debt. For the cases involving charges of deliberate misconduct, fraud or simulation, an aggravated fine of 150% can be imposed. For state and municipal tax debts, the fines may vary according to the local legislation and the time period.

4.0 BUSINESS VEHICLES

A non-resident may either establish a Brazilian business vehicle to carry on business in Brazil or operate directly through a foreign entity, with or without a Brazilian permanent establishment. In general, Brazil does not restrict foreign ownership of domestic enterprises, except in very specific and strategic sectors. An entity can be incorporated in Brazil as a branch or as a subsidiary.

Although a Branch may be seen as an extension of its parent company for legal purposes, it is treated as a separate entity for tax purposes, meaning that the register of a Brazilian branch does not offer tax advantages when compared to the incorporation of an independent Brazilian subsidiary.

Foreign companies may not operate branches in Brazil unless they receive prior authorization after submitting a special request to the Brazilian Ministry of Industry and Commerce. In practice, considering the bureaucratic slowness in obtaining such authorization, few branches of foreign companies operate in Brazil. In fact, the establishment of a branch in Brazil is not recommended, except in very special circumstances, such as foreign banks and international airlines that generally prefer to register branches to conduct their business in Brazil.

In view of this, entities are not commonly set up under the form of branches in Brazil, but rather, the majority of the foreign businesses are set up under the form of subsidiaries. As a general rule, all types of foreign direct investments in Brazil must be registered with the Brazilian Central Bank (BACEN) and the foreign shareholders or quota holders must have legal representatives in Brazil.

The incorporation of a legal entity in Brazil normally takes about 30-45 business days. The incorporation process includes the issuance of the tax registries, which are required to fulfill other companies' needs, such as opening bank accounts and leasing of office space. Depending on the activity to be performed and the location in which it will be performed, some specific licenses and authorizations may be required.

4.1 Limited liability company

Limited liability companies (LTDA) are regulated by the Brazilian Civil Code. The responsibility of each quota holder is limited to the amount of his quota, but all quota holders are jointly and severally liable for unpaid-in capital. The incorporation of a Brazilian LTDA requires at least two shareholders to sign the Articles of Incorporation. These shareholders can be Brazilian, foreign individuals, or entities, and there is no imposition of a minimum or a maximum amount of capital. There is no mandatory independent statutory audit in an LTDA, unless the legal entity or its group has assets, in its previous year's financial statements, greater than R$240 million, or gross revenue in excess of R$300 million/year.

The quota holder control depends on the ownership of 75% (or more) of the quotas of an LTDA. There is no obligation to distribute dividends to the quota holders.

4.2 Corporation

Corporations (S/A) are regulated by the Federal Corporation Law. Each shareholder's liability is limited to their contribution. The incorporation of an S/A requires at least two shareholders to sign the company's bylaws. The shareholders may be either Brazilian, foreign individuals, or entities, and at least 10% of the subscribed capital must be transferred to the company's bank account in order to incorporate this type of entity. A board of directors and an administrative council are mandatory for listed companies.

It is mandatory for all S/As listed on the stock market to have their financial statements audited by independent auditors. For a non-listed S/A, the audit is only required when its assets are greater than R$240 million or when its gross revenues exceed R$300 million. Corporations are required to file their financial statements with the local commercial registry and publish them in the Official Gazette, as well as in a major private newspaper. The control is exercised by the majority of shareholders that attend the general meetings.

The law requires annual payment of dividends with reference to the minimum portion established in the bylaws. Generally, this minimum limit is set at 25% of the net profit of the fiscal year. S/As are usually more costly to maintain and are subject to stricter requirements. On the other hand, this business vehicle is more flexible when it comes to the relationship between shareholder interests and voting rights.

4.3 Consortium

Consortiums are regulated by the Brazilian Corporate Law, which states that companies and other entities, whether or not under common control, may constitute a consortium in order to undertake a specific project. A consortium is an association of companies, either Brazilian resident or foreign, with the objective of developing a joint business or participating in a project that is larger than the individual capacity of the participants. This method is widely used in large-scale projects.

In a consortium, the activity is carried out directly by the parties, which assume rights and responsibilities in their own name under the terms of the consortium agreement. Hence, having the proper wording in the consortium agreement is of the utmost importance.

Although the consortium does not have a corporate veil (i.e., legal personality), it may be allowed to sign contracts in its own name, according to the provisions of the consortium agreement entered into by its members. Generally, a consortium member is elected as the leader to represent the consortium. In cases of a consortium composed of Brazilian and foreign companies, it is mandatory that the consortium leader be a Brazilian resident company, which should maintain separate accounting records of the consortium operations, through distinct accounts or separate bookkeeping.

The consortium agreement and its amendments must be filed with the Board of Commerce in the location where it is headquartered. Each consortium member should compute its own revenue, costs, expenses, rights and obligations proportionally to its participation in the consortium; however, there is no legal restriction to attribute them in a disproportional manner.

The use of a consortium by foreign entities for doing business in Brazil should be carefully examined. There are specificities related to the use of a consortium and from a practical perspective, a lack of clear guidance on the applicable taxation.

4.4 Single owned limited liability entity

Single owned limited liability entities (EIRELI) are also regulated by the Brazilian Civil Code. It can be incorporated by a single individual quota holder that holds 100% of the paid-in capital. The responsibility of the quota holder is limited to the amount of his quota, but all quota holders are jointly and severally liable for unpaid-in capital. The EIRELI follows the same rules as the limited liability company in terms of responsibility of the shareholder. The quota holder can be a Brazilian or foreign individual, and a minimum amount of capital equivalent to 100 times the current Brazilian minimum wage (currently equivalent to R$99,800) is imposed.

4.5 Branch of a foreign entity

Branches are very uncommon in Brazil, as they may only carry out activities in Brazil upon approval through ministerial authorization, which historically has been granted only in exceptional circumstances. Furthermore, there are no tax benefits to using a branch as opposed to a legal entity because both are subject to the same tax treatment; however, it is more complicated, costly and time consuming to establish a branch. It is generally impractical for a foreign corporation to operate a Brazilian services business through a Brazilian branch. Non-residents planning to operate a services business in Brazil will generally incorporate a Brazilian subsidiary.

4.6 Foreign corporation (without a Brazilian branch)

A foreign corporation that carries on business in Brazil through a Brazilian permanent establishment (PE) will be subject to corporate income tax in Brazil. However, the characterization of a PE in Brazil is rare to the extent that the Brazilian internal tax

legislation does not contain a clear definition of PE. For this reason, to analyze whether an entity could be considered to have a taxable presence in Brazil, the concept of "doing business" is more frequently invoked by local tax authorities when a foreign company undertakes business activities within Brazilian territory on a permanent basis. In other words, a company may be considered to be doing business in Brazil and be taxed as if it was a local company, even if it does not have an incorporated branch, agency or subsidiary in Brazil.

Additionally, some other isolated rules from the BITR describe situations in which tax authorities may characterize a foreign company as having a taxable presence in Brazil, such as: (i) branches of foreign corporations; (ii) sales made in Brazil by a Brazilian agent with powers to bind the foreign entity; and (iii) companies that failed to file their corporate and tax documents with the competent bodies (de facto corporations) but have a separate unit of business or a center of activity for the performance of trading and service activities.

In practice, this risk is very low, considering Brazil has a very restrictive and protective interpretation of domestic tax legislation and generally prefers to impose withholding and indirect taxation on the importation of services. As such, the low risk generally does not justify the presence of a PE as a foreign entity in Brazil .

5.0 FINANCING A CORPORATE SUBSIDIARY

5.1 Equity financing

5.1.1 Contributions for shares

The contribution of capital into a Brazilian entity in exchange for shares or quotas must be registered with the electronic system of the Brazilian Central Bank and the total amount injected as capital is subject to the tax on financial transactions (IOF) at a rate of 0.38% levied on the conversion of foreign currency into Brazilian reals.

The registration of the foreign direct investment with BACEN enables the future repatriation of capital to the foreign shareholders/quota holders in the form of capital redemption, dividends distribution or payment of interest on net equity.

5.1.2 Contributions without taking additional shares

Where an equity contribution is made by a shareholder to a Brazilian entity without the issuance of additional shares, the amount is added to the company's "capital reserve account." However, such amount may be capitalized in the future without triggering negative tax consequences.

5.1.3 Distributions of paid-up capital

A Brazilian entity is permitted to make distributions of its paid-up capital to a non-resident shareholder or quota holder in the form of capital redemption only if the existing capital is considered excessive vis-à-vis its corporate purpose and activities. In order to perform a capital redemption, a Brazilian LTDA is required to observe a minimum period of 90 days for prior notice of creditors, or 60 days in the case of corporations. The capital redemption resolution will only

become valid and effective when there is no opposition of creditors within the notice period.

5.2 Debt financing

The financing of a company through an intercompany loan would also have to be registered with the Brazilian Central Bank to allow the future repatriation of the loan's principal and interest abroad.

5.2.1 Withholding tax implications

Interest payments made by a Brazilian resident company to a non-resident company are subject to withholding tax (WHT) at a rate of 15%, irrespective of whether or not the transaction is at arm's length or not. The WHT rate is increased to 25% if the beneficiary of interest is resident in a low tax jurisdiction. The WHT rate can be reduced or a tax-sparing credit may be available under an applicable double-tax treaty. For example, the Brazil-Japan tax treaty limits withholding taxation on cross-border interest payments and also provides a tax-sparing credit of 20% provided that the interest is not exempt in Brazil.

Interest payments trigger a tax deduction in Brazil of up to 34% (combined tax rates of the Corporate Income Tax (CIT) and the Social Contribution Tax on Profits (SCT) over the amount of the interest payment deducted locally, as long as the thin capitalization and transfer pricing rules are complied with. Insofar as the interest is subject to 15% withholding tax, its payment may trigger a total tax savings of 19%.

5.3 Debt funding (interest)

5.3.1 Thin capitalization

If the Brazilian subsidiary is financed with debt, it may be subject to the Brazilian thin capitalization rules. These rules restrict the deductibility of interest paid or payable by a company resident in Brazil to certain non-resident shareholders, where the ratio of interest-bearing debt to equity exceeds 2 to 1. The debt-equity ratio is reduced to 0.3 to 1, in case the beneficiary of the interest is resident in a low tax jurisdiction or entitled to a privileged tax regime. Brazil presents an exhaustive list of those jurisdictions. To the extent that debt exceeds these ratios, there will be a proportionate denial of the interest deduction for corporate income tax purposes.

5.3.2 Transfer pricing rules – applicable to interest

Interest paid to related parties or to residents in low tax jurisdictions are subject to the Brazilian transfer pricing rules. The calculation of the maximum amount of deductible interest varies depending on the loan currency and the type of the interest rate, if floating or fixed. For example, in the case of loans granted in USD or EUR at floating rates, the deductible interest is limited to the six-month London Interbank Offered Rate plus a fixed spread of 3.5%. In the case of loans granted in USD at a fixed rate, the parameter rate is the market rate of the sovereign bonds issued by the government on the external market, indexed in USD, plus a fixed spread of 3.5%. The same rules must be observed when the Brazilian entity is the lender. A minimum interest rate should be recognized by the Brazilian company for tax purposes. In this case the applicable spread is 2.5%.

5.4 Stamp tax

The inflow of funds in the form of long-term loans is subject to IOF at 0% rate, as long as the term for repayment of the loan is longer than 180 days. Short-term loans (i.e., less than 180 days) are subject to IOF at a rate of 6% levied on the conversion of foreign currency into Brazilian real. In the case of a zero-rated long-term loan that is partially repaid or liquidated in advance (before the 180-day term), the loan principal amount would be subject to IOF at 6% rate plus a 20% fine and SELIC interest, accrued monthly between the date of the funds entry and the liquidation date. The payment of interest abroad will not trigger IOF.

6.0 CORPORATE INCOME TAX

6.1 Income tax rate

For 2018, the combined corporate tax rate is generally 34%. Other tax rates apply for specific businesses, such as insurance and financial institutions; they are subject to a 45% CIT rate. The effective corporate income tax rate may substantially change depending on the corporate income tax regime adopted in Brazil.

6.2 Capital gains

A Brazilian resident corporation, including a Brazilian subsidiary of a foreign corporation, must include all capital gains in its taxable income. Taxable capital gains are taxed in the same manner as ordinary income; current year accounting losses may be used to offset taxable capital gains accrued in the same fiscal year. Non-operational tax losses from previous years may be carried forward indefinitely and may be used to offset future capital gains, but they are limited to 30%. The segregation and control of ordinary tax losses from non-operational tax losses is required. Tax losses are lost if there is a change of control or change in the type of activity carried out by the

Brazilian company between the time the losses are generated and used.

According to the Brazilian domestic legislation, non-residents in Brazil are subject to withholding income taxation on capital gains arising from the disposition of Brazilian assets, of any kind, levied at rates varying from 15% to 22.5%. The vast majority of DTTs signed by Brazil authorize the concurrent taxation by both contracting countries and do not avoid capital gains taxation on the disposal of other Brazilian assets, such as shares, bonds, securities, instead of recognizing the exclusive right of taxation by the country of residence. Exceptions include the DTTs signed with Japan and Israel, among others.

6.3 Branch tax

Brazil does not impose a branch tax.

6.4 Computation of taxable income

6.4.1 Taxable base

Brazil has four systems of corporate income taxation:

i. Actual Profit Method

ii. Presumed Profit Method

iii. Arbitrated Profit Method; and

iv. SIMPLES – Simplified tax regime.

The Actual Profit Method is the general rule for corporate income taxation where the taxable base is determined by applying certain law-defined adjustments (add-backs and deductions) to the taxpayer's booked income. The taxation basis may consider the Regime de Competência (accrual basis) for deductibility purposes and also transfer pricing rules and thin capitalization rules. In this regime, tax losses may be carried forward indefinitely. Taxpayers are allowed to offset tax losses up to 30% of the taxable income per fiscal year.

The Presumed Profit Method is optional for a Brazilian company, as long as it is not required by law to adopt the Actual Profit Method and its annual gross revenue does not exceed R$78 million in the previous year. The corporate income taxable basis is determined upon the application of legally determined statutory percentages on a company's gross revenues. Expenses are not relevant for the determination of the company's taxable income, and tax losses cannot be offset under this system. Under this regime, the company is not affected by Brazilian thin capitalization rules and transfer pricing on import transactions. However, export transactions shall be in compliance with Brazilian transfer pricing rules.

SIMPLES – Simplified Tax Regime is a favorable taxation regime, applicable to micro- and small companies (as defined by law), which allows the payment of one tax that replaces six different federal taxes (IRPJ, CSLL, PIS, COFINS, IPI, INSS), one state tax (ICMS) and one municipal tax (ISS). Tax rates may vary from 4% to 33%, depending on the company's size and activity. SIMPLES is not applicable to companies with more than R$4.8 million of gross revenues and some specific businesses (banks, some transport companies, among others), including companies owned by foreign shareholders.

The Arbitrated Profit Method is similar to the Presumed Profit Method but with higher presumed profit margins (basically with 20% increase). This method is more commonly adopted by tax authorities if there is a lack of reliable accounting information. Although not common, taxpayers can also voluntarily adopt this method in some situations defined in tax regulations.

6.4.2 Deductions

A taxpayer is generally permitted to deduct its current expenses in computing business income. Brazilian tax rules, and decisions issued by federal administrative tax courts, establish four requirements to allow the tax deduction of expenses: (i) they should be actually incurred by the company; (ii) they should be usual to the activity developed by the taxpayer; (iii) they should be ordinary and necessary for the company's activity (i.e., benefit the Brazilian entity and be strictly connected with the source of revenues); and (iv) they should be properly documented. In contrast, non-deductible expenses are specifically listed by tax law and related, for instance, to donations in general, gifts, provisions, and other non-compulsory payments.

This general rule should always be observed for deductibility purposes of any type of expense. However, some figures have special deductibility rules; e.g., payments related to royalties.

Brazilian legal entities may only deduct expenses with royalties, for corporate income tax purposes, if such expenses are really necessary for those entities to use, possess, or benefit from certain goods or rights that are useful in their main activities. Additionally, for deductibility of royalties related to agreements that imply a transfer of technology signed

between a Brazilian company and a non-resident, it is mandatory that (i) the agreements be registered with the Brazilian Patent and Trademark Office (INPI); and (ii) the amount of royalties paid does not exceed the limitations imposed by the Minister of Finance.

6.4.3 Income tax reporting

Brazilian resident companies are required to file an annual corporate income tax return, called ECF, where Brazilian taxpayers need to report all transactions that impact the corporate income tax basis, such as accounting information, transfer pricing adjustments, country-by-country report information, among other tax and economic information. Corporate income tax returns must be filed in an electronic format and transmitted to tax authorities by the end of July following the tax year ending on December 31.

7.0 CROSS-BORDER PAYMENTS

7.1 Transfer pricing

Brazil is not a member of the Organisation for Economic Cooperation and Development (OECD) and its transfer pricing rules do not follow international standards or the OECD Transfer Pricing Guidelines. The Brazilian transfer pricing rules are based on fixed statutory profit margins and there are no profit-based methods or the concept of a functional and risk analysis. The basket approach is not authorized and transactions subject to Brazilian transfer pricing rules must be documented on an annual basis, through the filing of corporate income tax return specific forms that require taxpayers to disclose detailed information regarding their intercompany import and export transactions.

Brazilian transfer pricing rules provide a broad concept of related parties, encompassing not only transactions carried out between the parent company and its branches or subsidiaries or between controlled and associated companies, but also, among others, the case in which the foreign and the Brazilian companies are under the same corporate or administrative control or when at least 10% of the capital of each of those companies belongs directly or indirectly to the same company.

Brazil's transfer pricing regulations also apply to transactions between Brazilian legal entities, individuals or legal entities that are domiciled or reside in a low

tax jurisdiction or in a jurisdiction classified as a privileged tax regime.

7.2 Low tax jurisdictions and privileged tax regimes

Brazilian tax legislation establishes some adverse tax consequences for Brazilian companies dealing with foreign companies located in a low tax jurisdiction, included in the Brazilian "black list," such as (i) application of transfer pricing rules to transactions involving Brazilian entities, whether related or not; (ii) application of thin capitalization rules to credit transactions involving entities domiciled in Brazil; and (iii) an increase of the WHT rate to 25% on remittances of interest to their residents, in contrast to the ordinary rate of 15%. The special tax regime applicable to investments in the Brazilian financial and capital markets under Central Bank Resolution No. 4,373 does not apply.

Brazilian law also has the concept of "privileged tax regimes" (PTR), which are not jurisdictions per se, but specific types of legal entities that may benefit from a special tax regime in some countries. Dealings with legal entities considered as a listed PTR are also subject to certain detrimental tax consequences. As a rule, transactions carried out between Brazilian entities and entities located in a PTR are subject to the following tax consequences: (i) the application of transfer pricing rules to transactions involving Brazilian entities, whether related or not; and (ii) the application of thin capitalization rules to credit transactions involving entities domiciled in Brazil.

Moreover, transactions carried out between Brazilian companies and foreign companies located in a low tax jurisdiction or in a privileged tax regime are subject to deductibility restrictions in relation to the remittances of any type made from Brazil to abroad. Such restrictions are not applicable if the Brazilian company is able to identify the real beneficiary of the foreign entity, to present additional documentation and prove the operational capacity of the foreign entity.

Payments made by a Brazilian resident in favor of a non-resident in respect of certain types of interest payments, rents, royalties, management or administration fees, are subject to withholding income tax at rates varying from 15% to 25% depending of nature of the revenue and the location of the beneficiary. However, the WHT rate applicable on certain types of passive income, such as interest and royalties, may be reduced under an applicable DTT.

Dividends are exempt from WHT according to the Brazilian domestic legislation. In this respect, it is important to mention that Brazilian legislation also allows Brazilian entities subject to the Actual Profit Method to distribute, in addition to or as an alternative to dividends, a deductible interest amount to shareholders calculated based on the net equity of the entity—Interest on Net Equity (INE)—by applying an interest rate provided by the Brazilian government (TJLP) over the net equity of the Brazilian entity (currently around 6%). INE payments are subject to withholding tax at 15% (25% on payments to low tax jurisdictions) while deductible at 34%.

7.3 Withholding tax on services fees

As a general rule, remittances abroad for the payment of services are subject to WHT at the rates of 15% or 25% irrespective of whether or not the service was rendered in Brazil and the foreign service provider does not maintain a permanent establishment in Brazil. Services considered as having non-technical nature are subject to a 25% WHT rate, while services that have a technical nature are subject to a 15% WHT rate. Moreover, the remittance of royalties abroad are also subject to a WHT rate of 15%.

Although debatable, according to the Brazilian tax authorities' understanding, the WHT will only be due on the remittances of service fees to a treaty country if the respective treaty's protocol qualifies the payments under Article 12 (Royalty Provision) or if the payments fall within the scope of Article 14 of the treaty (Independent Service Professionals Provision). If neither Article 12 nor Article 14 applies, the payments would be qualified as business profits under Article 7 of the treaty and would not be subject to WHT.

In this respect, it is important to mention that most Brazilian tax treaties have expanded the concept of "royalties" to include income received as a consideration for the rendering of "technical assistance "and "technical services." Generally, the treaties' protocols do not provide guidelines on what should be understood under the concept of "technical assistance" and "technical services."

The remittance of technical service fees abroad is also subject to other Brazilian taxes due at the level of the Brazilian paying company, such as: Municipal Service Tax (2% to 5%), Contribution for Intervention in the Economic Domain—CIDE (10%); PIS/COFINS on Imports (9,25%) IOF/Foreign Exchange—IOF (0.38%). While WHT is a burden of foreign companies, the aforementioned indirect taxes are due by the Brazilian company in its own name, meaning it is not being deducted from the consideration payable to a foreign beneficiary.

8.0 PAYROLL TAXES

Brazilian employers paying remuneration to employees are liable to collect a number of taxes in Brazil.

8.1 Withholding income tax

Employees in Brazil are subject to WHT at progressive rates varying from 7.5% to 27.5%, depending on their monthly compensation, which shall be withheld by the employer on a monthly basis.

8.2 Social security contribution (INSS)

Employers are subject to (i) pay the INSS contribution at the rate of 20% over the employees' monthly compensation and (ii) withhold the employees' contribution to the INSS at the rate of 8%, 9% or 11% of the employees' compensation, limited to a certain amount subject to periodic update.

8.3 Other social contributions (Sistema S)

Employers are subject to pay the Sistema S contribution to finance social services at the rate that varies according to each industry.

8.4 Insurance against labor accidents (RAT)

Employers shall pay the RAT at a rate varying from 1% to 3%, on a monthly basis, over the employee's monthly salary. The RAT is indexed by a factor named *Fator Acidentário de Prevenção* (FAP), which varies from 0.5 to 2 and is based on the actual risks and accidents within the workplace.

8.5 Unemployment Guarantee Fund Deposits (FGTS)

Employers are required to deposit in the FGTS account of each employee the amount equivalent to 8% of the individual's monthly remuneration. This money is kept in this account and can only be withdrawn by the employee in special circumstances such as to buy a house, in case of serious illness and termination of the employment agreement without a cause.

9.0 INDIRECT TAXES

9.1 Taxes on goods

9.1.1 Excise tax (IPI)

IPI is a federal value-added tax imposed on each phase of the manufacturing process. Its rates vary depending on the essentiality of the manufactured goods. The IPI basis is the price of the manufactured goods. For IPI purposes, an industrial activity means any operation that modifies the nature, operation, finishing, presentation or purpose of a product, or that improves a product for consumption, such as its conversion, processing, packaging, repackaging or restoration.

The importation of goods is also subject to IPI. The first sale of an imported product is considered a taxable event for IPI purposes as well. However, the resale of locally manufactured products is not subject to IPI and exports are exempt from IPI. IPI is a non-cumulative value-added tax (VAT), where the amount charged in each successive taxable transaction is deducted from current transactions.

The IPI rates vary according to the tax classification of the goods in the IPI Tariff Table (that includes the same classification system as the Mercosul Harmonized Code System - TEC). Tax rates vary from 0% (essential foods) to more than 330% (cigarettes). Most of them range from 0% to 30%.

9.1.3 State VAT (ICMS)

ICMS is the main state tax and is imposed on transactions that imply the legal transfer of goods, and on interstate and inter-municipal transport services, as well as on telecom services. ICMS is also levied on imports. ICMS is a VAT that allows the taxpayer to recognize tax credits from the ICMS paid on the purchase of raw materials, intermediate products, packaging materials, and goods to be resold.

ICMS rates vary depending on the state and the nature of the goods or services. In the state of São Paulo, the general ICMS rate is 18%. The ICMS basis includes not only the sales price, but also the ICMS itself. Interstate transactions are subject to ICMS at rates varying from 7% to 12%, depending on the state. The ICMS applicable rate on interstate transactions with imported goods containing more than 40% of foreign content is 4%.

Export transactions are exempt from ICMS and taxpayers are allowed to maintain the credits

derived from the acquisition of raw materials used in the manufacturing of the products exported. Such credits can be transferred to third parties upon the authorization from tax authorities, which may take a considerable time to be granted.

ICMS is also levied under the so-called substitution regime, where taxation of the whole supply chain is concentrated at the first phase of the commercial chain—generally, industries. The manufacturer not only pays the ICMS at this stage, but also the ICMS due at the wholesale and retail stages, based on an assumed retail price that will probably be adopted on the sales to final consumers.

Under certain conditions, the ICMS legislation provides tax incentives for companies established in determined areas (i.e., north and northeast of Brazil) in the form of an exemption or a reduction of the ICMS rate, financing ICMS tax payments, and application of deferral system payment, among others. Those incentives vary from state to state and depend on special rules determined by the state's legislation.

9.2 Taxes on services

9.2.1 Contribution for intervening in the economic domain (CIDE)

CIDE royalties are a federal contribution levied at a 10% rate on amounts paid, credited, delivered, invested or remitted to individuals resident or domiciled abroad by Brazilian entities that hold license of use or acquirer of technology knowledge abroad (including agreements related to exploitation of patents, brand use and technology-supplying and technical assistance services).

For example, CIDE is levied on payments to non-residents in connection with: (i) royalties (assignment and licensing of brands/patents, etc.); (ii) technology transfers; (iii) technical assistance services and specialized technical services; and (iv) software licenses, when there is a transference of technology. CIDE is a tax imposed on the Brazilian entity in its own name, and therefore may not be reduced or limited by tax treaties and does not generate a tax credit abroad.

9.2.2 Municipal service tax – ISS

ISS is a municipal tax levied on services' gross revenues at rates varying from 2% to 5% depending on city and type of service provided. ISS is a cumulative tax and there is no credit system available.

The ISS calculation is very simple; however, controversies may arise from different interpretations of service classifications. Taxation in favor of the wrong municipality and conflicts between different municipalities where both are claiming the ISS are quite common. Tension also historically arises from the conflict between ICMS and ISS, and has intensified with the increase of transactions in the digital economy because the Brazilian legislation is not clear in categorizing the nature of digital transactions (i.e., goods vs. services). Brazilian legislation has been criticized for its inability to capture technological innovation and be flexible enough to keep pace with new technology trends.

ISS is also imposed on services provided by a foreign service supplier for the benefit of a Brazilian resident company. The Brazilian payer of any such amounts is liable for withholding and collecting the ISS to the municipal tax authorities on behalf of the non-resident recipient. Services exports are generally exempt of ISS, as long as the service is effectively rendered abroad and the result of the services is also verified abroad.

9.3 Taxes on gross revenues

9.3.1 Social contribution on gross revenues – PIS and COFINS

The PIS and COFINS are federal social contributions levied on the company's monthly gross receipts. As a general rule, PIS and COFINS are calculated based on the non-cumulative regime. Legal entities subject to calculating CIT and SCT under the actual profit method are obliged to calculate PIS and COFINS under the non-cumulative regime. However, there are specific legal entities that calculate CIT and SCT under the actual profit method, but earn specific revenues or carry out specific operations that may subject them to the PIS and COFINS cumulative regime and non-cumulative regime at same time.

The applicable rates under the non-cumulative regime are 1.65% and 7.6%, respectively. In this regime, the company is allowed to offset PIS and COFINS credits calculated on certain costs and expenses expressly authorized by the legislation in order to deduct from the PIS and COFINS

liabilities. Legal entities that opted for the presumed profit method to calculate CIT and SCT are subject to PIS and COFINS cumulative regime. The applicable rates in this regime are 0.65% and 3%, respectively, without the possibility of calculating and offsetting credits.

In addition, PIS and COFINS are also levied on the import of goods and services while exports of goods and services are exempted from PIS and COFINS. There are other PIS and COFINS taxation methods applicable to some industry sectors, such as pharmaceutical products, auto parts, oil and gas, which are subject to a monophasic regime of PIS and COFINS.

9.4 Property and transfer tax

9.4.1 State inheritance and gifts/ donations tax (ITCMD)

ITCMD is a state tax imposed on inheritance, gift/donation or succession, applicable on the transfer of real estate and other assets that do not involve payment or other consideration as compensation. The ITCMD rate varies depending on the state (2% to 8%). In the state of São Paulo, the current rate is 4%.

9.4.2 State tax on ownership of vehicles (IPVA)

IPVA is a state tax imposed on ownership of vehicles, applicable on the transfer of real estate and other assets that do not involve payment or other consideration as compensation. The calculation formula of this tax varies in each state. In the state of São Paulo, the IPVA corresponds to 1.5% to 4% of the vehicle value assessed by the state.

9.4.3 Municipal tax on ownership of urban land (IPTU)

IPTU is a municipal tax applicable on the ownership, control or possession of urban land or buildings. The calculation formula of this tax varies in each municipality. In the city of São Paulo, the IPTU ranges from 1.0% to 1.8% of the real estate's market value assessed by the municipality.

9.4.4 Municipal tax on transfer of real estate (ITBI)

ITBI is a municipal tax imposed on the sale, purchase or assignment of real estate or related rights, provided that such transaction is not a gift. The rate may vary according to the city. In the city of São Paulo, the rate is 3%.